MASTERARBEIT / MASTER'S THESIS

Titel der Masterarbeit / Title of the Master's Thesis

„TRUSTS & INEQUALITY.
The Links Between Economic Inequality and the Anglo-Saxon Legal Vehicle Called a Trust"

verfasst von / submitted by

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angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree of

Master (MA)

Wien, 2017 / Vienna 2017

Studienkennzahl lt. Studienblatt / degree programme code as it appears on the student record sheet:	A 067 805
Studienrichtung lt. Studienblatt / degree programme as it appears on the student record sheet:	Individuelles Masterstudium: Global Studies – a European Perspective
Betreut von / Supervisor:	Univ.-Prof. Alejandro Cunat, PhD

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Abstract

This master thesis examines the interplay between economic inequality and an Anglo-Saxon legal vehicle called a trust. It looks at the historical changes in economic inequality, the different policies designed to mitigate it, and the evolution of trusts to better understand what kind of connections trusts and inequality can have. The questions discussed in the paper include: What kind of links there exist between economic inequality and trusts? How do trusts fit in the discussion about inequality effects of globalisation? Are there differences between economic inequality levels of countries having trusts in their domestic legal systems and those that do not?

The main conclusion is that there are several ways trusts can be used to circumvent policies aimed at curbing inequality. The divided ownership and a fluid nature has made trusts the vehicles of choice for individuals who want to avoid and evade the rules established by their respective governments, such as taxation. Coupled with the capital mobility provided by capital account liberalisation, trusts have become increasingly useful in hiding legal ownership of assets without losing beneficial rights to using them. Although trusts are rooted in the Anglo-Saxon world, their impact is not limited to those countries, as they are used globally. The policymakers in non-trust jurisdictions should familiarise themselves with the concept to ensure that policy efforts to increase transparency of beneficial ownership would not go to waste.

Abstrakt

Diese Master-Arbeit untersucht die Wechselwirkung zwischen ökonomischer Ungleichheit und den, im angelsächsischen Rechtsystem, sogenannten „Trusts“. Die Arbeit betrachtet die historischen Veränderungen ökonomischer Ungleichheit, die verschiedenen Strategien diese zu mildern, und die Entwicklung von „Trusts“, um zu verstehen welche Verbindung „Trusts“ und Ungleichheit haben. Folgende Fragen werden in dieser Arbeit diskutiert: Welche Verbindungen zwischen ökonomischer Ungleichheit und „Trusts“ existieren? Wie passen „Trusts“ in die Diskussion über die von Globalisierung hervorgerufener Ungleichheit? Gibt es Unterschiede zwischen dem Ausmaß ökonomischer Ungleichheit in Ländern, die „Trusts“ in ihrem nationalen Rechtssystem eingebunden haben, im Vergleich zu jenen Ländern ohne?

Die Haupterkenntnis dieser Arbeit ist, dass es mithilfe von „Trust Policies“ verschiedene Wege gibt, um die Reduktion der Ungleichheit zu umgehen. Geteilte Besitzverhältnisse und der instabile Charakter hat den „Trust“ zum Werkzeug der Wahl für Personen werden lassen, die bestimmte Regeln der jeweiligen Regierungen, wie zum Beispiel Steuern, meiden und umgehen wollen. Gekoppelt mit der Mobilität des Kapitals, die durch die Liberalisierung des Kapitalverkehrs erzielt wurde, sind „Trusts“ zunehmend nützlich geworden, um rechtliches Eigentum an Vermögenswerten zu verstecken, ohne das Begünstigungsrechte zu verlieren. Obwohl „Trusts“ in der angelsächsischen Welt verwurzelt sind, beschränkt sich ihr Einfluss nicht auf diese Länder, da sie global genutzt werden. Politische Entscheidungsträger in Rechtsystemen ohne „Trusts“ sollten sich deshalb dennoch mit diesem Konzept vertraut machen, um sicher zu stellen, dass ihre Anstrengungen für mehr Transparenz bezüglich wirtschaftlichen Eigentums nicht verloren gehen.

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Abbreviations

APT	Asset Protection Trust
CFC	Consumption of fixed capital
CIT	Corporate Income Tax
CLAT	Charitable Lead Annuity Trust
DINA	Distributional National Accounts
EU	The European Union
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
GDP	Gross Domestic Product
GNI	Gross National Income
GRAT	Grantor Retained Annuity Trust
HO model	Heckscher-Ohlin model
IMF	International Monetary Fund
IRS	Internal Revenue Service
NFI	Net Foreign Income
NGO	Non-Governmental Organisation
NNI	Net National Income
OECD	Organisation for Economic Co-operation and Development
RAP	Rule Against Perpetuities
SBTC	Skill-biased Technical Change hypothesis
SPV	Special Purpose Vehicle
STEP	Society of Trust and Estate Practitioners
STAR	Special Trust (Alternative Regime) trust
TI	Transparency International
UK	The United Kingdom
US	The United States
VISTA	Virgin Islands Special Trust Act
WEF	World Economic Forum
WID.world	World Wealth & Income Database

1. Introduction

This master thesis examines the interplay between economic inequality and an Anglo-Saxon legal vehicle called a trust. Inequality is in 'fashion', and the debates surrounding it have become more frequent both in academia as well as on the arenas of international politics. For a recent example, inequality was at the center stage of this year's annual gathering of the World Economic Forum (WEF), where the world's economic elite acknowledged an urgent need to shift to more inclusive development and to reduce inequality.[1] When pundits seek after the reasons for increasing inequality of the past decades, globalisation is oftentimes identified as the culprit. The arguments about connections between globalisation and inequality can be detailed and nuanced but in the light of recent political upheavals, it seems there is a growing dissent towards globalisation *per se*, due to the assumption that economic globalisation and the associated freer trade automatically grow income and wealth disparities. Trusts, on the other hand, have remained firmly under these pundits' radar, especially outside of the Anglo-Saxon world.

It is wise to maintain healthy scepticism towards claims blaming the 'system', 'markets' or 'capitalism' for the predicaments human societies are facing. My aim is to go beyond blunt assumptions and to detect and unfold mechanisms and actors that have had a role to play in increasing inequality. By definition, for inequality to rise it need have been on a lower level before the rise. If we had functioning rules to constrain inequality before, why they are not working anymore? The central argument presented in this paper is that *trusts* can be used in several ways to bend and sometimes break these rules. Individuals can use trusts for managing their wealth efficiently, minimising taxes during their lives and after it. Trusts are also used to hide assets altogether from tax authorities and other creditors, evading some of the policies aimed at constraining inequality.

Trusts are peculiar legal vehicles – they do not exist in legal codes universally across the globe. They are firmly rooted in the British law tradition but are commonly used all over the Anglo-Saxon world and some other jurisdictions due to the diffusion of the British law system during the expansion of the British Empire. For us living in countries following other legal traditions (civil law, customary law or Muslim law), trusts are unfamiliar legal animals.[2] Especially the defining feature of a trust, division of ownership to legal and beneficial, is difficult to grasp for someone more accustomed to a legal system where ownership remains almost always absolute and undivided. At first glance it would seem a mundane exercise

[1] Vanham, 2017.

[2] I use a classification here employed by comparative law researchers in University of Ottawa. See more in University of Ottawa, 2017a.

for someone living in, say, Vienna to study trusts when they do not exist in the Austrian legal code. But in a globalised world also laws transcend country borders. A trust is a fine example of this: It is possible for three Viennese to form a trust according to the UK legislation even if none of them have ever set their foot on British soil. Trusts are more mobile or fluid than for example companies, and it is sometimes difficult to establish where a trust is situated at any given time. Often there is no need to register a new trust, which means that they have very little regulatory oversight compared to companies.

The divided ownership and a fluid nature has made trusts the vehicles of choice for individuals who want to avoid and evade the rules established by their respective governments. Coupled with the capital mobility provided by capital account liberalisation, trusts have become increasingly useful in hiding legal ownership of assets without losing beneficial rights to using them. Even though they are not universally embedded in all legal systems, the significance of the legal traditions of countries that have played hegemonic roles in the global fora for the past two centuries have ensured their acceptance. Even now, long after the peaks of first the UK and the subsequent US dominance in the world economy, common law countries account 6.31% of world population while covering 36.07% of the world GDP.[3] Some sorts of trust legislations have also been introduced in countries not following a common law system, such as China, Japan and Czech Republic, to name a few. In some other jurisdictions, famous for their secrecy provisions, the trust legislation has been fine tuned to compete with other such jurisdictions in attracting foreign capital.

As far as I am aware, there is not a comprehensive academic account of how trusts have evolved over time and what kinds of impacts this has had on economic inequality. Trusts in general have avoided broader academic interest due to the fact there is little statistics available about their existence. As they do not possess legal personality like companies or foundations, they do not have similar registration requirements. This means there is no way to provide even an estimate about the number of active trusts worldwide, not to mention assets that are held in them. Lacking figures, it has been impossible for economists to estimate the economic impact of trusts. The lack of numerical evidence about the extent of their use has not prevented research on *potential* impact trusts have on inequality through tax avoidance and evasion. In addition to some legal scholars pointing these possibilities out, there are several non-governmental organisations (NGOs) campaigning about the dangers some trust forms have for the third parties, that is natural and legal persons that are not part of the trust arrangement, in other words the larger society.[4] Legal historians have accounted the development of

[3] University of Ottawa, 2017b.

[4] See e.g. Sterk, 2000; Sitkoff & Schanzenbach, 2005; Silberstein-Loeb, 2015; Hofri-Winogradow, 2015. For NGOs, see the paper by the Tax Justice Network (TJN) researcher

commercial uses of trusts in detail, and based on this research Brooke Harrington (sociologist by training) recently pointed out the connections between trusts and the process of financialisation.[5] This was an important headway to understanding trusts' indirect inequality impact as Lin and Tomaskovic-Devey have earlier indicated the correlation between financialisation and inequality.[6]

Rather than focusing on pitfalls of a single trust legislation or on a specific case where a trust has been used to evade taxation or other rules and regulations, this paper aims to connect the dots between different strands of earlier research on trusts and to bring inequality questions to the mix. The idea is to look at the historical changes in economic inequality, the different policies designed to mitigate it, and the evolution of trusts to better understand what kind of connections trusts and inequality can have. The questions I seek to answer in this paper are: What kind of links there exist between economic inequality and trusts? How do trusts fit in the discussion about globalisation's inequality effects? Are there differences between economic inequality levels of countries having trusts in their domestic legal systems and those that do not?

Before giving a brief outline of the study, it is useful to remind the reader about some of the limitations I am facing when building the argument about connections between trusts and inequality. First, and as mentioned before, there is no sufficient data to make any definitive numerical estimates about the current use and economic impact of trusts. This denies me the possibility to examine statistics from different countries to come up with conclusions about trends in trust use and their correlation with inequality trends in those same countries. There are, however, some statistics available about numbers of trusts in the United Kingdom (UK) and France, as well as an estimate of how many households in the United States (US) are using trusts to manage their wealth.[7] It is worth noting that limited data can be viewed as an intentional barrier to deeper understanding about trusts and their users – one of the main appeals for some trust users is the possibility to hide ownership of assets or at least make it extremely difficult for outsiders to establish the connection between the trust asset and its beneficial owner. This assumption casts a shadow over the few pieces of statistics available about

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Andres Knobel, 2017. TJN and several other NGOs have formed the Financial Transparency Coalition (FTC) for further advocacy efforts to promote transparency about companies and trusts, see more in Financial Transparency Coalition, 2017.

[5] Harrington, 2016. For textbook accounts of trusts and their development, see e.g. Hudson, 2016 and Ramjohn, 2015. For more detailed accounts about the commercial uses, see e.g. Langbein, 1997 and Silberstein-Loeb, 2015.

[6] Tomaskovic-Devey & Lin, 2011; Lin & Tomaskovic-Devey, 2013.

[7] HM Revenue and Customs makes estimates about the number of UK trusts (HMRC 2017, p. 19), French tax authorities recently started to keep track of trusts having a connection point in France (Code général des impôts, Article 792-0, 2017), and 4.3% of the respondents to the Federal Reserve Survey of Consumer Finance reported having a trust or managed investment account in the US in 2013 (Bricker et al., 2014, p. 33).

trusts. The UK and French authorities produce figures based on tax declarations and the US estimates are based on consumer surveys. The UK and French statistics do not cover uses of trusts that are specifically aimed at evading taxation, and it is unlikely that the US citizens who create complex trust structures with the aim to obfuscate ownership of their assets would report this fact in a survey commissioned by the Federal Reserve. To alleviate this dearth of numbers I will refer to two proxy figures to indicate the significance of private trusts: The share of global wealth held 'offshore' and the number of professional trust and estate planners.[8] To conclude, the limited data about trusts is at the same time the main limitation and the main appeal to do this piece of research.

Second, because I am discussing changes to the global economy, and because trusts are extremely mobile legal vehicles, it is difficult to create a geographical scope for the study. Consequently, when the whole globe is in scope, it is impossible to study it exhaustively. I have selected two countries, the US and France, to use as example cases and whose experiences could in some instance be extrapolated to other countries. There were both theoretical and practical reasons for choosing these countries: There is good and detailed data available about the structure and development of economic inequality in both of them. They have both had an important role in advocating for increased capital mobility by themselves and through international institutions. Lastly, looking at these countries more in detail ensures that we are not solely focusing on countries that have or have not trusts in their domestic legislation, as the US has them and France does not.

Finally, although I discuss a number of different trust legislations around the world, there is an even greater number that I completely neglect. This drawback is further exacerbated by the fact that I do not discuss legal vehicles from other law traditions that bear resemblance to Anglo-Saxon trusts. Inequality impacts of *Anstalt*, *Treuhand*, *fiducie*, *fideicomiso* and *waqf*, to name a few, remain good topics for other research papers.

1.1 Outline of the Study

This paper consists of eight chapters:

1. Introduction
2. What is a Trust?
3. Income and Wealth Inequality
4. Reasons for Inequality
5. Trusts & Capital Mobility
6. Trusts & Taxation
7. Trust Users
8. Concluding Remarks

[8] I will use Zucman's estimates about offshore wealth (available at gabriel-zucman.eu) and the membership figures of the Society of Trust and Estate Practitioners Society (STEP).

Chapter 2 gives a concise outline of the basics of trusts and their historical development starting from their inception in the Middle Ages. Trusts cannot be explained without acknowledging the specifics of the Anglo-Saxon legal tradition, which means that the reader will be familiarized with the differences between the common law and the law of equity. This part draws from the work of several trust scholars and historians from both sides of the Atlantic.[9]

Chapter 3 consists of a brief introduction to inequality, why it is important to study it and how it can be measured. I will then proceed to look at a specific set of measures from the US and France. This data has been created by a group of researchers led by Emmanuel Saez and Thomas Piketty within the framework of the World Wealth & Income Database.[10] The same data can be used to detect historic variation in wealth composition in the two countries in question, which is an important factor to understand the systemic changes in the global economy that have created an environment where trusts can thrive.

In *Chapter 4* I will discuss globalisation and how this vague concept can be dissected to different phenomena that are often lumped under the common term. These includes changes in international trade, technology and economic institutions. I will also discuss a paramount development this combination of changes have produced: The liberalisation of capital movement during the latter part of the 20th century. Capital mobility has made it possible to use trusts more extensively than what was possible during capital account restrictions. Globalisation has had a profound effect on domestic government policies, including those geared at tackling inequality. In the last part of the chapter I will track historical changes in taxation of incomes and capital in the US and France.

Chapter 5 focuses on the effect capital mobility has had on trust use and vice versa. I will also explain how a concept once designed exclusively for private use has found several entry points to the realm of commerce and how there have been significant changes in trust legislation in a number of jurisdictions during the past three decades. This shows that trusts continue to evolve in the face of changing circumstances around them.

In *Chapter 6* I will analyse the connections between trusts and taxation. The central argument is that trusts are useful tools to avoid the grasp of redistributive policies, as they make it more difficult to detect ownership and taxable income. I will cover the 'traditional' uses of trusts for private wealth management, as in dynastic trusts and asset protection trusts, and point out how trusts are unbeatable legal vehicles for hiding ownership of assets through offshore structures, mainly to launder money or evade taxation. The

[9] Sanders, 1791; Maitland, 1894; Langbein, 1995; Ramjohn, 2015; Hudson, 2016.

[10] Alvaredo, et al., 2016.

discussion will then proceed to contemplate how trusts are not only relevant in reacting to redistributive policies – they can also be used to discourage having these policies in the first place. In conjunction with the free movement of capital and a wealth composition that is dominated by financial assets, trusts undermine the rationale behind capital income and wealth taxes. Because it is so easy to migrate the assets to another jurisdiction, policymakers cannot use these taxes to fight inequality efficiently. Company structures can be used to achieve similar goals but I will demonstrate why trusts are better equipped for moving capital fast.

Chapter 7 recaps what we know about trust users, based on the little data we have at our disposal. It also features a discussion on the profession of trust and estate planning and what its evolution indicates for the current and future stage of trust use. Finally, some estimates about the extent of offshore finance are presented, along with some remarks on the international efforts to curb the worst abuses of offshore finance.

Chapter 8 provides concluding remarks on what we have learned over the course of the paper. The main conclusion is that there are several ways trusts can be used to circumvent policies aimed at curbing inequality. These mainly work in conjunction with mobile capital and cross border asset transfers. Although trusts are rooted in the Anglo-Saxon world, their impact is not limited to those countries – actors in other countries can use them as well. The policymakers in non-trust jurisdictions should familiarise themselves with the concept so that the recent policy efforts to increase transparency about beneficial ownership of legal entities would not go to waste. If the policy response does not take trusts into consideration, there is a chance that actors who want to keep their ownership hidden shift from using anonymous companies to offshore trusts. Given the economic clout of the Anglo-Saxon countries and the systemic changes in the global economy, such as freer movement of capital and growing importance of financial assets, trusts are prone to play an even more important role in the future than what they have done until now. Trusts have enabled several innovative ways to organise assets and other investments, arguably making financial markets more efficient. But is the price the society pays for this increased efficiency proportionate to the threats trusts pose to the functioning of economic governance?

2 What is a Trust?

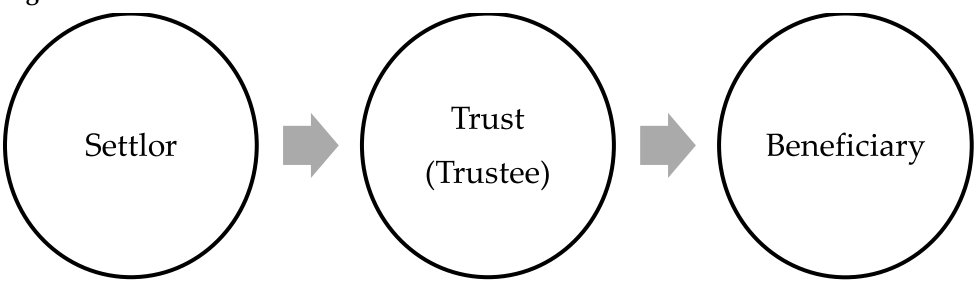
When you hear the word trust, you might first think of the ideas of reliability, responsibility and belief. There is another meaning to the word, though – a trust is a specific legal vehicle that is "An arrangement whereby a person (a trustee) holds property as its nominal owner for the good of one or more beneficiaries."[11] One major reason for general unfamiliarity with the trust concept is that it is only available in a specific set of countries, most of which follow the common law tradition. The aim of this chapter is to introduce the basic features of trusts and their historical development. This is necessary for garnering a better understanding of the potential impacts trusts have had and continue to have on economic inequality.

The chapter is divided to two sections: The first section introduces the basic structure and features of a trust and the second briefly explains the historical origins of the trust structure and some major developments the trust concept went through during the centuries.

2.1 Basic Structure

Trusts are three-way arrangements where a *settlor* transfers assets to a trust that is managed by a *trustee* for the benefit of a *beneficiary* or beneficiaries. Trusts could be conceptualised as gifts – the settlor wants to donate something to the beneficiary but instead of simply giving it directly they choose to use a trustee as a person responsible for executing the transaction over time. As Rudden puts it: "[T]he normal private trust is essentially a gift, projected on the plane of time and so subjected to a management regime."[12] The trust participants can be either people (natural persons) or different kind of entities, such as companies (legal persons). A trust is not usually regarded as an entity in itself but as an arrangement between the trust participants. Figure 1 represents the simple set-up of a trust.

Figure 1 Basic Trust Structure



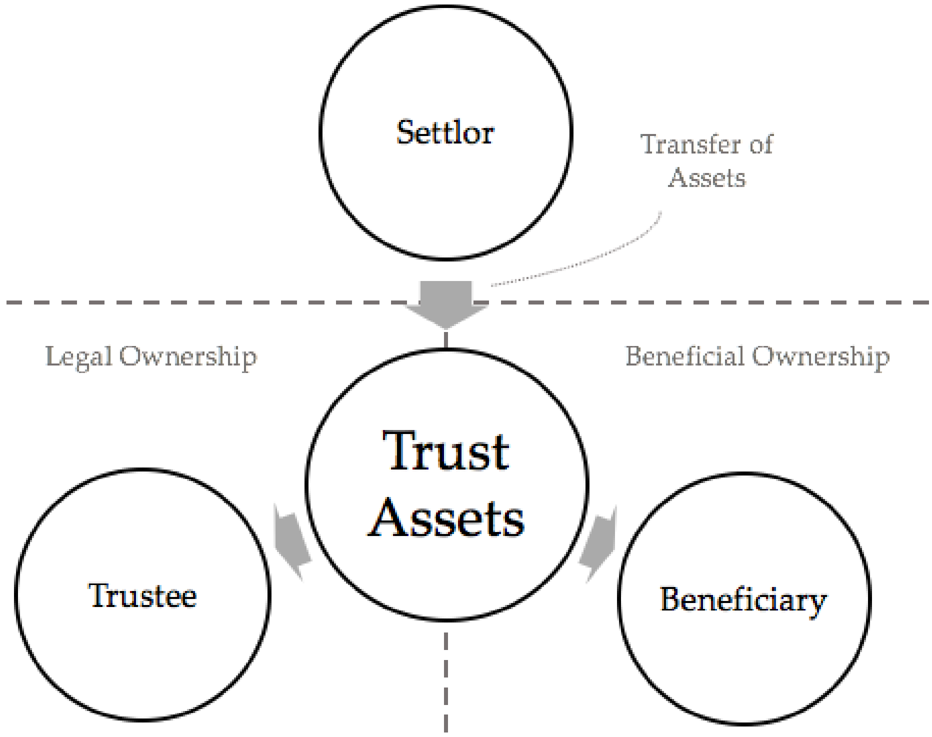
[11] The definition from the Oxford English Dictionary.

[12] Rudden, 1981, p. 610.

Viewing the trust arrangement this way, it is difficult to see what is so special about it. It looks like the transaction is quite straightforward, and as if there were only minor extra step when compared to giving the gift directly. However, there is one extremely important feature in even the simplest trust arrangement, which makes it an interesting topic for scholarly research: The division of ownership.[13] When a trust is settled, the ownership is transferred from the original owner (the settlor) to *both* the trustee and the beneficiary. The ownership is not merely neatly split but there is a careful division of roles: The trustee and the beneficiary do not have the same rights and responsibilities. The trustee is the legal owner of the assets, holding the title to them in official documentation and registers. The trustee is not only responsible for the assets they own, they also have a fiduciary responsibility to manage the assets in the best interests of the beneficiary. The beneficiary is the beneficial owner of the assets, as they hold an *equitable interest* to them and are entitled to enjoy their use and any possible profits the trust assets create. In other words, the settlor gives up their absolute ownership (legal and beneficial) of the assets when they transfer them to a trust. In the trust structure the ownership is divided into two: The legal ownership goes to the trustee and the beneficial ownership to the beneficiary. Note that people taking part in the trust structure can in some cases have more than one role (the settlor as one of the trustees or one of the beneficiaries) but usually trust structures where a single person holds all roles are considered invalid.[14] Figure 2 illustrates the division of ownership graphically.

[13] Sterk, 2000, p. 1041.
[14] Langbein, 1995, p. 632; Harrington, 2016, p. 3.

Figure 2 Division of Ownership in a Trust



2.1.1 Setting Up a Trust

In the typical case a trust is a legal arrangement that does not have a legal personality. This means that trusts can be established faster than legal entities and often they do not require any kind of registration to authorities or other third parties. In fact, sometimes trusts can be set up orally, without any written documentation.[15] To ascertain whether a trust arrangement exists, courts in the UK (the "birthplace" of trusts) refer to a so-called law of three certainties regarding the existence of an express[16] trust. [17] This concept was introduced in a judgement in 1840, according to which a valid trust needs to have the following:

1. Certainty of Intention
    - The settlor wishes to create a trust and this is clearly worded (but the usage of the word *trust* is not required)
2. Certainty of Subject Matter

[15] Hudson, 2016, pp. 214-8.
[16] For the sake of simplicity, by using the term 'trust' I refer to *express* trusts throughout the text. However, there is also another category of trusts called imposed trusts or implied trusts. These are further divided to resulting and constructive trusts. Imposed trusts do not entail intentional wishes from the part of the settlor but are either imposed by a court or implied through the operation of law. These types of trusts are not discussed in the thesis. For more information, see i.e. Chapters 11 & 12 in Hudson, 2016.
[17] *Knight v Knight*, 1840.

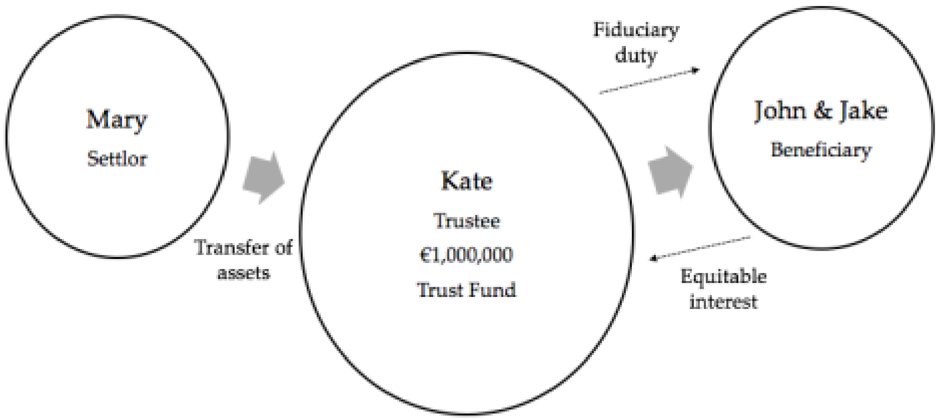
- The assets transferred to a trust must be clearly defined and identifiable

3. Certainty of Objects
    - The trust beneficiaries must be clearly named. When there is a class of beneficiaries instead of individuals, this class must be clearly defined

If there is uncertainty about any of the points above that cannot be resolved, the trust may be held void. In most cases, it is a simple exercise of examining whether these certainties are established in the trust deed – the written instrument that has been signed by both the settlor and the trustee. In the cases where a trust is created orally, it might be more open to interpretation whether these certainties exist. In most cases, oral trusts cannot be used in transferring ownership, as often the transfer requires alteration of other legal documentation (e.g. legal titles of real estate or shares) for establishing the certainty of intention and subject matter.[18]

Figure 3 depicts an example of a simple trust.

Figure 3 Simple Trust Example



Mary transfers €1,000,000 to a trust managed by Kate for the benefit of her twin sons John and Jake, who are 15 years old. Mary and Kate draw up a trust deed that stipulates that Kate is to distribute the accrued interest annually to John and Jake in equal portions over the next ten years, and finally transfer the trust fund in its entirety to them when they turn 25. In settling the trust, Mary gives up her ownership of the assets transferred to the trust fund. The €1,000,000 is now legally owned by Kate (the amount could be deposited to the trust's bank account under Kate's name) but it is John and Jake who get to enjoy the money once Kate distributes it to them according to the instructions written in the trust deed. Mary has given up her powers to dictate how the trust fund is used once she has settled the trust but she can rest assured that Kate will follow the instructions set down in

[18] Hudson, 2016, pp. 214-8.

the trust deed instead of using the money for her own interests. This is because Kate has accepted the role of the trustee, and she is bound by the established duties associated with that role, such as managing the fund according to the best interests of John and Jake. In other words, she has a *fiduciary duty* to them. She is also expected to invest the money prudently, avoiding risks as if she owned the trust fund for her own benefit. Should there be any doubts that Kate is not fulfilling her duties in the management of the trust, John and Jake, as the beneficiaries, can request information about Kate's actions. In the worst-case scenario, they can seek legal action against Kate if they suspect that she has breached the trust.

This is a very simple, typified example of a trust and it is easy to establish that all three certainties exist: 1) Mary has signed a trust deed which clearly marks her intention to create a trust, 2) the trust fund is clearly defined to be a sum of €1,000,000, and 3) John and Jake are named as the beneficiaries so there is no doubt who is entitled to benefit from the trust assets. This trust is a *fixed* trust; the trust deed stipulates that Kate must distribute the trust assets equally between John and Jake within an established time frame. Trusts can be set up to be *discretionary* as well. In this case, Mary would have given Kate the powers to distribute the trust assets to John and Jake at Kate's discretion. In other words, Kate would not have been obliged to make the annual payments in equal portions but could assess which of the sons should receive larger benefits. If the trust deed so allows, she could also deem that no distribution is required in year X and any income earned that year is added to the trust capital. Discretionary trusts have a special impact on the equitable interest of the beneficiaries. Whereas in the fixed trust it can be assessed that both Jake and John have an equitable interest in half of the total trust assets, this is not the case with the discretionary trust. They can only hope to benefit from the trust assets but it might be that one of them receives all the assets while the other receives nothing.[19] This can have far-reaching consequences for the possible creditors of Jake and/or John, which I will discuss later in the paper.[20]

The above example of a trust that can be either fixed or discretionary can be viewed as an archetypal trust concept. Modern applications of trust vehicles can be far more complex and can stretch the nature and structure of the trust concept. Before we can appreciate the contemporary uses and variations of trusts, we need to give a closer look at the historical origin and development of the trust.

[19] In trust law jargon, Jake and John have a 'spes' of receiving some/all the trust assets. See Ramjohn, 2015, p. 136.

[20] For a more detailed introduction to discretionary trusts, see e.g. Chapter 6 in Ramjohn, 2015.

2.2 Historical Origins and Development of the Trust

There are several birth stories of the trust but all of them lead to the Medieval Age. According to the dominant one, trusts were created to satisfy a demand arising from the English Crusaders in the 12th and 13th centuries.[21] The knights owning freehold land were afraid that someone would appropriate their lands while they were away in the Middle East for years at a time. By leaving the country, they left their families in a perilous position as women and minors were not legally able to be landowners at the time – the lands could be regarded ownerless and the families driven out of their homes. To solve this dilemma the Crusader (the settlor) would name a trusted person (the trustee) to be the legal owner of the land who, instead of benefitting from the land himself, would look after it in the best interests of the Crusader and his family (the beneficiaries). When the Crusader returned home, the trust could be dissolved and the Crusader would again enjoy the absolute ownership of the estate. Were the Crusader to perish during his endeavours, the trusted person would see to transferring the title to the lands to the Crusader's male heirs when they reached adulthood. The title to the land was of immense importance at the time, as it was practically the only source of wealth and other (aristocratic) titles were often connected to the land.[22]

Unfortunately for the Crusader, the English common law courts did not recognise this legal novelty as they were bound by strict legal tradition and the rule of precedent. To circumvent this obstacle, the Crusaders could use the *law of equity* instead of the common courts. Equity was a safeguard against the power of the common law courts and offered a legal realm for some concepts and notions that were note recognised by them. Ramjohn gives a concise definition for equity:

> The system of equity includes that portion of natural justice which is judicially enforceable but which for various reasons was not enforced by the courts of common law. In this context the expression 'natural justice' is used in the broad sense of recognising and giving effect to justiciable rights of aggrieved parties based on principles of fairness and conscience that were not acknowledged by the common law courts.[23]

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[21] It is probable that the English knights did not device the concept from the scratch but simply copied and modified an Islamic legal vehicle *waqf* that was used in the Levant at the time to donate property for religious or charitable purposes. The legal tradition for *waqf* was developed during the 7th, 8th and 9th centuries (Gaudiosi, 1988, p. 1233). This would explain rather neatly why the use of trust became popular among the Crusaders. According to yet another possible explanation, first trusts were created for the management of the assets of Franciscan monks as they took a vow of poverty upon joining a monastery, and could not thus own assets directly (Maitland, 1894, p. 130).

[22] Harrington, 2016, pp. 16-7; Hudson, 2016, pp. 36-9.

[23] Ramjohn, 2015, p. 1.

This possibility to seek justice outside of the common courts existed right from the inception of the English legal system in the 11th century.[24] The aggrieved party could directly petition the King about an unjust court ruling. After the legal system matured and the number of petitions proliferated, the position of the Lord Chancellor was created to relieve the King from the burden of dealing with the petitioners himself. By the 13th and 14th centuries, a dual legal system emerged where the common law courts adhered to the legal rules and the doctrine of precedent but the Court of Chancery[25] followed conscience: "[T]he role of a court of equity at that time was considered to be to reach a morally correct result without worrying about precedent".[26] This suited the trust concept very well and it was natural that it became nested in the law of equity instead of the common law. While the common law courts were blind to the idea of dividing ownership to a legal and equitable part, the court of equity were more interested in what was morally right and who really should be entitled to enjoy the ownership. They were more inclined to enforce trusts and the equitable rights of the beneficiaries than to be concerned about the legal titles and precedents.

Let us examine the case of the Crusader again. Transferring the legal title to another adult male (the trustee) was a simple act recognised by common law courts. Unfortunately, the settlor and the beneficiaries could not rest assured the trustee would live up to his promise to act in the best interests of the beneficiaries – the common law only recognised the legal ownership of the trustee, not the equitable interests of the beneficiaries. If the trustee decided to keep the property for himself, it was simply an "immoral breach of confidence" from his part but a perfectly legal move from the point of view of the common law courts.[27] However, the beneficiaries had one more card up their sleeves – they could take the case to the Court of Chancery, which was focused on questions of morality. The Court of Chancery acknowledged the idea of the trustee owning the assets for the benefit of someone else and the related moral obligation to act in the best interest of the beneficiaries. The latter were deemed to hold an equitable interest on the trust assets and were entitled to demand the trustee to act accordingly. It is noteworthy that the Court of Chancery did not challenge the trustee's legal title for the underlying assets but simply ruled against the moral wrongdoing of the trustee *in personam*, breaching the personal agreement between the settlor and the trustee. [28] Finally the settlor could depart from

[24] Hudson, 2016, p. 13.

[25] Court of Chancery is the Court that derived from Lord Chancellor's office. For hundreds of years it consisted of only the Chancellor himself and his assistant, the Master of Rolls. In 1813 the first Vice-Chancellor was appointed to help in Court rulings and ever since the rulings have become less based in the personal moral view of the Chancellor but more codified, following the precedents set in the past (Hudson, 2016, p. 14).

[26] Hudson, 2016, p. 14.

[27] Ramjohn, 2015, p. 5.

[28] *Ibid*.

his assets in confidence as he knew that the trustee was personally responsible "upon the *honor* and *conscience*" to act in the best interest of the beneficiaries.[29]

Trusts proved to be useful vehicles also after the knights ceased their crusading activities. The feudal common law system created several restrictions, taxes and other so called 'feudal incidents'[30] on land transfers, and the landowners wanted to avoid unjust and outdated systems of law by using trusts.[31] Dividing the ownership with trusts became a successful way to avoid the feudal common law because the transfer of ownership took place during the lifetime[32] of the settlor, and the heir received only the equitable interest in the trust asset, the feudal incidents were not triggered upon the transaction. Trusts were also used from early on to escape other creditor claims, as the concepts of 'moral virtue' and 'honour' intrinsic in the law of equity shielded trust assets from the 'unjust' creditor claims based in the common law. This did not go unnoticed and the British Parliament passed laws to regulate some of the trust uses aiming to avoid common laws as early as 1376 and 1377.[33] The inherent contradictions between the two legal systems were not eliminated, however, and the courts following different traditions would come to different judgements. To resolve the uncertainty this created, James I issued a royal decree in 1616 establishing the superiority of the law of equity over the common law.[34] This was further codified in the Judicature Act of 1873:

> Generally, in all matters not hereinbefore particularly mentioned in which there is any conflict or variance between the rules of equity and the rules of common law with reference to the same matter, *the rules of equity shall prevail*.[35]

The same Act also fused equity and common law together in the UK by giving all courts mandate to rule on both equity and common law matters.[36] This paved the way for a more widespread use of trusts as it decreased the uncertainty about the proper legal procedures governing it. Whereas before a plaintiff had to seek help from the specialised equity courts, after the Act came into force in 1875 they could also use the more numerous and accessible common law courts.[37]

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[29] Sanders, 1791, p. 256, emphasis in the original.
[30] E.g. wardship and escheat, see more in Ramjohn, 2015, p. 4.
[31] Langbein, 1995, pp. 632-3.
[32] Or *inter vivos* in Latin, which borrows the name for trusts created during the lifetime of the settlor: *inter vivos* trusts.
[33] Sterk, 2000, p. 1041.
[34] Kerly, 1890, p. 115; Hudson, 2016, p. 15.
[35] Judicature Act, 1873, s 25, emphasis added
[36] In the USA, New York was the first state to combine law and equity courts in 1850. Several states followed suit and the courts of law and equity were fused at the federal level in 1938 with the enactment of the Federal Rules of Civil Procedure, see more in Federal Judicial Center, 2017.
[37] Ramjohn, 2015, p. 19.

2.2.1 Transformation of Wealth Transforms Trusts

We have now established the 'birth story' of the trust and how its original purpose was to respond to specific asset management challenges faced by the Crusaders, and later to avoid some of the burdensome feudal land transfer rules. But even after the restrictions on land transfer were progressively abolished starting in the late 17th century, trusts prevailed as a tool that began to be used for managing other assets than land.[38] As mentioned above, throughout the feudal times right until the end of the 19th century, land was the primary source of wealth.[39] Today, land has been complemented and substituted by different kinds of financial assets such as bank deposits, bonds, securities, etc.[40] This change in the composition of wealth has translated to changes in the composition of trust assets. While there is no international data, according to the 2013 US Survey of Consumer Finances, 88,5% of the US trusts held some sort of a financial asset while only 11% contained real estate.[41] The dramatic difference in the characteristics of the assets managed by the trusts has had a decisive impact on the nature of the trusts in general, and the role of the trustees in particular.[42]

2.2.1.1 Role of a Trustee

When trust assets solely consisted of land, the role of the trustee was rather light: All they had to do was to look after land and make sure that it was maintained properly. Because the land held such a substantial intrinsic value, it was not necessary to make big investments to increase its productivity. Even if the trustee was passive, the beneficiaries were satisfied with the fruits of the land – literally and figuratively. In other words, being a trustee did not require taking up an active management role over the trust assets. At most it was dispensing the annual rental income and other profits to the beneficiaries and eventually transferring the legal title when the heirs came to age or at some other point of time stipulated in the trust deed.

When the trust assets diversified from being solely land to a portfolio of different financial assets, the wealth management duties of the trustees increased significantly. Financial assets require active and regular managing and decision-making to fine tune investment strategies according to the changing market conditions, to either distribute income to beneficiaries or to reinvest it to other financial assets, and to minimize the tax exposure of the trust assets. Whereas the traditional trustees used to accept their honourable roles understanding that it required occasional decisions about the

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[38] Langbein, 1995, p. 637.

[39] For an illustrative chart about the shift in Britain, see Piketty, 2014, p. 116. For a more detailed discussion on the change of the nature of wealth, see *ibid*. Chapter 3: *The Metamorphoses of Capital*.

[40] The current composition of wealth is discussed in greater detail in *Chapter 3*.

[41] Bricker et al., 2014, p. 33.

[42] Langbein, 1995, pp. 637-8.

management of land they were well accustomed to do, the new active duties became decidedly more cumbersome.[43] In the era of trusts consisting of financial asset portfolios, being a trustee is less like conveying a gift and more like managing a business.

2.2.1.2 Wealth management problems in traditional trusts

Considering the medieval origins of the trusts, they might not seem like the vehicles of choice for efficient and business-like management of diverse investment portfolios. Firstly, trusts are a product of equity, and the law of equity and its moral underpinnings do not provide a perfect fit with the cold business rationale. The rules of business relationships are set down in writing in the form of contracts that stipulate in detail what is expected from each party in the business relationship. Because the contract law has its basis in the 'rigid' common law tradition (instead of equity), both contracting parties know their duties and what to expect if the other party fails to deliver. The contract is what it is, nothing more or nothing less. This "certainty of contracts" is necessary for an efficient functioning of commercial life.[44] If trusts are brought into the equation, this certainty disappears because trusts are always based in the law of equity, with its equitable principles. How can business partners rely on each other and their respective commitment to the contract, when one of them could use equity (read: the law of moral or conscience) to claim that the outcome of the contract has been unfair for them? Even though unequal division of profits between contracting partners is perfectly legal under contract law (and the basic motive for individuals to do business in the first place), it could be challenged as immoral based on equitable principles.

Secondly, duties inherent in the role of the trustee makes an aspiring trustee think twice whether they want to fill those shoes in the end. These include, but are not limited to, duty to obey directions of the trust, duty to act in the best interest of the beneficiaries, duty to safeguard trust property, duty to act impartially between beneficiaries, duty to act prudently or at least exercise reasonable care, duty to distribute the trust property correctly, duty to avoid conflicts of interest and duty to act gratuitously.[45] And let us not forget: The trustees are personally liable for any losses in the trust fund if the trust is breached.[46] In sum, the role of the trustee has a long list of duties and the personal liability makes it a risky endeavour. You would think that asking for a proper compensation is in order but attaching a hefty price tag on your trusteeship was not held in high regard due to the duty to act gratuitously, as exemplified in this account by Sanders from the late 18th century: "The courts of equity look upon trusts as *honorary*, and as a burden

[43] Langbein, 1995, pp. 638-40.
[44] Hudson, 2016, pp. 909-10.
[45] Hudson, 2016, 313-50; Ramjohn, 2015, pp. 428-36.
[46] Hudson, 2016, Ch 18; Ramjohn, 2015, Ch 16.

upon the *honor* and *conscience* of the person intrusted, and not undertaken upon mercenary motives."[47] As long as honour and conscience do not pay the bills, it is difficult to see why anyone would want to become a professional trustee.

2.2.1.3 Overcoming the Problems

Considering that the concept of the trust is based on the goodwill, high moral standards and honour of the trustee to act in the best interests of the beneficiaries gratuitously and with a liability for any losses to the trust fund, it is surprising that there is a wealth of professional trustees and trustee companies who are willing to take up this burdensome role. This anomaly is explained by the flexibility of the trust arrangement. While traditionally the office of the trustee was an onerous one with no pay nor gains, this could be amended by a careful drafting of the trust instrument.[48]

First, there was the issue of remuneration. Until the end of the 18th century there was a clear view that the trustees should not be compensated for their services, as evidenced by the Lord Chancellor's judgement in *Robinson v Pett* and the previous quote by Sanders.[49] However, case law from the beginning of the 19th century supports the view that the trustees are to be reimbursed for the expenses they incur while exercising their role as a trustee.[50] This was not only restricted to travel expenses and such but also included hiring agents to do some of the activities belonging to the trustee. The power to delegate trustee tasks slowly developed in the US and the UK, up to the point the original trustee would not have to execute almost any of the tasks themselves. Today, Jersey has the most permissive legislation in place, which enables trustees to delegate all their tasks and powers, and that even delegates can delegate them onwards.[51] The possibility to use agents and delegates who required a fee for their services eventually led to a general agreement that the trustees are eligible for remuneration as well. This common view was finally codified in the UK Trustee Act 2000, which states that all trustees are entitled to compensation if the trust instrument so provides and, interestingly, professional trustees are automatically entitled

[47] Sanders, 1791, p. 256, emphasis in the original.
[48] Hudson, 2016, pp. 365-6.
[49] *Robinson v Pett*, 1734, 24 ER 1049, Lord Chancellor Talbot LC: "It is an established rule that a trustee, executor, or administrator, shall have no allowance for his care and trouble: the reason of which seems to be, for that on these pretences, if allowed, the trust estate might be loaded, and rendered of little value. Besides, the great difficulty there might be in settling the quantum of such allowance, especially as one man's time may be more valuable than that of another; and there can be no hardship in this respect upon any trustee, who may choose whether he will accept the trust, or not."
[50] See, eg, *Worrall v Harford*, 1802 8 Ves 4; *Malcolm v O'Callaghan*, 1837, 3 My & Cr 52; *Re Earl of Winchilsea's Policy Trusts*, 1888, 39 Ch D 168.
[51] Hofri-Winogradow, 2015, pp. 18-22.

for remuneration even if this was not stipulated in the original trust instrument.[52]

Second, the rules and customs pertaining to trust investment decisions changed over time. This was crucial for trusts to remain relevant when the general wealth composition changed profoundly during the 20th century. The old wealth composition based on land ownership required conservative investment decisions, and the trustees had to act prudently in their role as investing trust assets.[53] When financial assets made their way into trusts, this translated to specific prudent investor rules for financial assets. For example, in the US this meant favouring bonds over equities and in the UK there were quotas on how much of the trust assets could be invested in safe and risky vehicles. These were default rules that could be circumvented by careful trust deeds but since the investment strategies in general had developed over time these positions were amended in legislation first in the US in 1994 by the Uniform Prudent Investor Act and in the UK in the Trustee Act 2000.[54]

Third, limiting or excluding personal liabilities of trustees with broad exclusion clauses helped to decrease the risks in the trustee role. The precedent for validating exclusion clauses was set in a case from 1861, after which trustees could enjoy from limited liability provisions like those enjoyed by company directors.[55] This was a significant development as the traditional set of trustee responsibilities dampened, if not prohibited, the interest to offer trustee services professionally. Exposure to different sorts of liabilities would have made it simply too risky a business. After all you would have had to be quite self-confident in your abilities as an investor if you were willing to maintain personal liability for any losses you made on the stock market. Trustees have been exempted from more and more types of behaviour with an increasing pace during the past decades. A landmark case in the UK in 1997 established that trustees could not be held accountable for even grossly negligent breaches of the trust.[56] Most US states, the Bahamas, Belize, the Cayman Islands and the Cook Islands follow the same line when it comes to liability of trustees.[57]

These incremental changes to the nature of trusts and the role of trustees showcase the flexibility of the trust instrument. Although based in the medieval traditions of law of equity, the trust could be moulded to correspond to the demands of the modern world. This flexibility together with the concept of dividing ownership to the legal title and equitable

[52] The Trustee Act 2000, Section 28. The precedent for professional trustee remuneration beyond the original trust instrument, see *Re Duke of Norfolk's Settlement Trusts*, 1982, Ch 61.
[53] Hudson, 2017, p. 76.
[54] Hofri-Winogradow, 2015, pp. 16-17.
[55] *Wilkins v Hogg*, 1861, 31 LJ Ch 41.
[56] *Armitage v Nurse*, 1997.
[57] Hofri-Winogradow, 2015, pp. 4-5. The US Uniform Trust Code was introduced in 2000 and has since been enacted in 31 states and in District of Columbia, see Uniform Law Commission, 2017.

interest made trusts the wealth management tools that are more efficient and nimble than any other legal vehicles available in the common and civil law systems.[58]

After this basic introduction to trusts, the next two chapters are focused on inequality, its measurement, and the general causes for changes in the inequality levels. I will return to trusts and analyse the interplay between them and economic inequality in more detail in the *Chapters 5-7*.

[58] Langbein, 1995, p. 671.

3 Wealth and Income Inequality

To assess whether there is a connection between trusts and inequality, it is necessary to understand what inequality means and how it can be quantified. This Chapter proceeds as follows: First I will discuss the specific kind of inequality in focus in this paper. Second, I will present the tool I have chosen to measure inequality, *Distributional National Accounts* (DINA) and explain why I decided to use it. Third, I will briefly demonstrate how inequality has developed over time in the US and France according to DINA. Fourth, as it is possible to track composition of wealth and income sources with DINA, the last part of this Chapter recaps the general changes in the composition of inequality.

3.1 What Is inequality

There are many various kinds of inequality stemming from different socio-economic issues – the prominent examples are gender and racial inequality. The angle in this thesis leaves the socio- prefix out of the equation and focuses on economic inequality, more precisely on wealth and income inequality. Economic inequality means that the economic output is shared disproportionately – in the extreme scenario people are divided to two groups, haves and have-nots. The former enjoy from the vast majority of the economic output while the latter have to struggle for the scraps. Equality and inequality are always relative concepts. A society can be organised in a way where everyone is sharing a meagre output equally, or in a way where tremendous output is shared very unequally. Everyone in the first society could be poorer than the poorest in the second society, even though the first one is defined as equal and the second as unequal. Economic inequality would not be the most urgent societal question in the first society but it could be important for the second. This is largely dependent on whether the people on the less wealthy end of the spectrum feel like they are receiving a reasonable share, or if they have a reason to believe that their share is increasing or decreasing over time.

As briefly mentioned in the introduction, the debate about economic inequality has been brewing for years, especially since the Great Recession of 2007. The sudden economic turmoil and grisly real life lessons fed a 'gut feeling' even in the richest countries that although the economic system is creating astounding levels of wealth, it is not shared in a proportionate manner. A decade later this discontent on part of the population sometimes dubbed as the 'losers' of globalisation culminated in two momentous voting results. The UK, the country that has had most to do with the inception of the modern liberal economics, decided to supress their economic and political ties with the rest of Europe in a surprising referendum result in June 2016. The US, the country that has acted as the champion of the free market economy and trade liberalisation for the past 70 years, produced even more shockwaves by electing Donald Trump as the new president in November 2016. Throughout his campaign, Trump's key message was restoring jobs and wealth to the American middle classes, which have been 'robbed' by other countries during the economic globalisation of past decades.

Is there ground for the growing resentment? Has the economic growth of the past decades been exclusive to only some parts of societies? Is inequality rising and if so, should we be worried about it? The last question is relevant as some say that high level of inequality is a necessity for creating sufficient incentives for individuals to work hard, which creates a prospering society at large.[59] According to this view it is not useful to stare at inequality figures, as economy and well-being can grow robustly even in times of high inequality, or perhaps precisely because of that. This view has been contested by several economists who think that not only is inequality morally dubious, it is also detrimental for efficient economies and their growth.[60] Although the aggregate economic impact of inequality is an interesting academic debate, I will not enter it in more detail in this paper.[61] The overriding reason for studying inequality is the assumption that rising (perceived) inequality carries significant social costs. It can lead to increasingly polarised societies, which in turn increases the probability of disruptive events that can threaten their very existence. Managing inequality is necessary to avoid the worst kinds of upheavals leading to human suffering, such as large scale wars.[62]

3.2 How to Measure Inequality

Transforming inequality to numbers is not an easy task and there are many ways to go about it. Concepts such as Gini coefficient, Theil T's, Palma ratio and a plethora of different household survey methods are the basic bread and butter for inequality scholars, even if they would not say much for a layperson.[63] To promote the importance of the issue, the globally renowned charity Oxfam produces annual reports about global inequality that are more accessible in nature. Oxfam simply compares the net worth of the very richest to the estimated wealth of the bottom half of humanity. Their

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[59] This view is backed with marginal productivity of distribution theory, according to which each individual is earning income according to their productivity and thus contribution to society around them. Carl Menger, the founder of the Austrian school of economics, was first to offer a theory of marginal utility in mid-19th century, see Menger, 2007 [1871]. Menger's contemporaries built on the theory to define a theory of marginal productivity of distribution, see e.g. Clark, 1899, p. 1.

[60] See e.g. Atkinson, 2015; Stiglitz, 2012.

[61] Some of the most influential international economic organisations have in recent years published research evidencing inequality's detrimental effects for economic growth in the long run, making a clear turn from their earlier economic doctrines. See e.g. International Monetary Fund, 2015; OECD, 2015a.

[62] Stiglitz, 2012, pp. 104-6.

[63] For a concise introduction to inequality measures, see Galbraith, 2016.

latest report showcases the absurd levels of global inequality – the research claims that only eight men own the same amount of wealth as the poorer half of the world population.[64] That is 3.6 billion people. There have been many challenges to Oxfam's conclusions, the main problem being that Oxfam works with net worth, in other words they detract liabilities from assets.[65] But there are also highly authoritative voices, such as the former World Bank inequality economist, Branko Milanovic, saying the underlying data on global wealth distribution is as good as it gets with the currently available statistics.[66] Oxfam consistently uses estimates from the Credit Suisse Global Wealth Databook, and doing so they have revealed an alarming trend: In 2010, 388 richest accounted for the same wealth as the poorer half of the population, in 2014, the figure was 85, in 2015 80, in 2016 62 and now only 8.[67] According to this measure, the wealth on the global level is rapidly concentrating. However, conceptualising the meaning of inequality at the global level can be difficult, and it is even harder to deduce what should be done to address it and where to do it. For many observers, the level of smaller political entities is more relevant. What happens within countries?

Thomas Piketty offers a long historical perspective on inequality within selected countries in *Capital in the Twenty-First Century,* covering wealth and income distribution in Europe and the US for the past 250 years.[68] Piketty's main finding is that wealth and income inequalities have been rising since the 1980s after decades of more inclusive economic growth after the WWII. This is due to his central thesis: The rate of return in capital investment persistently maintains a higher level compared to the aggregate economic growth in the long run.[69] In other words, wealth tends to concentrate unless there are dedicated and substantial policy interventions to prevent it from doing so. Although Piketty's conclusions have garnered critics, at least in the US denying the increase in economic inequality has been very difficult to do, as various different researchers using different methodologies arrive at

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[64] Oxfam, 2017.

[65] See.g. Giles, 2016; Salmon, 2017.

[66] Milanovic, 2015.

[67] Oxfam, 2015; Oxfam, 2016. It should be noted that the methodology for collecting the underlying data source Oxfam uses, Credit Suisse Global Wealth Databook, has slightly changed throughout the years, affecting the comparability of the figures. This is especially apparent in the change between 2016 and 2017. See disclaimer in Oxfam, 2017, p. 11.

[68] *Capital in the Twenty-First Century* made a splash when the English translation came out in 2014. It became a bestseller in many countries, a considerable feat for an academic text of that size. Riding on this success, Piketty has been frequently advising many politicians. The latest examples are Jeremy Corbyn, the UK Labour party leader, and Benoît Hamon who was the presidential candidate of the Socialist party in the presidential elections in 2017 France. See Cowburn, 2016; Blamont, 2017.

[69] Piketty's "fundamental law" is expressed algebraically $r>g$, where r is the return of capital and g is economic growth.

similar results.[70] Covering wealth and income inequality developments for such a long period of time with the method of extensive use of tax records is a momentous task, even if the focus was on a small number of countries. Due to the success of the book it was easier for Piketty to further collaborate with a vast number of researchers across the globe to review the findings and extend the research to cover more countries. The following part describes what followed from this endeavour.

3.3 Distributional National Accounts by WID.world

Although all of the inequality measures mentioned above are important for providing more in-depth knowledge about the trends and nature of inequality, I have decided to employ another concept in this study. These inequality measures are based on *Distributional National Accounts* (DINA), available in the World Wealth and Income Database, or WID.world.

WID.world is a project led by Thomas Piketty, Facundo Alvaredo, Emmanuel Saez, Gabriel Zucman and the late Anthony Atkinson, and over a hundred other researchers worldwide has contributed to it in the past couple of years. The goal of the project is admirable: "[T]he most extensive available database on the historical evolution of the world distribution of income and wealth, both within countries and between countries."[71] Frustrated by the fact that the most widely used yardstick of economic performance, the gross domestic product (GDP), only deals on aggregate and average levels, Piketty & co. desired to use a measure of economy that could be disaggregated all the way down to the individual level. Creating a new economic measurement from scratch and collecting new information to use it across the globe would be a daunting task for a research project of any size. To exploit the dominant position and widespread use of GDP measures, they decided to use it as the basis for calculating a macroeconomical measure that could be used to that end. The *Net National Income* (NNI) of a country equals its GDP minus use of capital goods and net money flows across the country's borders.[72] A country's NNI is the glue between national accounting

[70] All of the following research conclude that economic inequality in the US is high and has increased over the past decades. Only differences are in how much wealth and incomes are concentrated at the top of the distribution. See especially the reports from the non-partisan Congressional Budget Office and the Joint Committee on Taxation (Congressional Budget Office, 2016; Congressional Budget Office & Joint Committee on Taxation, 2016). See also Bricker, Henriques, Krimmel, & Sabelhaus, 2015. For a more detailed review of different research on income and wealth inequality, see Kleinbard E. D., 2014, pp. 102–26.

[71] WID.world, 2017.

[72] Use of capital goods is also called capital depreciation, or consumption of fixed capital (CFC). Money flows crossing borders are called net foreign income (NFI). See more on the methodology used in WID.world website and Blanchet & Chancel, 2016. The World Bank has statistics about Gross National Income, which equals to NNI without taking into account capital depreciation, see World Bank, 2016. The task for the research team, then, was to come up with a consistent method to calculate CFC in different countries.

and inequality measures, as it represents the sum of the net incomes of all citizens in that country. After arriving at this figure, the researchers need to find means to distribute it among the citizens – there is not a straightforward way to do so. As briefly mentioned above, Piketty used tax reports in his influential book *Capital in the Twenty-First Century.* Fiscal information provides a solid starting point for the allocation of NNI, as you can see how much taxable income citizens have. However, national taxable income does not cover all national income.[73] To overcome this data shortage, researchers at WID.world employ different sources including fiscal data, national accounts, household surveys, and wealth rankings (or rich lists) to arrive at a consistent methodology of dividing 100% of national income down to percentiles of population.[74] The resulting dataset is called the Distributional National Account (DINA). As the name states, World Wealth and Income Database does not only measure income but also uses the same underlying data to examine and estimate the level of wealth and its distribution.[75]

The reasons for using the WID.world figures in this study are four-fold. First, they derive from a consistent methodology over time and between countries, which enables establishing historical trends within countries and comparing inequality levels between countries. This gives a solid statistical foundation for tracking the changes in inequality levels over time. Second, reconciling national accounts and individual income estimates allows the mapping of distribution of aggregate economic growth between different segments of the population. In other words, it is possible to look whether the growth in the national income has been shared equally or if some groups have gained a bigger piece of the cake. Third, the data allows a comparison between the distribution of both pre- and post-tax incomes. This gives an extensive insight on how redistributive policies such as taxation impact economic inequality.[76] Fourth, using concepts compatible with national accounting enables the differentiation between the types of income: We can establish whether wage labour, capital income or social security transfers constitute the main driver for incomes at different income segments. The same benefit can be extended to wealth composition – it is possible to see the "building blocks", the different asset classes, behind private fortunes. All four aspects of the chosen inequality measure are essential for understanding the possible inequality impacts of trusts.

Naturally there are also shortcomings for using WID.world data. First, national accounts provide the frame for calculating NNI and the subsequent DINA. National accounts are not always perfect and they can misrepresent

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[73] See Piketty, Saez, & Zucman, 2016, pp. 5-6. Taxable income has been used to study its distribution and income inequality for a long time. This work was pioneered by Simon Kuznets in the 1940s. See e.g., Kuznets, Epstein, & Jenks, 1941; Kuznets, 1953; Kuznets, 1955.

[74] Alvaredo, et al., 2016, p. 6.

[75] See Alvaredo, et al., 2016, pp. 37-51; Garbinti, Goubille-Lebret, & Piketty, 2016, pp. 18-24.

[76] Piketty, Saez, & Zucman, 2016, pp. 15-6.

and "lose" some of the cross-border financial flows. This is particularly apparent in the estimates of household wealth hidden offshore: In 2013 Zucman estimated that the global household wealth held offshore reached $5,9 trillion, and revised this to $7,6 trillion in his book two years later.[77] This accounts for 8% of global household wealth.[78] In order to take this missing wealth into account, the WID.world methodology uses Zucman's estimates on the regional origins of the missing wealth and adds it to the country measures in each region according to their GDP share.[79]

Second, and related to the first, the data for distributing NNI is firmly based on fiscal data, with complementing data coming from household surveys, other fiscal datasets and "rich lists" – in other words it is mostly based on self-reporting by individuals. Many of the traditional inequality measures are based solely on surveys that tend to underrepresent the wealthiest percentile.[80] Complementing this data with detailed fiscal information is an improvement but the data still depends on individuals declaring all their assets and income in their taxation. As the WID.world scholars remind, and as mentioned above, this is a significant flaw due to the contemporary possibilities to hide assets offshore.[81] The offshore wealth is thus not always reflected accurately in the DINA figures, nor is the income from that wealth. These shortcomings mean there are three ways in which the resulting figures may misrepresent the impact of missing wealth in the wealth and income distribution for a single country: First, Zucman's estimates are conservative, as he notes himself, and only include financial assets and not ownership of e.g., real estate, art collections, yachts or precious stones.[82] Second, Zucman makes qualified *regional* estimates of the origins of the offshore wealth. The WID.world methodology allocates these estimates evenly between all the countries in that region according to their GDP. It is possible that citizens of one country in the region are more prone to hide their wealth offshore than another, but this is not reflected using this methodology. Third, the offshore wealth pinned to a country can be distributed to citizens using different formulas. These can alter the DINA figures quite significantly.[83]

An additional shortcoming is that because WID.world is such a recent project, the available data is still in flux and has not reached its full potential. Initially the focus was in tracking top income shares, and the fruits of this work is visible in the datasets covering more than 30 countries. However, as

[77] Zucman, 2013, p. 1343; Zucman, 2015, p. 35.
[78] Zucman, 2015, p. 39.
[79] Blanchet & Chancel, 2016, pp. 9-11.
[80] Atkinson, 2015, pp. 48-50.
[81] Saez & Zucman, 2016, p. 524.
[82] Zucman, 2015, pp. 44-5. The civil society organisation Tax Justice Network had earlier estimated that the figure could be as high as $21-32 trillion, see Henry, 2012. Also Boston Consulting Group have higher estimates, over $10 trillion in 2016. See Beardsley, et al., 2017.
[83] Saez & Zucman, 2016, p. 539.

only incomes of the top decile were measured, this did not result in data about the distribution of the income (and wealth) between the rest of the population. At the moment, extensive datasets covering the whole range of income groups are only available from the US and France, although data from the UK and China should be added to the database soon.[84] This does not pose a paramount problem for my purposes because I will not make comparisons of inequality levels between a big number of countries.

To sum up, there are various ways to measure inequality but I have chosen the data from the WID.world because it suits my purposes best. In addition to establishing the trend in changes in income and wealth inequality, the data allows to track historical changes in the sources of income as well as the changes in the asset composition of different wealth segments. It is also possible to assess the impact of a country's redistributive policies to its inequality levels. In the next section I will illustrate how these variables have evolved during the past half century in the US and France.

3.4 Measuring Inequality in Selected Countries

In this section I will present the WID.world findings on the development of distributional national accounts in the US and France. I have selected these two countries because of the readily available and consistent data – they are the first two countries on the WID.world with comprehensive DINA datasets. For these two countries, it is possible to track the changes in wealth and income for each percentile of the population separately – and in even greater detail at the top of the distribution. I will begin by looking at wealth and income inequality in each country individually and then proceed to make a short comparison between them. The last part focuses on wealth composition and sources of income.

3.4.1 Wealth Inequality in the US

The first graph depicts the wealth shares in the US in 1962-2014. While the definitions of the bottom 50% and the top 10% are self-explanatory, it is worth noting that the middle 40% in the following graphs refer to the individuals between the bottom 50% and the top 10%, aka percentiles 50-90. In other words, it does not refer to the 'real' middle percentiles 30-70. The share of the top 10% is further divided to the top 1% and the next 9%. While the former does not require further explanations, the next 9% here means the percentiles 90-99; it depicts the share of the top 10% without the share of the top 1%. The data on bottom 50% and middle 40% shares in the US are available starting from 1962, so I will use it as a starting point for the historical review of inequality shares in the US here and France in the following section.

[84] WID.world, 2017.

Figure 4 Wealth Shares in the US 1962-2014[85]

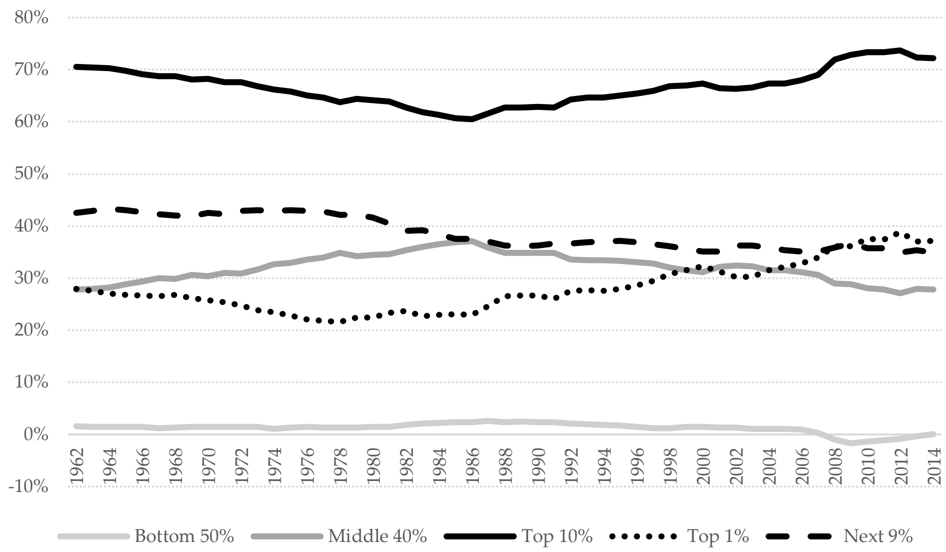


Figure 4 shows that fluctuations in the wealth shares have been relatively mild over the period starting from the 1960s. Bottom 50% of the population has very low levels of net wealth, and the indebtedness of this part of the population is highlighted around 2010 when the net wealth of the bottom 50% was *negative* for several consecutive years. The top 10% holds more wealth than the middle 40% throughout the time period but the graphs make a clear (inverted) U-shape: Wealth inequality levels decreased until the mid-1980s, after which they started on an upward slope again reaching a peak in early 2010s. The changes in the wealth shares of the top 10% and the middle 40% roughly mirror each other, and they are relatively gradual.

Although the top 10% share of the wealth in 2014 is only slightly bigger than what it was in 1962, the wealth within that group has changed hands. The wealth share of the richest 1% has risen from its lowest point 21.6% in 1978 to 37.2% in 2014 which is the latest year data is available. This 15.6 percentage point rise was mainly financed by the decrease in wealth of the next 9% by 7 and the middle 40% 7.2 percentage points respectively.[86] Although the wealth share of the top 10% has been on an upward slope since mid-1980s, the wealth share of the next 9% has been slowly *declining* since the 1970s. It looks like the wealth of the top 1% is on its own trajectory compared to others, and wealth is getting increasingly concentrated.

To get an idea of the dollar-level wealth, see the table below consisting of figures from 2012. Note that the figures in the table relate to households whereas the graphs depict personal wealth.

[85] Based on data in the Table TE1 in the Online Appendix of Piketty, Saez, & Zucman, 2016.
[86] Exact figures are available in Table TE1 in the Online Appendix for Piketty, Saez, & Zucman, 2016.

Table 1 Wealth Thresholds in the US in 2012[87]

	Households	Threshold	Average
Bottom 90%	144,600,000	-	$84,000
Top 10%	16,070,000	$662,000	$2,560,000
Top 10%–1%	14,463,000	$662,000	$1,310,000
Top 1%	1,607,000	$3,964,000	$13,840,000

Wealth is accumulated by income, and the next section looks at its development during the same time period.

3.4.2 Income Inequality in the US

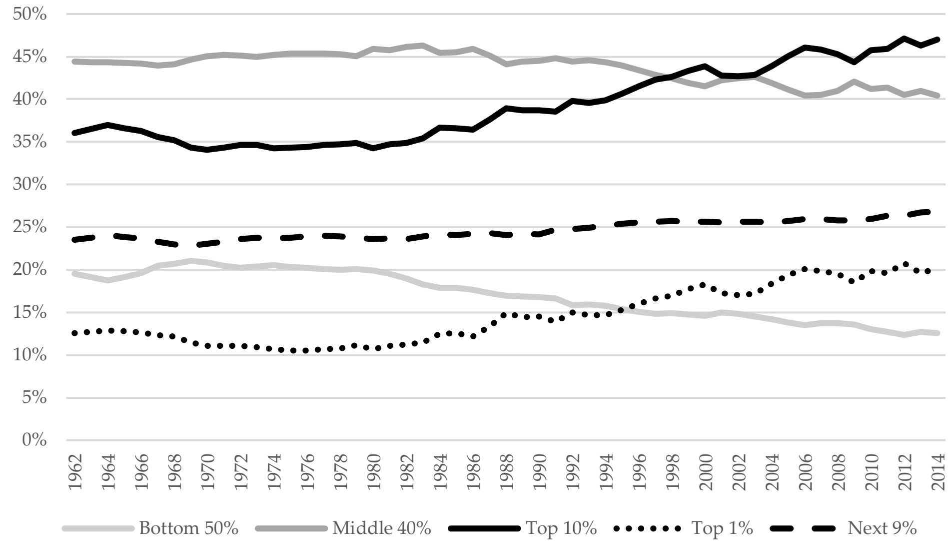
Before going into the graphs depicting income shares, it is useful to establish what we will be looking at. WID.world uses three different income concepts: Pre-tax factor income, pre-tax national income and post-tax national income. The difference between pre-tax factor income and pre-tax national income is that the former includes pensions on a contribution basis and the latter on a distributive basis. As the name suggests, post-tax national income is the income after taxes are paid and transfer payments are made.[88] The following figures are based on pre-tax national income, so it covers income of all adults (older than 20), including pension income. As the data is based on fiscal data and it is possible for married couples to file their tax returns together, their income is lumped together in the underlying data. In the following figures the income of couples is split equally among partners.[89]

[87] Table B2 in the Online Appendix for Saez & Zucman, 2016, available at http://eml.berkeley.edu/~saez and http://gabriel-zucman.eu/uswealth. This data is about households but figures for individuals do not differ significantly. The Online Appendix of Piketty, Saez, & Zucman, 2016 lists the average individual wealth levels, in other words they split the wealth of married couples equally. The resulting averages are calculated for bottom 90% ($91,632), top 10% ($2,639,075) and top 1% ($14,085,158) but these are 2014 dollars versus 2010 dollars used in Saez & Zucman. When you make the conversion, the averages are $84,883, $2,444,694 and $13,104,563.

[88] Piketty, Saez, & Zucman , 2016, p. 9.

[89] There are some changes to the results if incomes are not split equally but they are insignificant. You can see the differences between the results using different income concepts at wid.world.

Figure 5 Income Shares in the US 1962-2014[90]



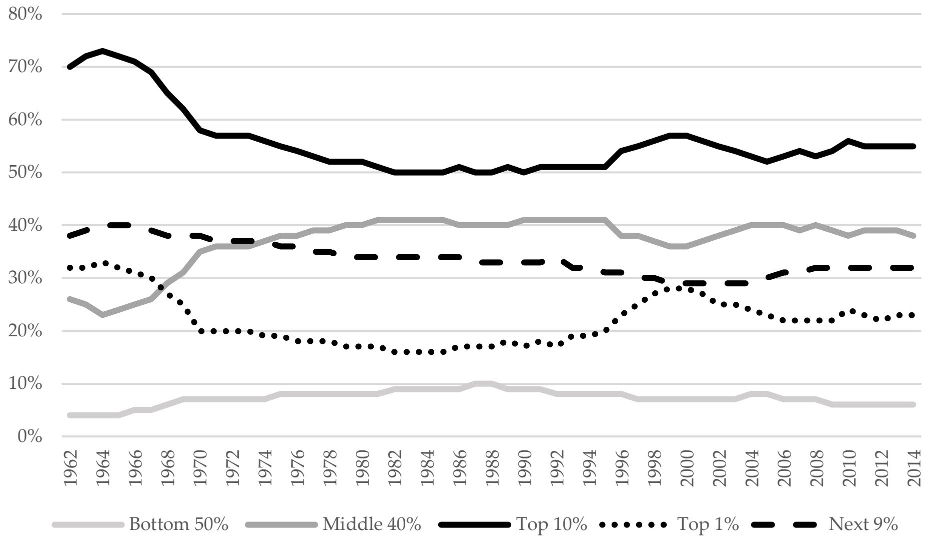
The changes in income shares have has led fluctuation over the years than in wealth: The shares of the income of the bottom 50% and the middle 40% have been steadily declining while the share of the income of the top 10% has been steadily rising since early 1980s. The share of the next 9% has not declined as was the case with wealth but has been gradually increasing throughout the period. The income share of the top 1% is rising more rapidly and catching up with the next 9% – the rise of the incomes of the top 10% is mainly due to the rise of incomes at the top 1%.

3.4.3 Wealth Inequality in France

Next we shall see how the wealth shares have developed in France. As stated above, the unfortunate fact is that similar comprehensive data on other European countries is not yet available. However, Garbinti et al. conclude that the trends depicted in the French data are roughly like trends in other European countries apparent in other datasets. [91]

[90] Based on Table TB1 in the Online Appendix for Piketty, Saez, & Zucman, 2016.
[91] Garbinti, Goubille-Lebret, & Piketty, 2016, p. 42.

Figure 6 Wealth Shares in France 1962-2014[92]



We can see from Figure 6 that, just like in the US, the changes in wealth shares are mainly coming from wealth transfers between the top 10% and the middle 40%. Even though the bottom 50% hold considerably more wealth than their counterpart in the US, their share does not exceed 10% of total wealth at any point during the measured period. At the beginning of the period both top 1% and the next 9% had bigger shares of wealth than the middle 40%. This changed during the 1960s and 1970s and has remained so until early 2010s. The wealth of the top 1% was rebounding from the low levels of 1970s and 1980s right until the turn of the millennium, when it sharply decreased again.

For an idea about what these wealth shares look in euro denominations, see the table below:

Table 2 Wealth Thresholds in France in 2012[93]

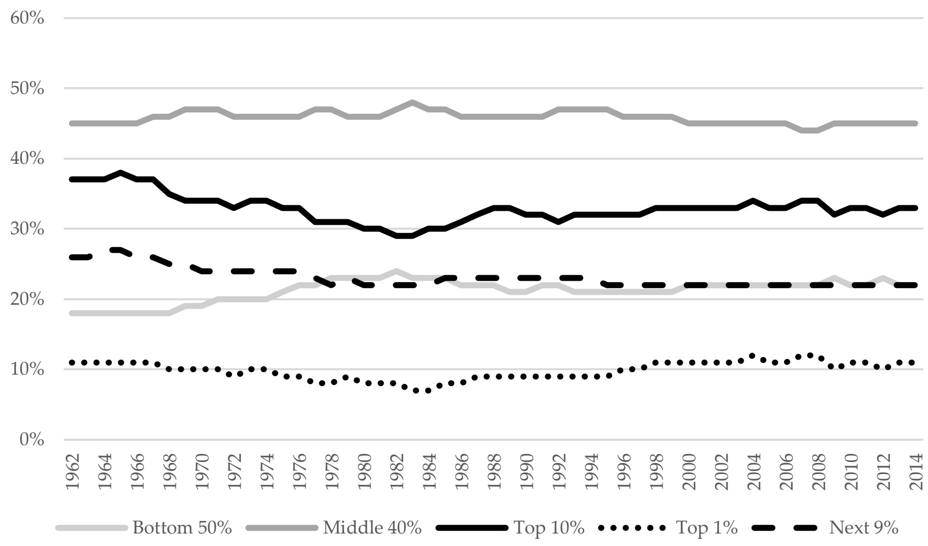
	Adults	Threshold	Average
Bottom 50%	25,431,041	-	20,643€
Middle 40%	20,344,833	89,404€	187,653€
Top 10%	5,086,000	392,200€	1,115,323€
Top 10%–1%	4,577,400	392,200€	736,036€
Top 1%	508,600	1,895,825€	4,528,902€

[92] Based on the Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2016.
[93] Table constructed based on the data in Table 1 in Garbinti, Goubille-Lebret, & Piketty, 2016.

3.4.4 Income Inequality in France

Figure 7 depicts the income shares of the top 10%, the middle 40% and the bottom 50% in France 1962-2014. The share of the top 10% has been divided to the top 1% and the next 9% like was done in the previous graphs.

Figure 7 Income Shares in France 1962-2014[94]



It is noteworthy that the middle 40% have the biggest share of the income, not the top 10%. The income shares have remained relatively static over time, at least when compared to the changes in the US figures. The share of the top 10% reached its lowest level of 29% in 1982 and has since gradually increased to 33% in 2014.

3.4.5 Comparison

We can now compare the figures from the US and France. At first glance, it looks like the US has become markedly more unequal society than France. Especially the developments at the very top of the distribution look different between these two countries. For easier and more detailed comparison, I have collected the key wealth figures in Table 3 below. I have chosen the year 1979 as the reference point for two reasons: First, according to the figures above, the period around 1980 seems to have been most equal in both countries during these 52 years in focus. Second, micro files of income returns in France are not available for all years prior to 1988 but they do exist for 1979.[95] To use the most accurate and comparable methods I therefore chose 1979 as the benchmark year. The reason to use 2012 instead of 2014 is the same: At the time of the research of Garbinti et al., 2012 was the most

[94] Based on the Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2017.

[95] Garbinti, Goubille-Lebret, & Piketty, 2016, p. 19.

recent year when micro files were available (they used income tax tabulations for producing the estimates for 2013 and 2014).[96]

Table 3 Comparison of Wealth Share Changes in the US and France

Share % of Total Wealth	USA			France		
	1979	**2012**	Change	**1979**	**2012**	Change
Top 10%	64.4	73.7	9.3	52.0	54.5	2.5
- Top 1%	22.4	38.9	16.5	17.4	22.4	5.0
- Next 9%	41.2	34.9	–6.3	34.7	32.1	–2.6
Middle 40%	33.8	26.8	–7.0	40.8	39.1	–1.7
Bottom 50%	1.3	–0.8	–2.1	7.2	6.4	–0.8

We can see in Table 3 that wealth shares in both countries have moved to the same direction: The increase in the top wealth shares are due to changes in the top 1% whereas the wealth of the next 9% has fallen. The US had more wealth concentration in the benchmark year 1979, and it has kept concentrating on a faster pace than in France. While the top 1% has more wealth in the US than the bottom 50% and the middle 40% combined, the top 1% in France possess less than half of the wealth owned by the bottom 90%.

For comparing income inequality, the growth rates of average income and the income of different groups is especially interesting. The following table shows the growth rate of pre-tax income in the US divided to two 34-year periods, 1946-1980 and 1980-2014.

[96] Garbinti, Goubille-Lebret, & Piketty, 2016, p. 19.

Table 4 Growth Rate of Pre-tax Income in the US, 1946-1980 and 1980-2014[97]

Income group	1946-1980 Average annual growth	1946-1980 Total cumulated growth	1980-2014 Average annual growth	1980-2014 Total cumulated growth
Full Population	2.0%	95%	1.4%	61%
Bottom 50%	2.1%	102%	0.0%	1%
Middle 40%	2.1%	105%	1.0%	42%
Top 10%	1.7%	79%	2.4%	121%
Top 1%	1.1%	47%	3.3%	205%
incl. Top 0.1%	1.3%	54%	4.3%	321%
incl. Top 0.01%	1.7%	75%	5.2%	454%

Table 4 shows that the US national income had a robust increase during both time periods: The decades during the "Golden Age" of capitalism after WWII translated to near doubling of national income by 1980. After 1980 the growth slowed down but still remained at solid 61%. By looking at aggregate income growth, it looks like the past third of a century was very good for Americans even if the incomes are not growing at the same spectacular pace as they did during the "Golden Age". When we look how the increased income was divided between population groups, the picture changes. Prior to 1980 the incomes of the bottom 90% roughly doubled while the incomes of the top 10% increased by 79%, and of the top 1% by 47%. This is an image of shared growth, and in stark contrast to the figures after 1980. The incomes of the bottom 90% have totally stagnated during the 34 years since 1980. The incomes at the middle have increased by 42%, which is way below the aggregate increase in income of 61%. 42% might seem like an adequate growth in income but when it is evenly spread over the whole time period, it translates to annual growth rate of around 1,0%. The top incomes are on their own trajectory, with ever bigger increases the higher you go – the incomes of the top 10% more than doubled and incomes of the top 1% tripled. The bulk of the growth of American incomes have gone to the top 10% income earners since 1980.

By way of comparison, Table 5 depicts the pre-tax income growth rates in France during roughly the same time periods. The income grew more rapidly in France during the post-war period than in the US (194% vs 95%) but fell approximately to half of that of the US in the time period starting from early 1980s (35% vs 61%). There are similarities in the division of income growth in both countries: Prior to 1980s the incomes of the bottom

[97] Piketty, Saez, & Zucman, 2016, Table 2. Notes: The table displays the cumulative real growth rates of pre-tax and post-tax national income per adult over two 34 years period: 1980 to 2014 and 1946 to 1980. The unit is the adult individual (aged 20 or above). Fractiles are defined relative to the total number of adults in the population. Income is split equally among spouses.

90% grew faster than those of the top 10%. This was reversed in the 1980s and the incomes have been growing fastest at the very top. There are big differences on the growth levels, though. While the incomes at the bottom in the US have been stagnant since 1980s, those in France have grown by 31%, or 0.9% annually. On the other hand, the top 1% incomes in the US grew by 205% in the past decades while the growth stood at 99% in France.

Table 5 Growth Rate of Pre-tax Income in the US, 1946-1980 and 1980-2014[98]

	1950-1983		1983-2014	
Income group	**Average annual growth**	**Total cumulated growth**	**Average annual growth**	**Total cumulated growth**
Full Population	3.3%	194%	1.0%	35%
Bottom 50%	3.5%	215%	0.9%	31%
Middle 40%	3.5%	211%	0.8%	27%
Top 10%	2.9%	158%	1.3%	50%
incl. Top 1%	*2.3%*	*109%*	*2.2%*	*99%*
incl. Top 0.1%	*1.7%*	*75%*	*2.8%*	*134%*
incl. Top 0.01%	*1.8%*	*81%*	*3.0%*	*147%*

3.5 Asset Composition and Sources of Income

After examining income and wealth inequality in the US and France, we shall now briefly look at what are the assets behind these varying degrees of wealth and income. As we can see in the graphs below, wealth is not just money in the bank account but a diverse portfolio consisting of different assets. Understanding which asset classes make up the dominant part of wealth is relevant when assessing whether trusts are a useful way to manage that wealth.

Although the database at WID.world does not allow to play with the decomposition of wealth in all countries at any given time, detailed data for the US and France exist. Again, we cannot assume that all European countries have the same wealth composition as France but at least we can distinguish the differences between the US and French wealth compositions, and how the compositions have evolved on both sides of the Atlantic.

Before examining the graphs in greater detail, a few words of the concepts and different asset classes used in the graphs. Here personal wealth is divided to two components: Financial and non-financial assets. Financial assets include bonds, equities, life insurance and deposits (currency and saving accounts). Non-financial assets are divided to housing and business assets, the latter being mostly the assets held by self-employed individuals

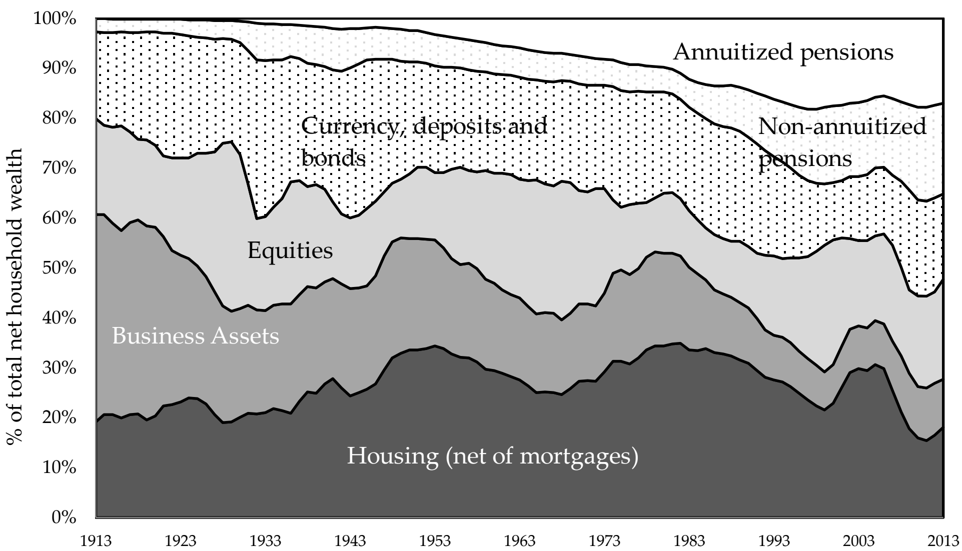
[98] Table based on Table 2a in Garbinti, Goubille-Lebret, & Piketty, 2017.

that are used for conducting business.[99] Pensions are a special category, as they are "conduit assets": They can be invested in financial and non-financial assets. In practice, a vast majority of pension wealth is invested in financial assets: In 2013 89% of the US pension wealth was invested in bonds and equities while the rest were mainly invested in currency, deposits and money market funds, with some investments in mortgages and other real assets.[100] While pensions are portioned to their own asset class in the US figures, they are not given a similar treatment in the French case. Note that consumer durables such as cars are not part of wealth examined here.

3.5.1 Asset Composition in the US

Figure 8 shows the composition of the aggregate US household wealth.

Figure 8 Composition of US household wealth[101]

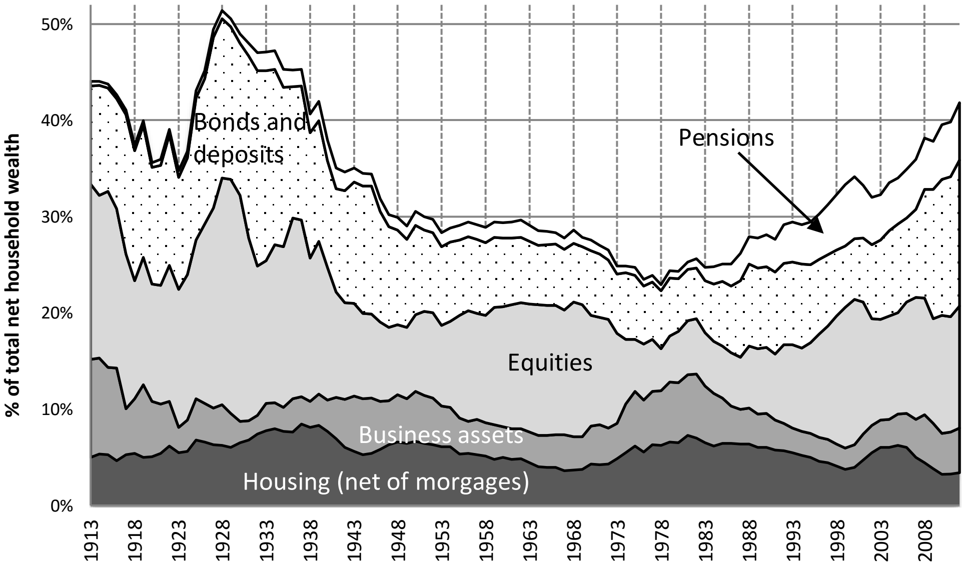


For the most part of the 20th century housing and business assets were the dominant sources of wealth in the US.[102] The share of pensions has been growing steadily throughout the century, picking up in pace since the 1980s. While they presented 14.7% of total wealth in 1980, their share has more than doubled to 35.2% in 2013. Remember that pensions are invested almost entirely in financial assets. In other words, the total share of financial assets has grown from less than 50% in the early 1980s to more than 70% in 2013.[103]

[99] Saez & Zucman, 2016, pp. 525-7; Garbinti, Goubille-Lebret, & Piketty, 2016, p. 17-8.
[100] Table A4 (Pension Wealth by Asset Class) in the online appendix of Saez & Zucman, 2016.
[101] The graph is based on Figure A2 in the online appendix of Saez & Zucman, 2016.
[102] Business Assets include sole proprietorships, partnerships, intellectual property products, and farm land and equipment.
[103] In 2013 equities accounted for 19.9%, and currency, deposits and bonds 17.1% of total wealth. Total pensions accounted for 35.2%. As 89% of pensions were equities and bonds with

While Figure 8 reflects the changes in the aggregate wealth in the US, Figure 9 zooms into the wealth held by the top 1%.

Figure 9 Composition of the Top 1% Wealth Share in the US[104]



Even if pensions have grown in importance for the top 1%, we can see the vast majority of its wealth comes from direct ownership of bonds and equities. This has been historically the case for the last century, except for a brief period around the turn of the 1980s. The following table further illustrates how certain asset classes are more concentrated on the hands of the wealthiest 1% than others.[105]

Table 6 Top 1% Share of Asset Class Wealth in the US

	% of total asset class wealth
Pensions	16.5
Bonds & Deposits	**62.0**
Equities	**69.3**
Business Assets	44.3
Housing	20.8

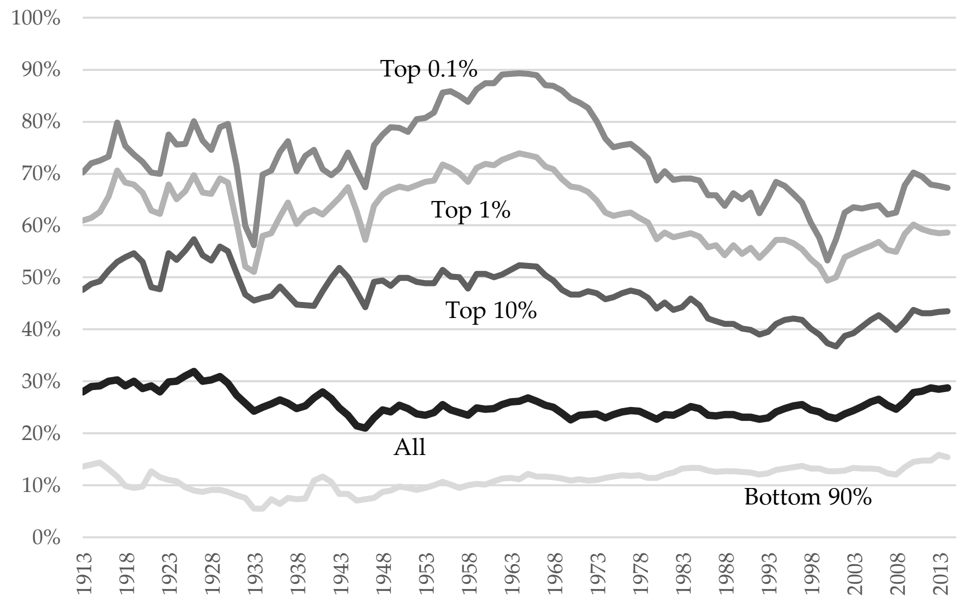
the remainder including some non-financial assets. Even with a conservative estimate (half of the remaining 11% invested in real assets) the share of the financial assets exceeds 70% (19.9+17.1+.945*35.2=70.3%).

[104] Based on Figure B5 in the online appendix of Saez & Zucman, 2016. Note that this figure represents household wealth and not individual wealth. This explains the small variations in the total wealth share of the top 1% in this figure and Figure 4.

[105] Data from Tables B7-B11 in the Online Appendix of Saez & Zucman, 2016.

These differences in wealth composition are reflected in the differences in income sources. In the following graph, total income is divided to labour and capital income, and the series depict the share of capital income out of the total income in each of the income groups.

Figure 10 Share of Capital in Pre-tax Income in the US[106]



It is easy to see that the importance of capital income varies markedly for different income groups. On aggregate level in 2013, capital income formed 29% of total income while labour income accounted for the rest 71%. This share falls to half (15.4%) for the bottom 90% of income earners. The top 1%, on the other hand, relies on capital markets for more than half of their income (58.6%). When compared to the total aggregate labour income, the share of the top 1% has remained relatively small over the past decades: Since 1962 it has never exceeded 9.5%.[107]

3.5.2 Asset Composition in France

The next section focuses on composition of wealth and income sources in France. We shall begin with the development of aggregate asset composition in France between 1970-2014. Note that the period in question is markedly shorter than the one we had with the US, and that the division is different. The underlying data on France provides asset composition information only starting from 1970. Just like with the case of the US,

[106] Based on Figure 8 in Piketty, Saez, & Zucman, 2016.
[107] Table B28 in the Online Appendix of Saez & Zucman, 2016.

personal wealth is divided to financial and non-financial assets. While financial assets were divided to equities, bonds and deposits, and pensions in the case of the US, here they are divided to deposits and the rest. Non-financial assets are divided to housing and business assets, the latter being mostly the assets held by self-employed individuals that are used for conducting business.[108]

Figure 11 Composition of Aggregate Personal Wealth in France 1970-2014[109]

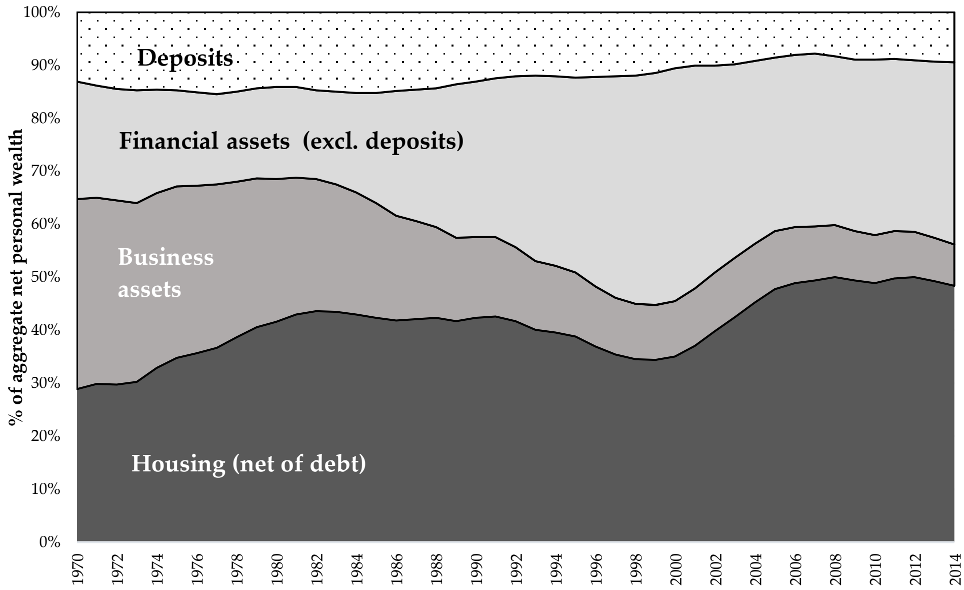


Figure 11 shows that non-financial assets have provided for the bulk of total aggregate wealth in France throughout the whole time period, with a dip in the late 1990s. The difference in the share of housing between France and the US is significant: In 2013 housing accounted for 49% of aggregate personal wealth in France, while the figure stood at 18% in the US.[110] The importance of financial assets has been growing, especially prior to 2000 but it has returned from its highest level of 55% in 1999 and 2000 to 43% in 2014. The next graph zooms into the wealth composition of the top 1%.[111]

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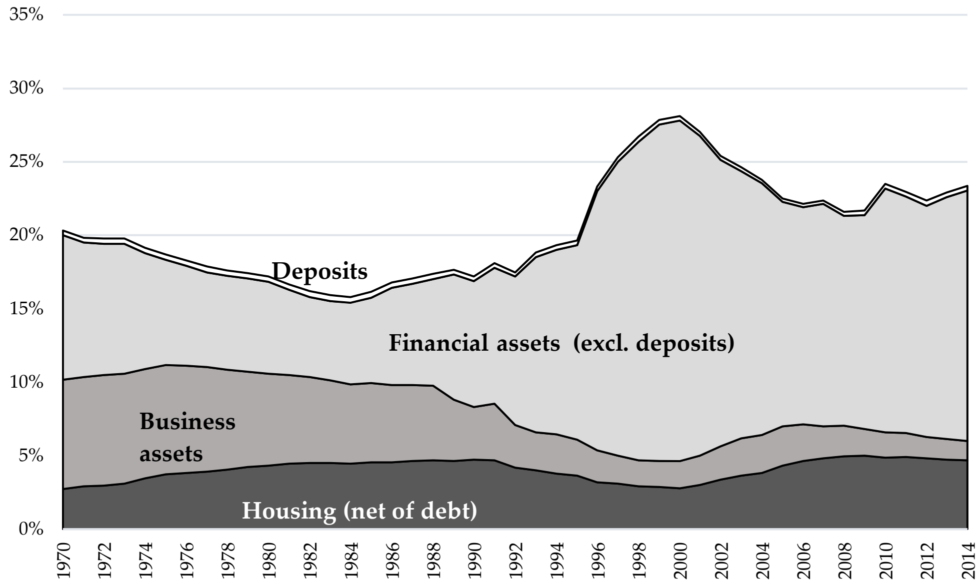
[108] Garbinti, Goubille-Lebret, & Piketty, 2016, p. 17-8.

[109] The figure is based on Figure 7 in Garbinti, Goubille-Lebret, & Piketty, 2016.

[110] One could argue that the share of the US housing market is still depressed due to the recent mortgage crisis. However, the share of housing in the US wealth was far from that in France even in the middle of the housing bubble leading up to the crisis. At its highest point, the share of the housing in the total household wealth prior was 30.6% in 2005.

[111] Based on Figure 17 in Garbinti, Goubille-Lebret, & Piketty, 2016.

Figure 12 Composition of Top 1% Wealth Share in France

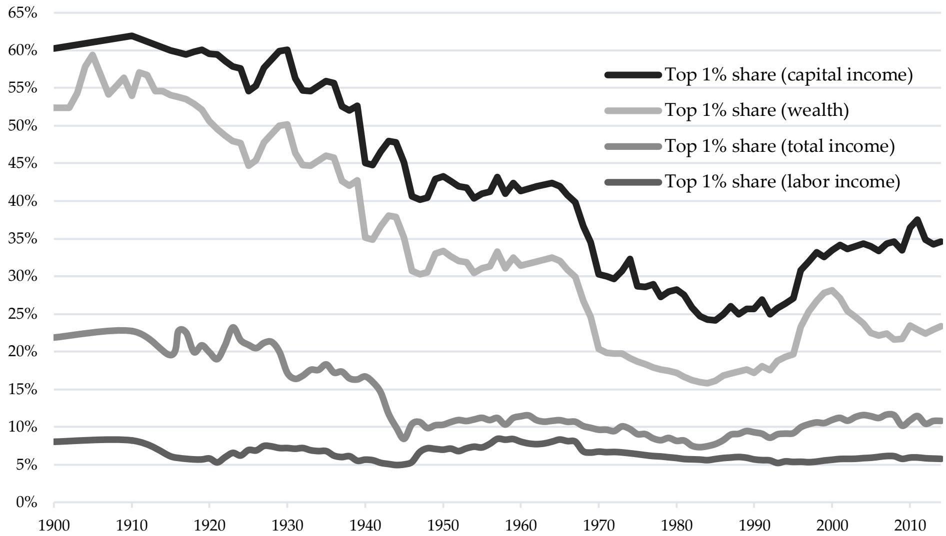


The percentage scale on the left side indicates the share of French aggregate personal wealth. If we compare this to Figure 6 we see that the hike in the wealth share of the top 1% right before 2000 was due to increases in financial asset values. At that point, financial assets made 82% of the wealth of the top 1%, while it has lowered to 74% in 2014. Even though the top 1% does not own as big of a portion of financial assets now than at the turn of the millennium, they still hold 50% of all aggregate financial assets in France.[112] In euro denomination, the average wealth in the top 1% was 4,5 million in 2014.

Figure 13 shows the top 1%'s share in different categories. The general rule of thumb is that wealth is more concentrated than income, and Figure 13 proves this fact. However, when income is divided to capital and labour income, we can see that the share of capital income is even more concentrated than wealth. On the other hand, the share of labour income is only 6%, meaning that 94% of all labour income is divided between the bottom 99%.

[112] The Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2017.

Figure 13 Top 1% Share: Income vs Wealth in France[113]



3.6 *What Have We Learned?*

After a bewildering number of graphs and tables we need to tie the lessons from the WID.world database together. We have established that both income and wealth inequality are on the rise in the US and France. Based on the historical data it looks like economic inequality reached it lowest levels during late 1970s and early 1980s in both countries but has been rebounding ever since. While this resurrection has been very strong in the case of the US, the inequality levels in France have been growing at a slower pace. Moreover, the concentration of income shares suggests that there are no signs of shrinking inequality levels, especially not in the US. One of the most striking findings were presented in Figure 5, which shows that in the US the top 10% receive nearly half of the total annual income, while the bottom 50% have to settle for 10%. The French data indicate more static levels of wealth and income inequality but the trend is gradually rising.

The wealth composition data showed that the share of financial assets in the American household wealth has reached a point that is unprecedented during the last century. In France, the share of financial assets has increased only slightly during the four decades from which we have data.[114] Unfortunately the French data does not go beyond 1970, making it impossible to compare the shares in the beginning of the century. As financial assets are more concentrated than non-financial assets, the growth in their share in the aggregate personal wealth is one of the main drivers of

[113] Based on Figure 9b in Garbinti, Goubille-Lebret, & Piketty, 2017. Note: Distribution of total income, labor income, capital income and net wealth among adults. Equal-split-adults series (income and wealth of married couples divided by two).

[114] From 35% in 1970 to 43% in 2014. See Figure 11.

economic inequality. Another important factor to consider is that current levels of income inequality are not a result of growing disparities in salaries: In France, the top 1% are earning 6% of the total labour income, while the figure is at 9% in the US.

The key takeaways for the analysis in the rest of the paper are:

1) Economic inequality has been on the rise since the early 1980s, when it was at the record lowest level in both countries
2) The share of financial assets in the total wealth has increased significantly since the early 1980s, from around 50% to 70% in the US and from around 30% to 40% in France
3) Distribution of financial assets is more concentrated than that of non-financial assets: The wealthiest 1% in the US owns 62% of all bonds and deposits and 69.3% of equities, in France, the wealthiest 1% own 50% of all financial assets (excluding deposits)
4) Income inequality is driven by differences in capital income shares, not labour income shares

4 Reasons for Inequality

The previous chapter showed us that economic inequality has been on the rise in the US and France since the early 1980s. There are numerous factors causing this development and it is impossible to list all of them within one paper. As mentioned in the introduction, globalisation has become a sort of a 'usual suspect' for growing income and wealth disparities of the past decades. Not many terms exist that have the same level of vagueness as 'globalisation', though. Here I will dissect it to more palatable pieces, to better assess various interlinked phenomena that are grouped together under the umbrella term of globalisation. These include advances in international trade, progress in (information) technology, globally mobile capital, and the institutional changes these changes have brought about, including taxation policies. Each of the issues are considered on a broader level, as they would require books of their own to properly assess the impacts they have had on our economies and societies. For deeper analysis of globalisation, I would invite the reader to refer to a collection of essays compiled by Weinstein.[115]

4.1 International Trade

The extent of modern day international trade is sometimes considered as the main proof of an unprecedented level of interconnectedness in the world. This statement misses its mark, though, as international trade was flourishing already at the end of the 19th century, especially after railroads and shipping technology enabled logistics and the telegraph cables made speedier communication overseas possible.[116] The world wars interrupted international trade, and it recovered slowly for the first couple of decades after. International trade grew in step with world production until 1980s but the former has since far outpaced the latter.[117] Today it is difficult to imagine a world without cross border trade and the links it has created, but what kind of impact it has on inequality?

Until the beginning of the 19th century, economists had promoted mercantilist policies and were wary of the effects of international trade. This changed with David Ricardo and the theory of comparative advantage, which was published in his book *On the Principles of Political Economy and Taxation* in 1817.[118] Ricardo was one of the most important thinkers of classic economic theory, and the Ricardian model underlining the aggregate

[115] Weinstein, 2005.
[116] Obstfeld, 1998, p. 11.
[117] Irwin, 2005, p. 20.
[118] Ricardo, 1817. Note that Ricardo himself admitted the theory is based on the assumption of immobile capital and in case it would become mobile, the theory would not hold. He did not think this was a serious concern because "men of property" would not want to move to a strange new land. See Ibid, Chapter 7, paragraph 19.

benefits all trading partners are receiving from opening up for international trade was one of its key corner stones. However, as it dealt with the benefits only on the aggregate level, it failed to take note of the changes in the domestic price levels and negotiation power of different factors of production, namely labour and capital. This phenomenon is further explained with the Heckscher-Ohlin (HO) model: When economies open up for trade, different production factors are affected in different ways.[119] According to this model either the owners of labour or capital benefit from opening up to international trade depending on whether the production factor they own is in abundance or not. Albeit an improvement to the basic Ricardian model, the HO model too suffered from not taking the multiplicity of actors into consideration: The economy is not neatly split into two fractions but to numerous different sectors where production factors are used in varying ratios. The Ricardo-Viner (or specific-factors) model gives the theoretical basis for understanding the variance in international trade's impact to different production sectors. As in the HO model, international trade will benefit the owners of the production factors that are in abundance in the economy compared to their new trading partners, and vice versa. Because different sectors require different production factors, it is inevitable that some sectors fare better than others when the economy opens up for trade. The export oriented sectors will reap the benefits while the import-competing sectors are losing out. Depending on the mobility of the specific production factor, its owner can either move to the export oriented sector and enjoy the rise in relative income or remain in the import-competing sectors and face the new, inferior relative income.[120] To sum up two hundred years of international trade theory, increased cross border trade improves aggregate wellbeing but produces both winners and losers on an individual and sectoral level.

The changes in international trade patterns during the last decades have meant that many workers have had to relocate to new sectors or face unemployment. This does not necessarily mean that increase in economic inequality would ensue. Obstfeld argues that at least until the end of the 20th century, there is no clear sign that the increased international trade would have had a significant impact on the US or European labour market.[121] Both markets have lost manufacturing jobs and as these are usually highly concentrated, they have an unproportioned impact on a local level; losing a single factory can create an economic malaise in a small town. The election results in the UK and the US in 2016 demonstrate that national campaigns can be won by basing them on the sentiment caused by the loss of factories and jobs. Although on aggregate terms both countries have been enjoying relatively healthy economic growth after the great recession, there have been

[119] Ohlin, 1933.
[120] Krugman, Obstfeld, & Melitz, 2012, pp. 83-97.
[121] Obstfeld, 1998, p. 21.

areas that have been particularly hurt and where the electorate showed their discontent by voting against the status quo.

4.2 Technology

Just like the railways and the telegraph ushered forwards unprecedented level of international trade in late 19th century, the advancements in information, telecommunications and transportation technologies have forged the shape of modern globalisation. The possibility to instantaneously communicate with people and organisations anywhere in the world has changed our conception of place and time: The globe is more interconnected than ever. Of course, this has meant profound changes to our economies and trade patterns. Production processes look very different from those used 50 years ago as they are fragmented through vertical specialization and outsourcing, and the possibilities for international trade in services have ballooned.

On a theoretical level, the inequality effect of technology comes from its impact on productivity. Firstly, technological progress makes workers more productive: Less hours of work is needed for producing one unit of work. To achieve the same output less work hours are needed, thus the demand for labour decreases over time if the aggregate production output remains stable. In some cases, the worker could be replaced altogether, as their output can be automated. Depending on how the productivity change is managed, it could either lead to less working hours for all workers or increasing unemployment. Secondly, it is debatable whether technological change produces similar results for all market participants. The skill-biased technical change (SBTC) hypothesis argues that technological advancement increases the productivity of skilled labour more than that of unskilled labour, resulting in increase in the pay gap between the two as well as higher returns for education.[122] However, the SBTC hypothesis has faced a fair share of criticism as the trends in pay inequality do not seem to coincide with its assumptions. Consequently, a modified argument called the polarization thesis was floated by Autor et al.[123] According to it computerisation has indeed increased the productivity of high skill workers but has not had a significant effect on the low skill workers in blue-collar industries and services. Instead, it has severely undercut demand for 'routine cognitive workers' that were traditionally situated somewhere between the high skill and low skill workers in pay scales. The impact of technology is hard to quantify and although the pay trends in the US with stagnation in pay in the middle of the distribution would suggest the polarization thesis holds true, it is difficult to prove that this has happened mostly because of computerisation.

[122] Neckerman & Torche, 2007, p. 338; Atkinson, 2015, p. 85.
[123] Autor, Katz, & Kearney, 2006.

The impact of technological advancement on inequality is difficult to quantify. On one hand, huge leaps in technology have brought new products and services to the masses on a tremendous scale, and most of them are accessible to people on all parts of the inequality spectrum. Moreover, the new industries have meant the creation of various entirely new jobs. On the other hand, new technologies have made a lot of old jobs redundant at a faster pace than they have created new ones. This process is not showing any signs of slowing down. On the contrary, the future wide scale introduction of automation and artificial intelligence technologies to manufacturing and services could lead to drastic changes in the structure of labour markets. Future technologies could have surprising impacts on pay inequality: Whereas until now computerisation has meant automation of routine tasks, we are not far from algorithms replacing some of the work done by professionals at the higher end of the pay spectrum, such as lawyers and doctors.

4.3 Institutional Change

If the role of technology is difficult to quantify, the impact of institutional changes could be even harder to translate to numbers. I use the concept of institutional change here to refer to broader adjustments caused by the combination of technology and international trade: The shift from manufacturing to services, realignments in the production chains, changes in corporate governance (shareholder value regime), privatisation and deregulation of many industries, and the weaning power of trade unions. Not all these changes have been inevitable, and in some cases it seems like they have been guided more by ideology than empirical evidence. The role of trade unions is a good example of this. Cheaper transportation, innovation in production processes, increased internal trade within multinationals and the influx of new labour force into the global economy after the fall of Soviet Union and the rise of China inevitably led to a new situation for labour. With fragmented production, the workers in one locale could be replaced with those in another, which has pitted workers against each other on the international level. As if the impact of these processes on labour's negotiation leverage would not be enough, many governments introduced policies that reduced trade unions' institutional power even further. Without the old leverage and fewer members, the trade unions have not been able to be as assertive in wage negotiations as before. However, there is little direct evidence showing that decreasing trade union power would leave to growing wage disparities.[124] Institutional changes are always embedded in their social context, making it difficult to make sweeping statements of their impact on other factors. Privatisation is a good example: By definition something jointly owned is transferred to private hands, and the wealth

[124] Neckerman & Torche, 2007, p. 338.

inequality consequence should be self-evident. Fall of communist regimes and the rise of oligarchs is the emblematic example of this development. Then again, did the people in communist regimes really enjoy the ownership of these assets in an equal manner, or was it only the party elite that reaped the benefits? If so, the new situation did not really change the level of inequality but only made it easier to detect. The multi-faceted nature of institutional changes makes them a good topic of continued inequality research.[125]

4.4 Capital Mobility

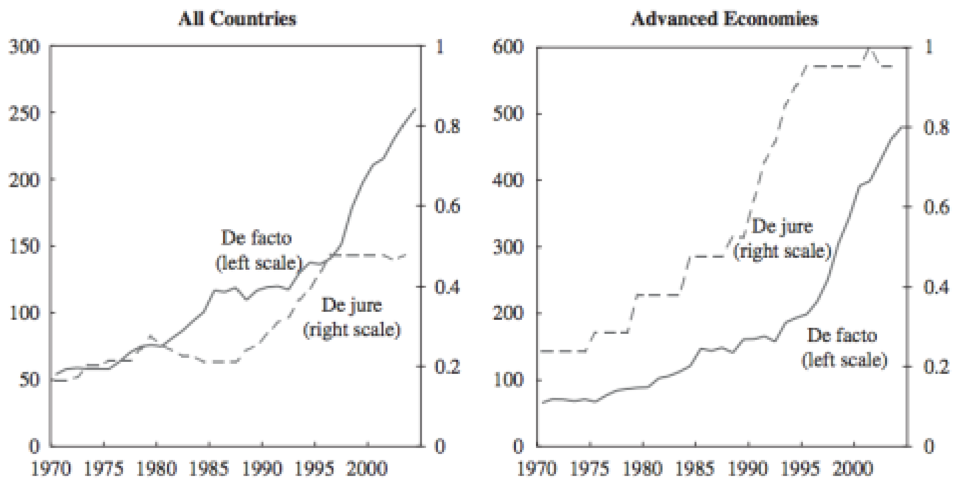
Capital mobility and global financial markets are another key aspect of modern globalisation. The current level of interconnectedness would not be possible without high levels of international trade, modern technology, international cooperation and policy changes. Just like international trade in general, global financial markets were flourishing before the first world war. It was greatly facilitated by the gold standard in use at the time. However, the great wars and the depression made an end to the gold standard, and countries built protectionist walls that made cross-border capital movement very difficult. After the interruption caused by the world wars, the easy currency convertibility was not regarded as important as a stable environment to rebuild the domestic economies. While the current accounts were incrementally opened to enable international trade, controlling the capital account was regarded as the most efficient way to prevent trade imbalances from getting out of hand.[126] The Bretton Woods agreement and the organisations it established encapsulated this view and financial markets were tightly regulated across the world until Nixon put an end to the Bretton Woods in 1973.[127]

Maintaining open current accounts but closed capital accounts proved to be unsustainable due to the emergence of multinational enterprises and the Euro-dollar market.[128] There were ripe opportunities to circumvent the capital controls through misinvoicing and other creative bookkeeping measures.[129] According to Eichengreen, the fall of the Bretton Woods system in 1973 was an inevitable consequence of increasing international capital mobility, where capital controls could not offer the same kind of buffer for domestic policies as they had done before.[130] It was not possible to preserve the pegged but adjustable exchange rates and governments had to choose whether they would lean to free floating or irrevocably pegged rates. The two countries in our focus chose different alternatives: The US let the dollar

[125] Atkinson, 2015, pp. 93-5.
[126] Eichengreen, 1996, pp. 120-1.
[127] *Ibid.*, pp. 94-5.
[128] *Ibid.*, pp. 121-2.
[129] Obstfeld, 1998, p. 17.
[130] Eichengreen, 1996, p. 136.

float while France, after decades of different attempts, pegged its currency once and for all with the Deutsche Mark and other European currencies by creating the Euro.[131] France was struggling with its balance of payments during Mitterand's presidency in the 1980s, and to facilitate the expansionary economic policies they imposed more capital controls. The results were not as expected and the experience led the Socialist government to change the long-standing French view on capital controls. Convinced that they were only effective for the middle class while the wealthy could easily escape them, the Socialists decided that abolishing capital controls would create a more level playing field for the average French citizen.[132] This caused a rapid change in the European position towards capital controls – while capital controls were widely used until the late 1980s, all capital restrictions were abolished in the Maastricht Treaty in 1993 between the then European Community's Member States, and between Member States and third countries.[133] Article 73b.1 is very clear on this point: "Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."[134] This marked the first time a legal text comparable to a constitution ensured totally free movement of capital, making a marked shift from the earlier paradigm of restrictions on the flows of "hot money".[135] The following figure from a 2009 IMF paper depicts the change in legislation in Europe (right panel), and how it spurred on almost exponential growth on de facto international financial integration.

Figure 14 Evolution of International Financial Integration: 1970-2004[136]



[131] Eichengreen, 1996, p. 137.
[132] Abdelal, 2007, p. 16; Eichengreen, 1996, p. 166.
[133] Abdelal, 2007, p. 57.
[134] Treaty on European Union (Maastricht Treaty), 1992.
[135] Abdelal, 2007, p. 46.
[136] Kose, Prasad, Rogoff, & Wei, p. 17. Note: This figure shows unweighted cross-country averages, within each group, of two measures of capital account openness. The de jure

The 30-year experiment with open global financial markets have left the economists with mixed feelings. In theory, apart from facilitating international trade, less friction in cross border finance leads to better allocation of capital and improved possibilities to access finance even in those locales that are short on domestic savings. [137] Assuming that developing countries can offer the best investment opportunities (because the markets there are still developing), global financial markets could reduce the gap between rich and poor countries. There could be stabilising benefits as well: Extended investment options offer possibilities to diversify risk. Not only could this alleviate the negative effect uncertainty has on individual investment decisions, but also lead to more aggregate investment. Unfortunately, there is not much empirical evidence to support the assumption of major benefits to developing countries and increased stability in the financial system, and Rodrik and Subramanian conclude that "it seems increasingly clear that the benefits of financial globalization are hard to find" and that it "has not generated increased investment or higher growth in emerging markets."[138]

While it is unclear what kind of impact free mobility of capital has had on international inequality and economic growth, it is difficult to deny that it has posed a challenge to domestic fiscal policies. When capital can emigrate wherever it wants, it can also choose destinations with lowest tax rates rather than the ones with the best investment opportunities. This realisation has led to deregulation and declining corporate tax rates in many countries to attract investment, in a process also dubbed as the "race to the bottom". However, changes in statutory rates do not paint the whole picture. Capital mobility enables multinational enterprises to create complex corporate structures with webs of hundreds of subsidiaries located all around the world, and to channel their investments through chosen nodes to minimize the tax consequences of their operations.[139] This strategy makes use of international trade agreements and tax treaties, and the differences in calculating taxable income between countries. One might assume that creating these elaborate structures and moving assets around several times before reaching the final destination would be inefficient but it saves multinationals millions of tax euros and dollars – and gives them a competitive advantage over their smaller domestic competitors who cannot make use of the same arbitration of international tax laws. A recent example of using this legal fiction involves Apple: After finding out that Apple's effective tax rate for its European profits in 2014 was 0,005%, the European

measure is based on the IMF 0–1 capital account restrictiveness classification, with 1 representing countries that have open capital accounts. The de facto measure is based on the ratio of gross stocks of foreign assets and liabilities to GDP, with the raw data taken from Lane & Milesi-Ferretti, 2006.

[137] Obstfeld, 1998, p. 10.

[138] Rodrik & Subramanian, 2009, p. 136.

[139] Obstfeld, 1998, p. 19.

Commission ordered it to pay €13 billion of undue tax benefits to Ireland.[140] This was not an isolated case and by looking at sheer volumes, corporate tax avoidance enabled by free movement of capital causes enormous losses to tax revenue. The European Parliamentary Research Service estimates that the annual lost tax revenue from corporate tax avoidance could be as high as 160-190 billion euros in the EU alone.[141] And it is not only corporations that engage in these practices – free movement of private capital provides also individuals with better means to elude the tax collector. Zucman estimates that the yearly global tax loss from individuals moving and hiding assets abroad would be around $200 billion.[142] In the following section, I will discuss the importance of taxation in regards economic inequality, and how the tax policies have responded to the challenges of globalisation.

4.5 Taxation

Governments have a wide range of policies at their disposal to address economic inequality, and naturally any change to those policies has a significant impact on realised inequality. One could say that almost all functions of a welfare state is geared for decreasing different kinds of inequalities existing in societies. In this section I will only focus on taxation, as it is crucial for managing inequality as well as funding the means to do so. Taxation has a two-fold impact on inequality: First, if it is organised progressively, it decreases inequality directly, as the wealthy pay relatively more taxes than the poor. Second, taxation is the main source of government income, which helps to finance public services and transfer payments, which are often aimed at decreasing inequality levels even further. Welfare policies were increasingly popular after the wars but more recently they have been on the line of fire. have However, these policies have become increasingly jeopardised, as graphically showcased in some of the Southern European countries in the aftermath of the Euro crisis. The beginning of the unravelling of welfare policies can be traced further back, though. Starting from Thatcher's There Is No Alternative politics in the UK, globalisation and international competition have been quoted as obligating removal of some of the services that were previously taken for granted.[143] Similar steps were taken in other member states of the Organisation for Economic Co-operation and Development (OECD) in the following years. Förster and Tóth summarise this development as follows:

> "The redistributive power of the welfare state was weakened in the period between the mid-1990s to mid-2000s. While in the period between mid-1980s and mid-1990s the share of increased market income inequality offset

[140] European Commission, 2016.
[141] Dover, Ferrett, Gravino, Jones, & Merler, 2015.
[142] Zucman, 2015.
[143] Harvey, 2005, pp. 64-7.

> by taxes and transfers was measured at the level of almost 60%, this share has declined to around 20% by the mid-2000s."[144]

The timing of these policy changes is striking from the point of view of international trade theory we discussed before. While international trade and financial integration stepped up pace in the 1980s and 1990s, the theory suggests that increased aggregate wellbeing would follow suit. At the same time, various models show that this development will inevitably bring differing results across sectors, creating "winners" and "losers". To avoid increasing disparities between the two, redistributive policies would have needed to be ramped up in step with policies supporting further economic openness. Nevertheless, it seems the OECD governments took the exact opposite approach. were introduced. As these policy changes are numerous and vary in significance, the below assessment is restricted to three types of taxes: the income tax, the estate/inheritance tax and the wealth tax. For illustration, I have included figures depicting historical change in these tax policies in the US and France.

4.5.1 Income Taxation

Taxes on our wages are the most familiar forms of taxation to most of us. This is often divided to two categories: Labour income tax and social security payments.[145] To give an idea about general tax levels in practice I use the OECD statistics due to their easy availability. The average income tax in the OECD countries in 2016 was 15,7% and social security payments 9,8%, making the total average taxes on wages 25,5%.[146] Many countries levy progressive income taxes. In a nutshell, progression in taxation means that those who earn more pay not only *absolutely* but also *relatively* more tax. This is achieved through different tax rates at different levels of income. Taxation is often based on a bracket structure – it could be divided for example to income brackets of 0-10,000; 10,001-20,000; 20,001-30,000; 30,001-40,000 and 40,001+. Each of these brackets would have an individual tax level, say, 10%, 20%, 30% and 40% respectively. This means that if you earn 35,000, you pay 10% from your first 10,000 of income (1,000), 20% on your second 10,000 (2,000), 30% on the third 10,000 (3,000) and 40% for the last 5,000 (2,000). This adds up to a total income tax payment of 8,000 on your income of 35,000, making your final tax rate 22,9%. 31 out of 35 OECD countries have some level of progression in their income taxation system.[147]

It is important to note that the progression in income taxation does not necessarily cover all forms of payments. When considering wage income,

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[144] Förster & Tóth, 2015, p. 1083, as cited in Atkinson, 2015, p. 67.

[145] It could be argued that social security payments are not taxes *per se* but merely tax like payments. I group them together as taxes on wages with labour income taxes.

[146] OECD, 2017a, p. 20.

[147] The four countries (Czech Republic, Estonia, Hungary, Latvia) without progressive taxation have flat personal income tax rates, see OECD, 2017a, pp. 237, 261, 318, 395.

social security payments are usually set at flat rates, which makes overall taxation less progressive.[148] If all other variables remain equal, country A having a higher share of income taxes relative to social security payments (e.g., 20/10) has a more progressive tax system than country B that has a lower share of income taxes relative to social security payments (e.g., 15/15).

The wage income is not the only kind of income – capital creates income too. It accrues from asset ownership and includes income from rents, dividends, capital gains and interest.[149] Tax systems on capital income vary from country to country. Sometimes they are taxed according to their own rate, completely separate from wage income.[150] In other cases, all kinds of income is lumped together and taxed according to the same income tax brackets. However, even in these systems it is a usual practice to have exceptional tax rates for certain kinds of capital income, such as capital gains and dividends, in order to incentivise saving and investment.

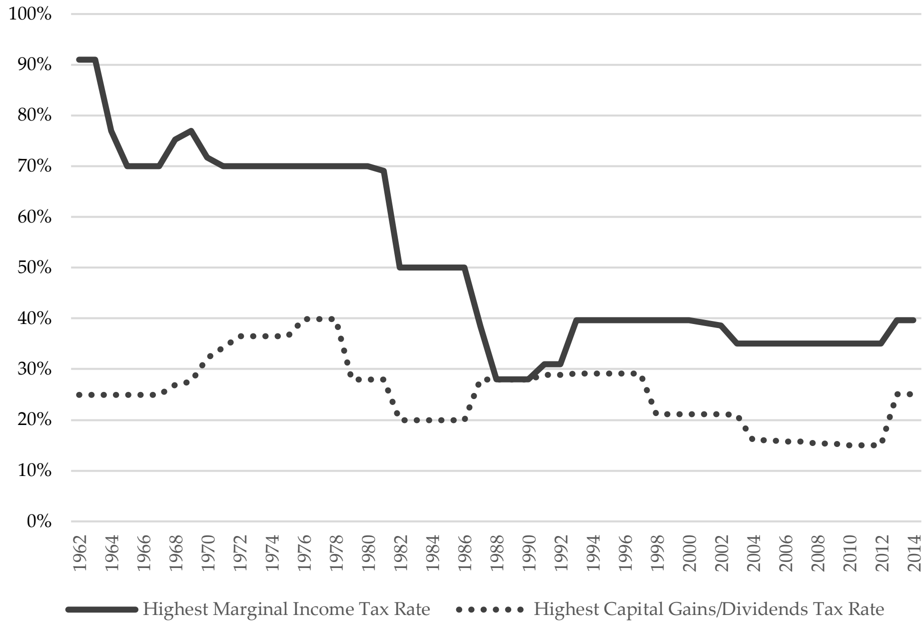
The two figures below depict the changes in highest marginal tax rates in the US and France in 1962-2014.

[148] There are several ways social security payments are calculated. They can be added on top of the income tax rate: Using the previous example, 10% worth of social security payments would increase the total taxes on wages from 8,000 to 11,500 (8,000+35,000*.10), making the new tax rate 32,9%. In some countries, social security payments are deducted from the taxable income. In this case 3,500 in social security payments would decrease the taxable income to 31,500. This results in income tax of 6,600 instead of 8,000. The total taxes on wages would be 10,100, or 28,9%. In yet other cases the social security payments can be deducted not on their full value but only until a certain threshold. See different tax systems in the OECD countries, OECD, 2017a, pp. 169-562.

[149] Cf. Atkinson, 2015, p. 309.

[150] Also called as 'dual income tax' systems, see cf. Kleinbard, 2010, p. 42.

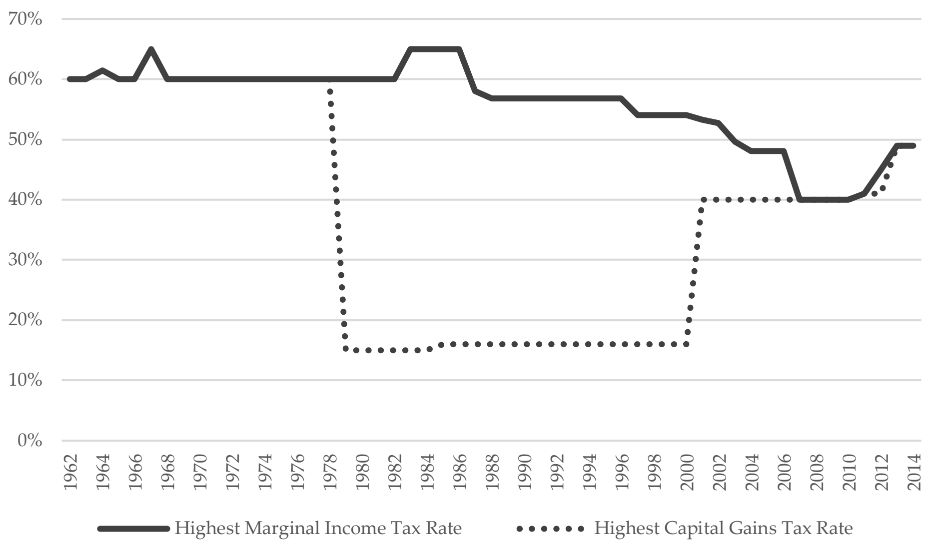
Figure 15 Income Tax Rates in the US[151]



Although all income is generally taxed according to the same bracket, the US has had special tax rates for capital gains and dividend income for the whole period. The highest income tax rate has declined dramatically since the early 1960s, dropping from more than 90% to close to 40% in early 2010s. For most part of the period in focus, the rates on capital gains and dividends were between 20% and 30%, and they have been markedly smaller throughout the past decades, except for the brief period at late 1980s when Reagan lowered the general income tax rates to the same level.

151 For income tax rate, Tax Policy Center, 2017a; for capital gains rate, Tax Policy Center, 2017b.

Figure 16 Income Tax Rates in France[152]



In France, all kinds of income were taxed at the same rate until 1979, when the taxation of capital gains was significantly lowered. Taxation of dividends was also lowered in 1979: It continued to be taxed at the same rate as other income but an abatement of 50% to taxable amount was introduced. Starting from 2013 all income is again taxed at the same rates but with abatements for dividend and capital gain income. For dividends, this was lowered to 40%, and for capital gains it was set at 50% if the shares had been held between 2-8 years before sale and 65% if held longer than 8 years.[153] The figure includes the exceptional additional "solidarity" tax of 4% for incomes exceeding 500,000€, which was introduced in 2012.

4.5.2 Estate/Inheritance Taxes and Wealth Taxes

Estate/Inheritance and Wealth taxes are primarily meant for tackling disparities in accumulated wealth. Intuitively, the best way to address wealth inequality would be to levy direct wealth taxes but there are only a handful of countries that do so. One of the main reasons for reluctance for setting up a wealth tax is its costly administration relative to its revenue, as it requires a lot of work on the part of the tax authorities to assess whether the assets are valued correctly.[154] There are also legal and institutional hurdles for introducing a wealth tax – in some countries the constitution prohibits levying appropriative taxes. A direct wealth tax could be easily identified as one, which means that implementing it would necessitate changes in constitutions.[155] Regardless of these possible problems scholars

[152] Based on data from André, Goupille, Guillot, Piketty, & Tenand, 2016.
[153] For more information on French taxation of investment income, see French Property, 2017a.
[154] Atkinson, 2015, pp. 199-200; Glennerster, 2012.
[155] For the case of the US, see Bankman & Shaviro, 2014, pp. 46-9.; for Germany, see Glennerster, 2012, p. 3.

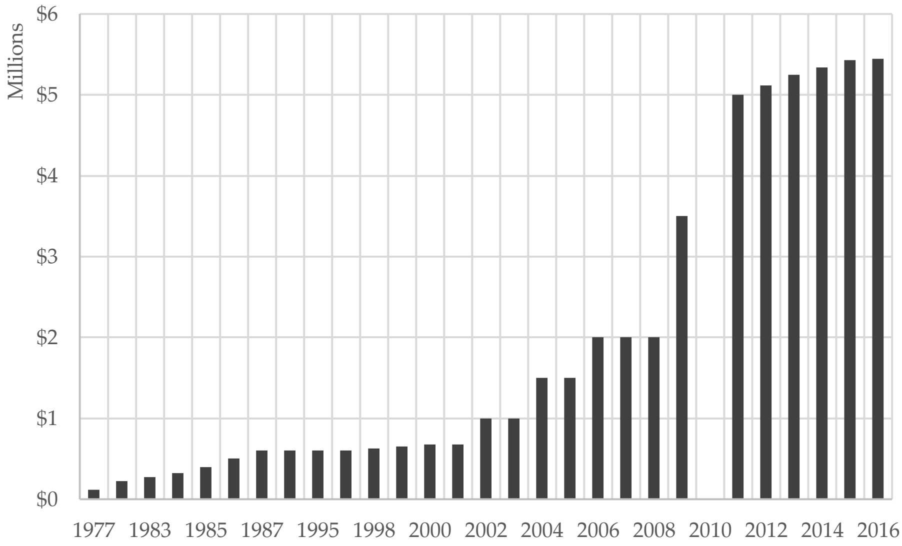
such as Piketty and Zucman argue that wealth tax would be a plausible and effective solution for increasing wealth inequality, as most of the old administrational hurdles can be overcome by modern technology and international cooperation.[156] At least for now, countries seem not convinced as new wealth tax regimes have not emerged in recent years.

A far more popular way to tax wealth comes in the form of inheritance or estate tax. Both taxes are levied upon an individual's death, the difference being that inheritance taxes are levied on the people who receive an inheritance (the inheritors) and estate taxes are levied on the whole estate that was left behind by the deceased, prior its distribution to the inheritors. These taxes are targeting inter-generational wealth accumulation, aiming to prevent the emergence of dynasties familiar to feudal ages. This was the main argument for introducing such taxes in newly extablished democracies such as the US and France.[157] Fast forward a couple of hundreds of years and 17 OECD countries levied an inheritance or estate tax in 2014.[158] One of the reasons for only half the OECD countries levying these taxes might be explained by the persistent criticism that the wealth of the deceased is taxed twice: Once during their lifetime in the form of income taxes and again upon the transfer of the wealth to the heirs and other inheritors. However, they are tolerated better than wealth taxes as it is more justifiable for governments to tax 'unearned' wealth than the wealth individuals have accumulated by their activities during their life time in the form of a direct wealth tax.[159]

In the US, the federal government levies an estate tax, meaning the whole estate of the decedent is taxed as a single entity. The share of the estate tax in the entire tax revenue is negligible, 0.5%.[160] This is explained by very high exclusion amounts: In 2016, estate tax was levied on estates exceeding total value of $5,450,000, and this figure was doubled for married couples. For the exceeding amount, tax rates vary between 18-40%. The highest tax rate is applied on the amount exceeding $1,000,000.[161] In practice, few estates have to pay estate tax at all upon the death of the estate holder. The following figure shows the development of the exempted amount since 1977. Before the exempted amounts ballooned, inheritance taxes represented a higher share in the total tax revenue, topping 2% during the 1960s.[162]

[156] Piketty, 2014, Ch 15; Zucman, 2014.
[157] Beckert, 2005, pp. 361-4.
[158] OECD, 2017b.
[159] Beckert, 2008.
[160] OECD, 2017c. This figure also includes taxes on *inter vivos* gifts.
[161] IRS, 2016a, p. 6.
[162] OECD, 2017c.

Figure 17 The US Estate Tax Exemption 1977-2016[163]



France collects inheritance tax from inheritors instead of taxing the estate upon the death of the estate holder. Tax rates and exemptions differ based on inheritor's relationship with the deceased, for example their children are entitled to a personal tax free allowance of 100,000€ and the highest tax rate is 45%.[164] Even if there would be a big number of inheritors, the exempted amounts are far smaller than what they are in the US. This helps explain why the share of inheritance taxes of total tax revenue in France (1,1%) is more than double of that in the US.[165] France is one of the few countries that levies a wealth tax. It has been in place since 1982, with an abolishment for 1987 and a quick reintroduction in 1988. In 2016, the highest tax rate was 1,5% for wealth exceeding €10 million. Revenue collected by the wealth tax represents 0,5% of the total tax revenue.[166] Wealth is taxed more in France than in the US, and different wealth taxes combined bring three times as much revenue as the estate and gift taxes in the US. This could help explain why the concentration of wealth has not been so dramatic in France than in the US during the past decades.

4.6 Conclusion

This chapter introduced some of the factors grouped under the umbrella term globalisation, which have had a part to play in changing inequality levels. Although domestic fiscal policies are not directly a product of globalisation, changes in them have been justified by the new environment of globalised economy. Even if the "race to the bottom" has primarily

[163] The Joint Committee on Taxation, 2015; IRS, 2016a, p. 9.
[164] Notaires de France, 2017.
[165] OECD, 2017c.
[166] OECD, 2017c.

affected business taxation and regulation, I focused on personal taxes as the increased profits earned by companies are eventually transformed to personal income. As the above figures attest, the highest income tax rates have been declining in both the US and France, and less and less of inheritances are taxed. Even if 'globalisation' was the main culprit for the rise of *pre-tax* income inequality during the past decades, the tax policies have had a significant role to play in the increase of *post-tax* income inequality. The following table depicts the growth in incomes both before and after taxes in the US during two time periods, 1946-1980 and 1980-2014.

Table 7 Pre- and Post-Tax Income in the US[167]

	Pre-tax income growth		Post-tax income growth	
Income group	**1946-1980**	**1980-2014**	**1946-1980**	**1980-2014**
Full Population	95%	61%	95%	61%
Bottom 50%	102%	1%	130%	21%
Middle 40%	105%	42%	98%	49%
Top 10%	79%	121%	69%	113%
Top 1%	47%	205%	58%	194%
Top 0.1%	54%	321%	104%	299%
Top 0.01%	75%	454%	201%	424%
Top 0.001%	57%	636%	163%	617%

It is evident that incomes grew more rapidly during the first period, which has been a common phenomenon in rich countries. As discussed in *Chapter 3*, perhaps the most striking datapoint here is that the pre-tax incomes of the bottom 50% have stagnated during the second time period. Due to transfer payments their post-tax income grew slightly, although well below the average. This is in marked contrast with the earlier period, when their pre-tax income doubled and they saw an additional growth of 30 percentage point after taxation – not only have the bottom 50% seen any increase in their market incomes since 1980, the tax system does not work as well in their favour as it used to. Looking at the figures from other perspective, it could be even argued that taxation at the very top has become more equitable, as the income of the top 1% grew more rapidly post- than pre-tax during the first time period. A glance at Figure 15 could explain this anomaly: The highest tax rates were set at extremely high levels after the WWII and came down in mid-1960s, well in time to have a significant impact

[167] Piketty, Saez, & Zucman, 2016, Table 2. Notes: The table displays the cumulative real growth rates of pre-tax and post-tax national income per adult over two 34 years period: 1980 to 2014 and 1946 to 1980. The unit is the adult individual (aged 20 or above). Fractiles are defined relative to the total number of adults in the population. Income is split equally among spouses.

on the cumulative income growth by 1980.[168] The US tax system has had a negligible effect on the very dramatic growth of top incomes after 1980: The incomes have grown at markedly different speeds without any meaningful redistributional impact after taxes have been collected. The combination of two issues could explain this: The highest general income rate has been reduced dramatically, and the labour and capital income have been treated differently while the financial assets have been concentrating in the hands of the very wealthy (the top 1% receives 42% of total capital income in the US and 35% in France).[169]

To conclude, pre-tax income inequality has been rising faster during the past decades than in the previous time period. Whereas previously the tax system was making the income distribution more equal, it has not managed the same feat more recently. In the following chapter I will discuss how trusts can be used to avoid and evade personal taxes, greatly diminishing their redistributive effects. Trusts exacerbate the problems capital mobility has brought for fiscal authorities. This happens through a double effect: Firstly, trusts enhance capital mobility, providing a legal vehicle for cross border transactions that has several advantages over other legal vehicles such as companies. Secondly, trusts are used to hide asset ownership, which makes taxation of those assets and the income deriving from them more difficult.

[168] See also Piketty, 2016, p. 19.

[169] See Figure 13 in *Chapter 3* for France and Table 14 in the Online Appendix of Piketty, Saez, & Zucman, 2016 for the US.

5 Trusts & Capital Mobility

As noted in the previous chapter, the rules supporting capital mobility spread through many countries during the last decades of the 20th century, and were established as a norm that other countries were encouraged to pursue. To enjoy the new possibilities this entailed, actors had to use different legal vehicles to conduct cross-border investments and other transactions. International banking provided a crucial platform but some of the investment opportunities were out of reach for individuals directly owning a deposit or brokerage account in their home countries – this could happen due to existing limitation for foreign ownership in the destination country or a lack of a trade and/or tax agreement between the two countries. One way to remedy this situation would be to establish a presence in the destination country through a legal entity. Another was to channel the investment via a third country that does have needed agreements in place with the destination country. Even if there were individuals who wanted to start investing internationally, all this hassle could discourage them. If they could not afford a full-service investment advisor, they were more prone to pool their investments with others in joint investment schemes, where a professional account manager would structure the investments for them.[170]

As it happens, trusts were useful in all the instances mentioned above. First mainly used in the Anglo-Saxon world (which accounted for a fair share of the global economy throughout the 20th century), trusts gradually became more familiar in other countries as well. Before discussing how trusts enhance capital mobility, I will briefly recap how trusts became a truly global phenomenon.

5.1 Globalising Trusts

In *Chapter 2* we learned how the 1,000-year-old trust institution has proven to be a resilient one, and its flexible design ensured its continuing relevance for estate planning and wealth management in the UK. Firmly nested in the Anglo-Saxon legal tradition, it was not self-evident that it could expand widely across the globe, even if its usefulness in wealth management was acclaimed. At the turn of the 20th century, Cambridge professor Frederic Maitland, sometimes regarded as the biggest authority on trust scholarship, held the view that the trust vehicle could be "the most distinctive achievement" of the whole Anglo-American legal tradition.[171] It is safe to say that trusts had made their mark on the Anglo-American sphere of life for hundreds of years but their widespread use in international wealth

[170] The investments channeled through mutual funds have increased tenfold since 1982, see *Section 5.2.5*.

[171] Maitland, 1936, p. 23. The lectures of Maitland were compiled to a book for the first time in 1909. Maitland passed away in 1906.

management and especially by offshore financial centres is a more recent phenomenon.

The scarcity in changes to the English trust practice and law governing trusts was due to the political economy circumstances. It was difficult to create practices that went directly against state interests within a relatively small polity, and the proper use of trusts was agreed in a dialogue between the wealthy landowners and the state. As noted earlier, the most aggressive uses of trusts to circumvent laws were eventually banned.[172] Uniformity in the law throughout the British Empire ensured that even if the polity was growing, trust users could not find ways to undercut the ruling interests in London. This top-down uniformity of the common law started to unravel when the former colonies claimed independence. Although the former colonies used the English common law as the basis of their legal systems, the pluralisation of trust laws was inevitable as the number of semi-independent legislatures increased. This provided an opportunity for trust users – the British Crown Colonies (today the British Overseas Territories), the Crown Dependencies (Jersey, Guernsey and the Isle of Man) and the Commonwealth of Nations included a lot of smaller jurisdictions with the same legal tradition with small differences that could be useful in setting up trust structures outside the British mainland. Trusts went 'offshore', which was a crucial development in the internationalisation of trusts and the trust industry. The first overseas trust centres were not far away from the shore: The Channel Islands started offering dedicated trust services in the 1920s. However, the waves of independence in mid-1900s marked the 1960s as the true beginning of the offshore trust industry. [173]

The political economy behind the offshore trust industry is relatively straightforward. The British financial elite wanted to enjoy from the benefits of a familiar and stable legal system, while avoiding some of its downsides. The Overseas Territories and Crown Dependencies provided exactly that with legal systems firmly based on the English system, and often a score of British lawyers running the offshore trust service providers. Moreover, the small colonies' pursuits to become financial centres were supported by London, as it was regarded as a good development strategy on otherwise resource poor islands.[174] The novel idea of offshore financial centres seemed to be a win for everyone. Until 1980s, the offshore services across the old British Empire were mainly aimed at wealthy nationals in the UK, Australia and New Zealand.[175] These services gained some interest in the US as well but the Tax Reform Act of 1976 effectively deleted the possible income tax advantages domestic settlors gained from settling offshore trusts. It is worth

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[172] E.g. the uses to avoid feudal incidents and later other forms of inheritance taxes were tackled by the Crown and the Parliament. See *Chapter 2*.

[173] Palan, Muprhy, & Chavagneux, 2010, p. 92.

[174] *Ibid.*, pp. 124-5.

[175] Sterk, 2000, p. 1047.

noting that if an individual was not afraid to steer from the side of tax avoidance to tax evasion, settling trusts in offshore jurisdictions that upheld high banking secrecy standards was still a lucrative option because the IRS would not be aware of the offshore trust nor its assets.[176]

The jurisdictional competition for attracting foreign capital including trust funds started in the 1960s after the new wave of newly independent British colonies joined the fold. The competition intensified in the 1980s and 1990s, as the liberalisation of capital movements meant new markets and a bigger customer base for offshore trust service providers. More jurisdictions wanted their stake in the game, which led to revisions of existing trust legislation and introductions of novel ones in places like the Cayman Islands, British Virgin Islands, the Cook Islands, Bahamas, Bermuda, Nevis and so on. At the same time, many states in the US started to tweak their trust rules.[177] Suddenly there were ample choices of different types of trusts and trust jurisdictions that could be used and combined for varying different needs.

5.1.1 The Hague Convention

The expansion of the trust institution has not been limited to only common law countries. Already in 1937, one legal scholar stated that it had also penetrated civil law systems in a "remarkable" way.[178] 50 years later, Gaillard and Trautmann underlined the same notion when stating that non-trust jurisdictions are increasingly confronted with international structures involving trusts, and that the small volume of trust related cases does not reflect the popularity of trust use as in most cases transactions are executed under the trustee's name without any reference to the underlying trust.[179] The mid-1980s was an important period for globalisation of trusts – besides the proliferation of offshore trust centres, it saw an international convention on trust legislation.

The Hague Convention on the Law Applicable to Trusts on their Recognition was held in 1985 and it has three main provisions. First, the jurisdictions having ratified the convention recognise "trusts created voluntarily and evidenced in writing" in other signatory jurisdictions and elsewhere.[180] Second, the settlor is free to choose which law is applicable for the trust by explicitly mentioning it in the trust deed. The applicable law does not necessarily have to come from any of the jurisdictions where the trust parties are resident. Third, signatory jurisdictions cannot discard the more favourable rules set in other jurisdictions' trust law.[181] Furthermore,

[176] Sterk, 2000, p. 1047-8.
[177] Sitkoff & Schanzenbach, 2005, pp. 375-7.
[178] Amos, 1937, pp. 1263-4.
[179] Gaillard & Trautman, 1987, p. 313.
[180] Hayton, 2016, p. 8.
[181] Hudson, 2016, p. 918.

there are guidelines to assess what is the governing law for a trust whose trust deed does not state it explicitly. These include a safeguard for abusive choice of governing trust law: If it is deemed to have no or little connection to the trust, another jurisdiction that is deemed to be more connected to it will provide the governing law. However, as long as the settlor uses a trustee located in the governing law jurisdiction, there should be no doubt about the proper connection.[182]

The Hague Convention is by no means a comprehensive global agreement – in fact only 12 countries have ratified it. This group of countries include several trust jurisdictions but not all. In addition to the UK, Canada and Australia, the UK overseas territories of Bermuda, British Virgin Islands, Gibraltar and the Turks and Caicos Islands have ratified it, as well as all the Crown Dependencies (Guernsey, Isle of Man, Jersey).[183] Five EU Member States (Italy, Luxembourg, Malta, the Netherlands and Cyprus) have ratified it, as well as Switzerland.[184] Hayton argues that it is not surprising that not more common law jurisdictions have ratified the convention, as their domestic legislation already understands and acknowledges trusts settled home or abroad. On the other hand, the fact that only eight civil law countries have ratified it raises concerns whether the Convention has created a more robust foundation for trust use around the world.[185] However, the Convention plays an important role in Europe: The citizens in the European single market are free to use financial services from any other EU Member States, and often the private banking functions of high street banks are concentrated in Luxembourg, the UK and the Netherlands, even if these banks' whole customer base would be located elsewhere.[186] Considering this, the EU citizens not coming from the Convention signatory countries are able to access trust service providers located in the signatory countries either directly or through their domestic financial institutions.

5.2 Increased Mobility

This section depicts the main reasons why trusts are useful legal vehicles for managing cross-border business and investments. After this I will compare trusts to companies and lay out the advantages the former have over the latter.

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[182] Hudson, 2016, p. 918.
[183] Hayton, 2016, pp. 1-2.
[184] In addition, Hong Kong, Liechtenstein, Monaco and San Marino have ratified the Convention, and France and the United States have signed but not ratified it. See The Hague Conference on Private International Law, 2017.
[185] Hayton, 2016, p. 2.
[186] For example Nordea, the biggest consumer bank in Scandinavia, had its private banking unit in Luxembourg. The unit in question became infamous in the Panama Papers leaks, as the documents revealed that it had neglected anti-money laundering rules and possibly facilitated tax evasion of its customers. See Chopping, 2016.

5.2.1 Fast Set Up

Because trust is not an entity but a legal arrangement between the trust parties, it can be set up instantly. There is no need to create new entities and wait for approval from relevant authorities. The trustee can open a bank account for the trust the very same day and it will be held in the trustee's name, although if the bank is following the international anti-money laundering rules devised by the Financial Action Task Force, they should ask whether the trustee is opening the bank account on behalf of someone else or as a trustee for a trust. In this case, the bank should also ask for a copy of the trust deed or some other proof of the existence of the trust.[187] After opening the account, the trustee can start trading with the trust funds.

5.2.2 Continuous Movement

As discussed in Chapter 2, trusts can be regarded as gifts in progress: "[T]he normal private trust is essentially a gift, projected on the plane of time and so subjected to a management regime."[188] The trust fund is always on the move, on its way from the settlor to the beneficiary. The settlor has departed with the fund ownership and given the legal rights *temporarily* to the trustee, who is to forward the benefits onward to the beneficiary. Therefore, it can be difficult to establish where the trust fund is located at any given moment, and which laws it needs to follow. For example, New Zealand uses the settlor's home jurisdiction to establish the residence of the trust, whereas most other jurisdictions would pin the residence to the trustee's home jurisdiction.[189]

5.2.3 Using the preferred legal system

As per traditional trust legislation and the Hague Convention, the settlor can decide which trust jurisdiction legislation the trust follows when they set it up. If the settlor's home jurisdiction has high level of taxation or other regulations that would prohibit investments in a desired investment destination, these can be circumvented by settling a trust in a jurisdiction that does not have the same prohibitive rules in place and the investments can be conducted through the trust. This is also useful in cases when the home jurisdiction and the destination jurisdiction do not have double tax treaties in place. To gain additional certainty about the tax treatment of the investment, it can be channelled through a trust that is situated in a jurisdiction that has a relevant tax treaty in force.

Note that domestic courts can challenge whether the trust is situated in the jurisdiction the settlor proclaimed when setting up the trust. This

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[187] FATF, 2012-2017, pp. 58-60.

[188] Rudden, 1981, p. 610.

[189] Treasury of New Zealand , 2016, p. 14

happened in a significant Canadian case, where the settlors were living in Canada but settled a trust under Bahamian law. The court judged that the real management of the trust was done in Canada, so the trust should follow Canadian legislation.[190] This was important as the trust funds would have been sheltered from Canadian taxes if it would have been regarded as a Bahamian trust. This case is discussed further in *Chapter 6*.

5.2.4 Low Maintenance

After the trust is settled, there is no need to file annual returns or tax declarations. As the trust did not need a license to start operations, neither does it require reporting to authorities to maintain that license. Decreased paper work applies to taxes as well. Under the tax code of several jurisdictions (the Cayman Islands and British Virgin Islands to name a few) the trust itself is not required to pay any taxes on its income. When there are no taxes due, the settlor does not have to consider the tax treatment of the investment vehicle they set up to manage their international investments, nor pay for accountants to file tax returns on their behalf.[191]

5.2.5 Fast Relocation

Trusts provide flexibility for moving trust funds rapidly to another location. This can be done in two different ways. The trust deed can give the trustee the power to 'decant' the funds to another existing trust under specific circumstances.[192] Another option is to include a 'flee' clause in the trust deed. This would authorise the trustee to alter the trust deed so that it will be relocated to another jurisdiction and/or under the management of another trustee should a need for that arise.[193]

5.2.6 Advantages over Companies

Unlike trusts, companies or corporations are familiar legal vehicles in all modern legal systems. Does this not mean companies would be a better choice to manage international investments? It is true that companies are more widely used in cross border business, especially in the form of subsidiaries as a part of a bigger corporate structure. However, in some instances trusts have certain benefits over companies and could be preferred by individuals and businesses alike. Some of them are mentioned above, namely the lack of registration requirements and other regulations. Not having to register brings several advantages: First, without registration, there are no registration fees. There are no limits to how many trusts one can

[190] *Garron Family Trust v. The Queen*, 2009.
[191] Langbein, 1997, p. 181.
[192] Culp & Bennett Mellen, 2010.
[193] See for example this representative case from a New York trust lawyer: Tanzi, 2013.

settle and the cost is not an issue unlike when setting up complex corporate structures. Second, trusts do not have to wait for an approval from local authorities as is the case with companies. In some cases, this can take some time, which hinders the mobility of capital. Third, lack of registration makes it easier to operate under the radar as there will not be a paper trail.

The differences do not end in the establishment phase. Usually companies have strict regulations and operational rules to follow to maintain their license to operate.[194] For example, it is common that corporation statute requires that companies have an annual shareholders meeting, which is expensive and burdensome to organise. Parties to a trust do not have to meet annually, or at all for that matter. The same statutes may state that in their certificate of corporation, corporations must list what is the maximum number of authorised shares. Changing this number requires shareholder's approval and is again consuming resources. This is a serious drawback for some mutual funds, especially money market funds that issue and redeem substantial amounts of shares according to short-term fluctuations in interest rates. Corporations cannot simply list an astronomical number when asked about the authorised shares because in many instances the annual filing fees are dependent on that number.[195]

Trusts are an excellent legal platform for joint investment schemes: The basic structure allows the settlor to transfer their funds to the trustee to invest in their behalf, without having to find business partners for establishing an investment company and hiring a manager with specific rights and responsibilities for making the investments. As mentioned above, the organisational structure of trusts is better suited for issuing and redeeming large numbers of shares necessary for the operations of money market funds. For these reasons, the first mutual funds in the US were based on a trust structure. Even today, mutual fund can only be set up as an investment trust, such as Massachusetts Business Trust or Delaware Statutory Trust, or as a special investment company, whose governance structure is similar to trusts even if it is called a company.[196] In total, mutual funds had $15,7 trillion in assets in 2015 and they managed 22% of American household financial assets. In 1982, the corresponding figure was 2%.[197] A sizeable portion of the US financial assets are hence managed through a trust even if the settlors

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[194] Several jurisdictions have legislated for less burdensome governance requirements for specific kind of companies, such as holding or investment companies. For an US example, see Maryland Investment Company code, Langbein, 1997, p. 187. An international example that lowers the requirements for company governance significantly, see International Business Companies in British Virgin Islands, Chapter 291 of the Revised Laws of the Virgin Islands, 1991.

[195] Langbein, 1997, p. 184.

[196] *Ibid.*, p. 171. Note that the mutual funds that are structured as corporations are frequently structured under the Maryland Investment Company code, which in many ways duplicates the benefits of a trust by not requiring an annual shareholders meeting, see Langbein, 1997, p. 187.

[197] Investment Company Institute, 2016, pp. 9-12.

and beneficiaries would not be explicitly aware of their roles in the structure. There are other reasons why trusts are frequently used in collective investment schemes: Basing an investor-asset manager relationship on trust law simplifies the process as both parties know that unless there are changes in the contract adjoining the trust, the trustee has fiduciary responsibilities and must act in a loyal and prudent manner. In other words, they must invest the assets without individual gain and as if they were investing their own assets. The default fiduciary responsibilities are the reason why pension funds are required to be structured in a trust form in the US.[198]

The ring-fencing of trust assets from trustee assets is yet another advantage. In the case of trustee insolvency their creditors cannot access the assets held in the trustee's name in a trust because the trustee does not hold the beneficiary interest, the beneficiaries do. This regime of asset segregation makes it also attainable for investors to let the trustee hold ownership of the trust asset without establishing a specific entity with legal personality.[199] While an obvious asset for setting up investment funds, this feature helps other international joint business ventures as well. When embarking on a joint project, the partnering entities can choose to set up a trust that holds their respective stakes. When the number of partners increases, the risk of one of them becoming insolvent increases in step. Should this happen, the creditors cannot access the insolvent partner's investments in the project while it is in process. This gives an additional insurance for all the partnering entities as they do not have to fear postponement or cancellation of the project because one of their partners goes bankrupt. These arrangements are called special purpose vehicles (SPVs), and they also help banks and other financial institutions shift some of their debt exposure off their balance sheets, decreasing their borrowing costs.[200] This practice became infamous during the Enron scandal when it was revealed that the company had hidden most of its debts to offshore SPVs.[201]

Last but not least, because a trust does not have a legal personality, the trust income cannot be taxed at the entity level as is the case with companies and corporate income tax (CIT). Escaping entity-level taxation is one of the main reasons of the introduction of the trust structure to joint investment schemes, real estate and royalties. As the ownership of the trustee is only nominal, they do not have to pay any taxes on the income of the trust – this is the burden of the beneficiary when the income is distributed to them. This makes trusts useful tools in complex corporate structures that have numerous subsidiaries and holding companies. However, this sort of favourable taxation is not an exclusive domain for trusts: The US Congress

[198] Langbein, 1997, pp. 182-3.
[199] *Ibid.*, pp. 179-80.
[200] *Ibid.*, pp. 172-3.
[201] For more about the Enron case, see Niskanen, 2005.

extended 'trust-type' tax treatment to mutual funds that were set up as corporations instead of trusts already in 1936.[202]

5.3 Conclusion

Trusts and capital mobility are mutually reinforcing institutions: The former provides ways to make the most of capital mobility while the latter increases the demand for trusts and their providers. Through the Anglo-Saxon economic dominance, trusts were first used in the biggest domestic markets and were gradually accepted in locales whose legal systems do not follow the common law or equity traditions. Trusts became one of the most important legal vehicles used in cross-border transactions and international investment ventures, alongside with corporations. While they are widely used for making money move faster, here the focus is on two features that makes them especially useful in undermining fiscal policies: First, the ability to settle a trust on another side of the world instantaneously and not leaving any kind of paper trail behind for doing so. Second, the possibility to move the trust assets to another jurisdiction the moment tax authorities or other creditors start making questions about the funds. For these reasons, trusts are great tools for hiding asset ownership, which is a significant problem for tax authorities: To collect taxes deriving from assets, they need to be linked to their real owners. In the next chapter, I will discuss some of the key ways trusts are used to avoid and evade individual taxes.

[202] Langbein, 1997, p. 181.

6 *Trusts & Taxation*

Chapter 5 gave an outline on how trusts enhance capital mobility, and how possibilities to move capital across borders have created more demand for trusts. In this chapter, the aim is to highlight how this symbiosis can be used to undermine domestic fiscal policies. Tax systems do not excel at taxing mobile factors. To collect personal taxes, the authorities need to identify a taxable person, a taxable asset and a link between the two. As a simple example, taxes on real estate are relatively easy to collect: The piece of land or housing cannot be moved and in most cases the ownership is recorded in a land registry. Authorities will quickly establish who is to be taxed and at what level. When the authorities want to tax mobile assets, it becomes trickier. Usually public authorities require financial institutions to share information about their domestic clients' assets so they can be taxed. But there are low barriers to move these assets to another jurisdiction, where the financial institutions are not bound by the rules of a foreign country. If there is no cooperation agreement between the two countries' authorities, it is up to the asset owner to disclose what kind of asset they own in the other jurisdiction. This is where trusts enter the picture. Firstly, trusts are good vehicles to execute international investments, as discussed in the previous chapter. They are some of the factors that lower barriers for cross-border investments. Secondly, because trusts divide ownership, it can become difficult for the home country to establish who should be taxed, especially if they are not familiar with trusts. Thirdly, trusts are useful tools for hiding asset ownership. This comes handy for those who know that their home tax authorities do not automatically receive information about their foreign assets and want to minimise the possibility that the authorities would detect these assets in the rare occasion they would start investigating a possible tax fraud. Fourthly, if the tax authorities would eventually detect the trust and its assets, it can be difficult to retrieve the funds situated in a foreign jurisdiction.

The chapter begins with explaining how tax authorities deal with trusts in the US and France. In the US, there are clear rules for taxing domestic trusts and an extensive disclosure requirement about foreign trusts. France too requires disclosure of certain trusts, even though it does not have legislation for domestic trusts. The rest of the chapter is divided to two sections, titled tax avoidance and tax evasion. Put shortly, the former is a legal practice to minimise one's tax exposure while the latter is illegal, and the measures taken knowingly cheat tax authorities. It is often difficult to draw a clear line between the two and many trust structures explicitly exploit this grey territory between them. The links between tax minimisation through trusts and economic inequality are straightforward. Trusts are primarily used to minimise capital income and inheritance taxation. In the earlier chapters we learned that most of the capital income goes to the top income earners, and only wealthy families (exceptionally wealthy in the US case) face inheritance taxation. Following this, it is more likely that the top income earners and the wealthiest minimise taxes with trusts. Several consequences follow: First, the incomes at the very top increase, which exacerbates economic inequality. Second, either the tax revenue falls or it is replaced with other taxes. In the former case the governments need to suspend some of the public services they provide, which in most cases where aimed at decreasing inequality in their societies. In the latter, after failing to tax mobile capital, they shift the tax burden to more immobile factors, such as labour. In *Chapter 3*, it was established that labour income is spread far more equitably in the society than capital income. Consequently, the tax burden is shifted from the very top to a bigger group of taxpayers. For these reasons, tax evasion and avoidance using trusts becomes an important question when discussing economic inequality and the possible policies and other remedies for it.

6.1 Trust Taxation

In a system where taxation is based on asset ownership, trusts are prone to create confusion. After a trust is settled, which of the trust parties should pay taxes on the trust assets? The trustee does not have the beneficiary ownership of the assets while the beneficiaries do, but they might not be able to enjoy the assets as it is the trustee's role to distribute the assets to them based on the agreement with the settlor. If neither must pay taxes, there would be a glaring loophole in the tax system. In the US, private trust income that is not distributed to the beneficiaries is separated from the trustee's or beneficiaries' personal income and taxed following a bracket system, much like that of personal income taxation. Both personal and private trust income have the same highest tax rate, 39.6% but whereas this rate kicks in for a single filer only for incomes exceeding $415,050, the trusts pay taxes at this rate for the income exceeding $7,000.[203] This is meant to deter taxpayers from settling numerous trusts and thereby portion their income to so small pieces that they would face lighter tax treatment than what would be the case if they would earn the income directly (this strategy was in use until late 1960s).[204] If the trust income is distributed to beneficiaries during the same tax year, that incomes is considered as personal income for the beneficiary and taxed accordingly (so not at the trust level). Looking purely at the tax rates for domestic trusts, it would look like trusts are a poor choice for tax minimisation strategies in the US.

Unlike most countries, the US imposes taxes on its residents, citizens and corporations on their worldwide income. [205] To do this successfully, the

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[203] Internal Revenue Code, 2017.

[204] Saez & Zucman, 2016, p. 538.

[205] US federal income taxes are due on only the income that exceeds the foreign earned income exclusion (inflation adjusted, around €100,000 in 2016) and that is taxed at lower levels than

Internal Revenue Service (IRS) requires all American taxpayers (residents and citizens) to disclose their foreign financial assets on an annual basis. This requirement includes the disclosure of all foreign trusts where the taxpayer is a party. [206] The piece of legislation mandating this, the Foreign Account Tax Compliance Act (FATCA), also requires all foreign financial institutions to disclose the account balances of American citizens and residents to the IRS. FATCA was introduced in 2010 and its aim is to curb offshore tax evasion. Taxpayers that used foreign legal vehicles to minimize their taxation in the US are now forced to disclose assets held through those vehicles, and while they might be unwilling to do so, the foreign banks holding the assets might be more willing. The financial institutions that fail to report to the IRS will have to pay 30% withholding tax on all US-sourced payments it receives, which makes their operations in the US practically impossible.[207] This is a sufficient incentive for the big international banks that want to continue accessing the vast markets in the US. Naturally, it is still possible for taxpayers to evade taxation by choosing not to disclose their foreign assets and using financial institutions that do not do business in the US and therefore do not care about the sanctions.

France has a more traditional tax system in the sense that it is residence based – the French citizen moving to another country does not have to pay taxes to France, nor do companies and other legal vehicles (read trusts) that are privately owned by a French resident but reside outside of France. France has not taken unilateral actions to demand foreign financial institutions to report the assets of French residents to French tax authorities (as the US has done with FATCA) but it participates in the Common Reporting Standard (CRS), a multilateral automatic information exchange platform established by the OECD.[208] Under this scheme, the financial institutions are required to report on their foreign account holders to their local tax authorities, who then exchange information about the foreign account holders with their respective home tax authorities. CRS includes wording about trusts, requiring the exchange of information on all controlling persons of a trust. This includes "the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust."[209]

In 2010, France introduced a requirement for all trusts having a connection point to France to disclose to the French tax authorities the creation, modification or termination of a trust, the trust deed, and the

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income in the US. Taxpayers receive foreign tax credits on taxes paid to their residency country, which can be used to offset taxes due to the US. See IRS, 2017a.

[206] IRS, 2016b.

[207] IRS, 2017b.

[208] OECD, 2017d.

[209] OECD, 2014, pp. 198-9.

market value of trust assets as of January 1st of the reporting year.[210] This means that if a French resident is either a settlor, trustee or a beneficiary in a trust, the trust must be registered at the French tax authorities. In addition, if the trust assets include any French real estate or stock, the trust must be disclosed to the authorities.[211] Disclosing a foreign trust to authorities does not mean that the trust would have to pay income tax to France – this is limited to the cases where the trust is subjected to a "privileged tax system".[212] If a French resident is deemed to own more than 10% of a legal entity that is situated in a jurisdiction having a "privileged tax system" the income by that entity is deemed to be direct income for the resident and taxed accordingly. According to the French authorities, there are not many "privileged tax systems" in the world as the list only includes Botswana, Brunei, Guatemala, Marshall Islands, Nauru, Niue and Panama (was included in the list after the Panama Papers scandal).[213] Although the French tax authorities do not tax the income of the foreign trust, the assets placed in such a trust are included in the calculations of wealth of the settlor for imposing wealth tax.[214] The requirement for disclosing trusts to tax authorities is a rather exceptional one among jurisdictions that do not have trusts in their domestic legislation. It is a novel approach and less exhaustive requirements for trust registration have only been discussed on the European level very recently.[215] Considering this, France seems to be particularly concerned about the possible threat offshore trusts pose for domestic fiscal policies.

6.2 *Avoiding Taxes with Trusts*

Tax avoidance refers to the actions taken by individuals and corporations to legally minimize the taxes they are due in their home jurisdictions. Sometimes these measures are said to be within the letter of the law, while going against the spirit of the law. Usually professional trust and estate planners (or wealth managers) use specific loopholes in the domestic legislation that cause a preferential tax treatment for the assets in question. Using these loopholes often requires setting up customised legal structures such as trusts either domestically or offshore. Most common taxes to be avoided are capital income tax and inheritance/estate tax. Avoiding the latter was one of the first novel uses for trusts after the Crusaders were over. This practice is still well alive, although it has become slightly more complex than what it used to be during the feudal ages.

[210] *Code général des impôts* - Article 1649 AB; LOI n° 2013-1117, 2013; Bochatay, Moreau, & Aubineau, 2012, p. 121.
[211] *Ibid.*
[212] *Code général des impôts* - Article 123 bis.
[213] Gouvernement, 2017.
[214] *Code général des impôts* - Article 885 G ter.
[215] Delivorias, 2017.

I will start by cases to avoid capital income taxes. Due to the US legislation, it is difficult to use trusts to decrease tax exposure but moving assets to an offshore trust can minimize a French taxpayer's tax bill. When considering the uses for avoiding inheritance/estate taxes, the situation becomes opposite. While there are several trust structures that are frequently used in the US to legally minimise federal estate taxes, if the settlor is a French resident upon their death, all trust assets are taxed at an exceptional rate of 60%.[216] Therefore, trust and estate planners advise to avoid the use of trusts if the settlor is living in France.[217]

6.2.1 Moving Assets Offshore

The classic way to avoid taxes in one's home country is to move the taxable asset to another jurisdiction with a more favourable tax regime. For example Bahamas, Bermuda and Cayman Islands are jurisdictions that do not levy any kind of income taxes. Assets can be moved with the assistance of an offshore trust service provider, who draws up a trust in their home jurisdiction and acts as its trustee. The original owner transfers the assets to the trust, after which the owner is not entitled to them anymore and the legal ownership is transferred to the trustee in the offshore location. The settlor can name whomever they want (usually the immediate family members, including themselves) as the beneficiaries of the trust. As most of the offshore trust jurisdictions do not impose capital income taxes, the returns from trust investments are tax free. It is important to note that the settlors do not create these structures themselves but use professional service providers. Moreover, the settlors are usually one step removed from these providers as it is the family lawyers and/or investment advisors who liaise between the offshore trust service providers and the customers. From the customer (settlor) point of view, using these services is like using normal private banking/wealth management services. Most of the time the ultimate goal of these arrangements is to transfer the assets to family members or other donees. They are in accordance with the original trust principles: The settlor has given up their assets to be held and managed by the trustee for the benefit of selected beneficiaries.

In the previous section, we learned that simply moving assets to another jurisdiction would not be an effective solution in the US, as it imposes taxes on worldwide income. All citizens and non-citizen residents have to file a form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, in conjunction with their tax filing if they are involved with a foreign trust.[218] This form requires the disclosure of all trusts that are settled directly or indirectly by a US citizen, or where a US citizen is

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[216] *Code général des impôts*, Article 792-0 bis.
[217] French Property, 2017b.
[218] IRS, 2016b.

a beneficiary. Failing to do so will result in a penalty up to 35% of the amount paid to the trust, regardless of whether the foreign trust had any beneficial tax consequences for the settlor.[219] The rules are comprehensive and cover all cases where a US citizen settles a trust anywhere in the world. In most cases, a foreign trust is deemed a "grantor trust", meaning the original settlor (of grantor in the North American context) is still considered the owner of the trust assets and all trust income is counted as the settlor's personal income for tax purposes.[220]

Most countries, including France, only tax their residents and changing the residency of the asset ownership can reduce taxes significantly. This can be done in a totally transparent manner as there is nothing illegal in doing so. The settlor can settle a trust for investment purposes, either transferring financial assets directly or money with instructions to purchase financial assets. The income from these investments accrues tax free and tax consequences only hit when the profits are transferred to beneficiaries. The reader might note that there is not much of a difference in the tax treatment of a normal, onshore investment account. However, trusts are more flexible in a sense that it is not necessary to transfer the profits to the beneficiaries directly. For example, the trustee could use the profits to buy real estate to the trust fund and let beneficiaries live in it. In this case beneficiaries would not have to pay income taxes, as profits do not leave the trust fund. Acquiring real estate through offshore trusts and companies is surprisingly easy in many countries (although most often it is better for the trustee to set up an offshore company through which to purchase real estate to the trust). A report by Transparency International (TI) found that the US is particularly weak in enforcing anti-money laundering legislation and anonymous foreign trusts and companies can buy real estate without any problems.[221] Another report from TI, done together with Thomson Reuters, showed that there are 23,653 offshore companies owning property in London alone, and in almost half the companies had not registered their basic details in the UK registries.[222] In other words, it is not possible to determine who is the real beneficial owner of these companies. The trustee could also make donations to an educational institution, which would consequently help in the beneficiaries' admittance to the given institution. These are only two examples of the endless variety of methods to transfer benefits to beneficiaries indirectly without tax consequences.

6.2.2 Dynastic Trusts

Because trusts are not legal entities but arrangements, they were not designed to exist in perpetuity: The rule against perpetuities (RAP)

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219 Internal Revenue Code §§ 6048; 6677(a).
220 IRS, 2014.
221 Martini, 2017.
222 Transparency International UK & Thomson Reuters, 2016.

mandated that there be a definitive resolution for a trust. In the UK, case law established that a trust can exist at most 21 years after the death of any of the trust parties.[223] The reasoning behind was to eliminate the possibility of creating a perpetual ownerless limbo, where the trust assets would remain forever out of reach of the beneficiaries' creditors. The courts also wanted to limit the 'dead hand' control of the settlor – with a perpetual trust they could dictate how the family fortune is used for decades or even centuries after they have passed away.[224] The traditional rule against perpetuities has not remained stagnant, though. The perpetuity period was first extended to 80 years in 1964 and again to 125 years in 2010 in the UK.[225] Many jurisdictions have gone even further: Most US states and several offshore jurisdictions have either abolished the rule in entirety or extended it to very long periods, such as 365 years in Nevada or 1,000 years in Alaska and Colorado.[226] Sitkoff and Schanzenbach argue that these changes in state legislation in the US were primarily driven by the change in the Federal Tax Code in 1986, which introduced generous exemptions to wealth transfer and estate taxes.[227] This is a compelling argument as only Idaho, Wisconsin and South Dakota had abolished the rule against perpetuities before 1986, but more than half of the states (led by Delaware) had abolished it by 2013. [228] In a relatively short period of time, the US states let go of the rule against perpetuities, and it became possible to settle dynastic trusts.

In addition to ensuring that the 'family dynasty' continues, dynastic trusts bring some estate tax benefits. Federal estate taxes concern only the wealthiest estates in the country. The exempted amount has grown steadily over the years, and in 2017 an individual could transfer up to $5.5 million ($11 million for married couples) without incurring gift or estate taxes. Due to the high exemption, only approximately 0.2% of estates pay federal estate taxes.[229] To make the most of this exemption, it is important for the settlor to settle a dynastic trust well before their death. The funds transferred to a trust should not exceed the limit of $5,5/$11 million at the time of the transfer but there is no limit to how much the assets can appreciate over time. The assets should not generate annual income, as the domestic trusts in the US are taxed heavily, as we learned earlier. Suitable assets include growth stock or real estate. For example, an entrepreneur could place shares of their privately held company to the trust before the business really takes off and is sold or publicly listed. As the valuation of private stock is difficult, their true market value could be many times what they were valued when transferred to the trust. The same strategy could be used with any kinds of trusts but dynastic

223 Hudson, 2016, pp. 214-8.
224 Sitkoff & Schanzenbach, 2005, p. 365.
225 Perpetuities and Accumulations Act, 2009, c 18, s 5; see also Hudson, 2016, pp. 186-8.
226 Shaftel, 2016.
227 Sitkoff & Schanzenbach, 2005, p. 373, 399.
228 Hofri-Winogradow, 2015, p. 23.
229 Huang & Cho, 2017.

trusts have one additional benefit. The settlor can determine that their descendants up to *n*th generation are beneficiaries to the trust. This way the trust fund does not have to exchange hands many times and incur gift or estate taxes at each occasion. With the rule against perpetuities repealed, there is no limit to how long the trust can continue benefiting the original settlor's descendants.

6.2.3 CLATs & GRATs

Dynastic trusts are not the only way to avoid inheritance taxes in the US. Charitable lead annuity trusts (CLATs) are set up for a relatively short period of 20 to 30 years at the death of the settlor. The assets placed in CLATs are meant for charity, so they do not incur estate taxes as long as all of the funds are distributed to charitable causes annually in fixed amounts.[230] The catch is that the amount which has to be distributed to charity is calculated at time of death and the IRS estimates this based on a formula tied to treasury bond yields.[231] For example, if the original fund is $100,000,000 and the benchmark appreciation rate based on bond yields is set at 1%, the trust must be designed to distribute $5,500,000 annually during its duration of 20 years to go tax free. However, if the return on investments made with the original fund exceed 1% p.a., the excess profits are added to the fund and the entire excess can be transferred to heirs tax free at the end of the trust period. If the real return would be 5,5% instead of 1% (a rather conservative estimate), the heirs would pocket the value of the original fund of $100,000,000 in total as the annual return would cover the calculated annual distributions. And at the same time, the estate gains philanthropic reputation by donating more than $100 million to a charity close to their heart (or that employs family members as special consultants), or to a prestigious university that is sure to accept young family members.[232]

Another similar structure is a grantor retained annuity trust (GRAT). It is otherwise like a CLAT but instead of making annual payments to a charity, it makes them back to the settlor. The settlor settles a trust and creates it in a way that it will transfer the funds plus interest according to the IRS formula back during the existence of the trust. If the real rate of return exceeds that, all proceeds go to selected beneficiaries tax free. Tax planners describe it as "heads I win, tails we tie" arrangement, and it was declared legitimate in a US Tax Court case in 2000.[233] Note that all GRAT income is deemed personal income of the settlor and therefore subject to personal income taxes. Both GRATs and CLATs are predominantly used by the super-rich, as you need a sizable fortune to create real tax benefits. Both types have been used by the Walton family (Wal-Mart owners), while the Coors family and the Nike

[230] IRS, 2015, section 4.76.5.4.2.1.

[231] Internal Revenue Code Section 2702(a)(2)(B) and 2702(b).

[232] Mider, 2013.

[233] *Audrey J. Walton vs. Commissioner of Internal Revenue*, 2000.

founder Philip H. Knight have been using GRATs. The CLATs were also used by the estate of Jacqueline Kennedy Onassis, which explains why they are sometimes called "Jackie O." trusts.[234]

Trust structures for avoiding inheritance taxes are not only used in the US. One prominent case from the UK is the family wealth of Duke of Westminster. When the previous Duke of Westminster passed away in 2016, his personal net worth was estimated at £9bn. The Duke was survived by his 25-year-old son but although the UK inheritance tax is set at 40%, the new Duke of Westminster will not face a tax bill of billions of pounds as the assets have been transferred to a series of discretionary trusts a long time ago, which are run for the "benefit of current and future members of the Grosvenor family".[235] Naturally the trusts are not devoid of any tax consequence but the tax levels are considerably lower. According to the UK tax code, trusts are required to pay a periodic tax amounting to 6% of the total trust assets every ten years. However, there are a lot of possibilities to apply for tax reliefs. In the case of the Duke of Westminster, most of the assets are eligible for reliefs, driving the tax rate down from 6%.[236]

6.2.4 STAR trusts

STAR trusts are the Cayman Islands' contribution to offshore trust structures. The name comes from the original statute, the Special Trusts (Alternative Regime) Law 1997. STAR trusts differ from traditional trusts in one key way – these trusts break the trust triangle and the rule of the three certainties as they do not require clearly defined beneficiaries. At first sight you could argue that these structures have nothing to do with trusts, as some commentators do.[237] The opposing view is that the structure is still valid as STAR trusts have an additional party added to the arrangement, an *enforcer*.[238] The person (or company) in this role has the right to hold the trustee accountable for their actions, in other words to enforce the trust. In a traditional trust structure the beneficiaries have this right. The enforcer does not hold the equitable rights to the trust assets, which means that STAR trusts enable ownership structures where no one is the beneficial owner to the assets.[239] STAR trusts can also exist in perpetuity, unlike normal Cayman trusts that have a perpetuities period of 150 years.[240] These trusts were created to attract foreign capital and to increase trust service providers' business in the Caymans: STAR trusts can only exist if at least one of the trustees is a designated and registered trustee company from the Caymans.

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[234] Mider, 2013.
[235] Grosvenor Group, 2017.
[236] Garside, 2016.
[237] Hudson, 2016, p. 920.
[238] Duckworth, 2013, pp. 217-8.
[239] Hofri-Winogradow, 2015, p. 9.
[240] *Perpetuities Law § 4 paragraph 109*, 1995 (Cayman Islands).

The Caymans have also ring-fenced their own tax revenue, as it is not possible to hold real estate in the Islands through STAR trusts.[241]

STAR trusts can be useful in avoiding taxes in both the US and France. For American tax avoiders, STAR trusts can be used the same way as any other dynastic trust as they can exist in perpetuity. STAR trusts bring even more flexibility as it is not necessary to specify which descendants are beneficiaries for the trust – they can be created to benefit the well-being of the family or some other similar cause. The enforcer has comprehensive powers to order the trustee to distribute trust assets to anyone as long as it can be regarded as benefitting the original purpose. In addition, as the US taxpayers who could be receiving benefits from the STAR trust are not named parties to it, they do not have to disclose it to the IRS.

If French taxpayers want to avoid registering a trust where they are a party, using a structure involving a STAR trust can help. When a French resident is listed as a beneficiary in a trust, they need to disclose this to the French tax authorities. As STAR trusts do not necessarily have any names of beneficiaries listed, technically the registration requirement would not be triggered even if a French resident would receive payments from a STAR trust. In situations where a French resident wants to settle a trust, it becomes more complicated. One option is to create an offshore company that holds their investment assets. They can then proceed to add as many layers of companies and foundations as they want, as long as the last entity settles a STAR trust which has a Cayman trustee service provider as the trustee, someone close to the French taxpayer as an enforcer (the tax authorities only mention settlors, trustees and beneficiaries in the registration requirements, which means that there is no obstacle for having a French resident named as the enforcer) and no listed beneficiaries. If the trust assets do not include any French real estate or stock, in the French tax authority's eyes there is no disclosure requirement as it will not have any connection points to France. The French resident has moved their assets to another jurisdiction that does not have income taxes but still continues to enjoy the trust assets tax free while living in France.

The Cayman Island's STAR trusts have proven to be very successful, and have been used without major problems for 20 years and are frequently advertised as one of the most innovative and flexible ways to manage wealth.[242] The Cayman legislation takes a less aggressive stance on onshore creditors than some other offshore trust jurisdictions (such as the Cook Islands), which could explain why the regime has not been seriously challenged by foreign governments.[243] STAR trusts are not only used in

[241] Hayton, 2012, p. 14.

[242] See for example STEP Cayman Islands, 2015, pp. 3, 11.

[243] The Cayman courts are willing to recognise fraudulent transfers and their statute of limitations is six years, much longer than that of 1-2 years in some other jurisdictions *Fraudulent Dispositions Law*, 1989 (Cayman Islands).

personal wealth management but they are one of financial institutions' favourite tools for creating 'orphan' special purpose vehicles (SPVs).[244]

6.2.5 VISTA trusts

VISTA trusts were created to provide a solution to a specific problem posed by transferring a significant portion of family business shares to a trust. In this scenario, the trustee would suddenly have a significant voting power of even direct control over the business. In a traditional trust, it is the trustee's duty to take decisions in the best interests of the beneficiaries in a prudent manner. In some instances, this could include preventing the business from engaging in a risky venture or even selling the shares if there is a good offer on the table. Enter novel legislation in the British Virgin Islands and the Virgin Islands Special Trusts Act (VISTA) of 2003. A VISTA trust can only have BVI company shares in its trust fund, but the company owned by the trust can own everything from shares of other companies to real estate and deposits. The legislation guarantees that the VISTA trustee will not have power in the management of the BVI company although on paper the trustee is its legal owner. Using this structure, an entrepreneur anywhere in the world can transfer the ownership of their business to a VISTA trust and avoid domestic taxation on dividends, capital gains or eventual inheritance. All this while still retaining full control over the business and its management.[245]

VISTA aims to give a solid legal vehicle for managing family business succession with minimal tax impact. Although this might sound like a small niche when considering the broader picture of inequality, these situations can involve a lot of money and therefore a lot of potential tax revenue. A case from the Tax Court of Canada shows how a family business had first grown to a $50 million enterprise by 1998, at which point the ownership was restructured using a trust settled in Barbados, and by the time the original owners sold the business, its value had risen to $500 million. In 1998, the entire stock of shares was exchanged for preferred shares at fixed value of $50 million and new common shares. Initially, the common shares were not valuable as the preferred shares covered the value of the business. But these growth shares would increase in value when the value of the business would exceed $50 million. The new common shares were placed in two Canadian holding companies whose shares were owned by two trusts settled in Barbados with a Barbados corporation as a trustee. When the business was sold, the shares owned by the two Barbados trusts were worth approximately $450 million. The original business owners argued that as the trusts were resident in Barbados, they would have to pay capital gains taxes to Barbados instead of Canada. Conveniently, Barbados does not impose

[244] Gorton & Souleles, 2004, p. 555.

[245] Appleby Global, 2016.

capital gains tax. Although the scheme looked nice on paper, the Canadian tax authority successfully challenged it based on a combination of reasons. Firstly, both trusts had enforcers who had power to replace the trustee, and the business owners had powers to replace the enforcers. The owners thus had indirect power to remove the trustee. Secondly, the trust documents indicated that the trustees would always defer to the original owner in trust transactions. Thirdly, the trustee in Barbados was a corporation owned by an accountancy firm and was not specialised in providing trustee services. Fourthly, the trustee adhered to investment advice of the original owners' advisors who were resident in Canada. The court ruled that the trusts were resident in Canada as their true management was done from Canada, and thereby obliged to pay taxes on all capital gains from the sale of the business.[246]

By using a VISTA trust, the original owners could have saved the capital gains tax, as the trustee of a VISTA can only be a dedicated trust service provider resident and licensed in BVI. Also, the original owners would not have had to create trust deeds that would give them the effective power over the trust. In a VISTA arrangement, the trustees have power over the trust (and the company shares) but the settlor retains power over the company (and its assets) held in the trust. Considering this, the court would have had harder time to show that the trust is managed from Canada and thereby a Canadian resident. Unfortunately, there is not a similar case where a VISTA was used so it is impossible to say with certainty whether VISTA would help avoid capital gains taxes in these cases. VISTA trusts have existed now for 13 years and BVI trust service providers state they are frequently and successfully used for managing family business ownership.[247]

6.3 *Evading Taxes with Trusts*

Tax avoidance is not the only game in town, and those who are willing can veer on the side of tax evasion. Unlike with avoidance, there is no question whether these activities are legal. Tax evaders have intentionally misled tax authorities not to pay taxes or to underpay them. In the US, evading taxes is a felony and will most likely lead to criminal charges, and other countries do not take it any more lightly.[248] Evasion is about hiding, and trusts are excellent tools for making ownership disappear. The key is to hide your assets as well as possible, using legal structures as complicated as possible. It is worth noting that the ultimate aim is not necessarily to transfer the assets to someone else: On paper, it looks like you have given away your assets but in reality you still have 100% control over their use and a ready access to them. Obfuscating ownership is also a safeguard against tax

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[246] *Garron Family Trust v. The Queen*, 2009.
[247] O'Neal Webster, 2014.
[248] IRS, 2016c.

evasion charges, as it becomes more difficult to establish whether you have violated disclosure rules or acted wilfully or not.

Setting up such structures requires expertise, which is aptly provided by estate planners, offshore trust service providers and lawyers. The Panama Papers leak evidenced how only one legal firm based in Panama had created more than 214,000 offshore companies, trusts and foundations for their customers all over the world.[249] Furthermore, the leaks confirmed that most of the time the offshore structures include several layers of different legal vehicles. In other words, offshore companies and trusts are used together to create a chain of ownership that is next to impossible to follow to the real beneficial owner. Although the extent of the offshore world came as a surprise for some, its problematic existence has been acknowledged for years. In a hallmark study made for the World Bank, a group of academics reviewed 150 corruption cases and the ways in which the wrongdoers could access their ill-gotten gains. Anonymous companies where used most frequently but the authors made an important remark on trusts:

> "Investigators interviewed as part of this study argued that the grand corruption investigations in our database failed to capture the true extent to which trusts are used. Trusts, they said, prove such a hurdle to investigation, prosecution (or civil judgment), and asset recovery that they are seldom prioritized in corruption investigations."[250]

6.3.1 Failure to Disclose

The essence of tax evasion is not to let the tax authorities know that you have income or assets that should be taxed. In many cases authorities have established automatic information sharing systems, where for example employers and domestic financial institutions automatically disclose taxable events to tax authorities without any action needed by the taxpayer. To avoid these automatic systems, a tax evader must distance themselves from the assets they own. Common way to achieve this is to use legal structures such as companies and trusts. In a jurisdiction with domestic trust legislation, the evader does not even have to use offshore services but in most cases they want to take distance from their home jurisdiction to make the discovery of the structure less likely. Using an offshore trust service provider is easy and they are very accessible – a brief internet search shows an abundance of mass-marketed offshore trust structures.[251] If the evader feels uneasy about dealing with service providers on the other side of the world through internet, there are plenty of reputable trust and estate planners located closer to home: The Society of Trust and Estate Practitioners (STEP) has 20,000

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[249] ICIJ, 2016.
[250] van der Does de Willebois, Halter, Harrison, Park, & Sharman, 2011, pp. 33, 45.
[251] Offshore Company, 2017; PT Shamrock, 2017a; OCRA Worldwide, 2017; CCP Offshore Services, 2017; Price Bailey Wealth Solutions 2017.

members across 95 countries.[252] Naturally not all STEP members are willing to assist in tax fraud but as a recent exposé by Global Witness demonstrates, even the most respectable lawyers are often willing to turn a blind eye to make a new profitable client.[253]

By moving assets to an offshore trust and not disclosing its existence, it is possible to evade income and estate taxation in the US. In France, the income from the trust assets is only taxed when it is transferred to the beneficiaries. However, it is the responsibility of the beneficiary to disclose these transfers to tax authorities and they can choose not to. On top of this, they can evade inheritance taxes if authorities do not detect the trust upon the death of the settlor. When assets are hidden in offshore trusts, the net worth of the settlor decreases in the eyes of the tax authorities, thereby reducing their exposure to the French wealth tax. In the following section, I will represent a mechanical example of how trusts are used in hiding wealth. Finally, I will proceed to make some brief remarks about yet another special form of trusts, called asset protection trusts.

6.3.2 Mechanical Example

Until now we have discussed the possibilities for using trusts to evade taxes but not how this works in practice. Creating offshore structures to avoid and evade taxation is, well, creative. In this section I will explain the mechanics on how an individual manages to move their money offshore using trusts, making it look like they do not own them anymore while at the same time having full access to them wherever they live.

You could think that entering the intricate world of offshore would be a difficult task. However, to find a way to get there you go to the usual starting point: Google.com. A quick search reveals several offshore service providers' mass-marketed schemes. For example, one provider quotes $1,500 for establishing a trust in Nevis and acting as a trustee for a year.[254] Another provider has a 'menu' of trustees whose annual pay depends on their home jurisdictions, anything between $1,200-$2,200.[255] Settling a Cook Islands trust is a bit pricier, $4,960 for the first year and annual fees thereafter of $3,960.[256] These examples showcase the entry level of offshore – when the stakes get higher, the process goes through trusted family lawyers and investment advisors. But for those who value a more DIY approach, it is possible to have

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[252] STEP, 2017a.

[253] Kroft, 2016. A Global Witness investigator went undercover, posing as a representative of a corrupt leader (and making it evident) and visited 13 New York law firms asking for help to bring shady assets to the US to be reinvested. 12 out of 13 law firms were ready to assist in this process, including James Silkenat, the President of the American Bar Association at the time.

[254] CCP Offshore Services, 2017.

[255] OCRA Worldwide , 2017.

[256] PT Shamrock, 2017b.

a trust in the Cook Islands, Nevis or some other exotic jurisdiction running in no time.

Moving the assets from under the curious eyes of tax authorities is only the first step – a tax evader wants to keep enjoying from the assets and possibly wants to have ready access to them at all times. This can be achieved by opening an offshore bank account. Note that the account does not have the settlor's name in any of its paperwork. The trustee holds the account in their name, or alternatively the trust fund includes an offshore company that has a bank account. Again, the offshore company has no links to the settlor, as both the owners and directors are dummies catered by the offshore service provider. This is a practice that has been in use for at least 70 years.[257] Naturally, setting up an offshore company is an additional cost but typically the service providers recommend opening one or more to create more links to the ownership chain.[258] US tax evaders do not even have to go offshore to open an anonymous company as the US is one of the easiest jurisdictions for creating one. In fact, in many states it is harder to get a library card than to set up a company.[259]

After the bank account is up and running, there are two common methods to access the funds deposited there. The more straightforward one is to grant the settlor the power of attorney for full access to the offshore company's assets, and get a credit card connected to the bank account. The card is either in the name of the offshore company, or it is also possible to get totally anonymous credit cards (there are no names on it, just the card number).[260] Now the settlor (and other beneficiaries if so wanted) can simply use the credit card to make their purchases or withdraw money from an ATM. Opening an anonymous bank account is an additional cost between $1,200-$3,600.[261] In Cook Islands the more expensive trust creation is offset to some degree by lower fees for opening a local bank account, $700.[262] The bank account does not have to be in the same jurisdiction as the trust, and it provides a possibility to add an additional layer of secrecy to the structure.

The second way is to use the offshore company owned by the trust to draw up dummy loans to the onshore settlor. The loan can work as a two-way street, if so desired. The settlor can set the terms and either not pay the loans back or create an extremely long payment schedule with low interest. Alternatively, in case they have additional funds they want to move

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[257] van der Does de Willebois, Halter, Harrison, Park, & Sharman, 2011, p. 12.
[258] IRS, 2016d.
[259] Ioannides, 2017, p.6; The following video shows how creating an anonymous company for a *cat* takes only five minutes in Delaware: Del Toro, 2016.
[260] PrivacyWorld, 2017.
[261] OCRA Worldwide , 2017.
[262] PT Shamrock, 2017b.

offshore, they can set very unfavourable terms for the loans and transfer funds discreetly to the offshore trust.[263]

Trusts being the most flexible wealth management tool, it is not limited to holding cash deposits. A trust can contain anything from financial instruments to art, real estate, cars and yachts. Having the funds lie on an offshore bank account does not create good rates of return. Settling the trust (or a company owned by a trust) in a jurisdiction that does not levy income taxes and using the fund to purchase equity and fixed income assets ensures the biggest tax benefits.[264] Another classic move is to transfer physical assets such as real estate to an offshore trust. Although there might not be substantial tax benefits involved, this is a safety mechanism for the tax evader: In case they are tangled up in lawsuits (brought upon by tax authorities or other creditors), these assets cannot be seized. Additionally, renting a house or leasing a car or yacht from an offshore trust provides another way to transfer funds offshore besides loan repayments.

A recent divorce case from a Florida court revealed what kind of a web of offshore ownership one Finnish-born multi-millionaire had set up for his fortune. Having success in business endeavours with his wife, they had amassed a vast fortune. However, some of their businesses used shady practices and they were frequently under investigation from customer protection agencies. On top of that, the couple had estranged and the husband now wanted to protect the fortune from American tax authorities, lawsuits, creditors and his wife. His team of lawyers used all the tricks described above, transferring assets to offshore trusts. In the court proceedings it was revealed that they had settled separate Cook Islands trusts for his penthouse, yacht and even a helicopter.[265] As a business owner, there were a couple of other ways to move money offshore. These were inspired from multinational companies' tax avoidance practices and involved profit shifting through transfer pricing. Two separate strategies were used: First, the onshore businesses sold their intellectual property rights to offshore structures solely owned by the husband for a pittance and then started to pay royalties for using them in future. Second, other offshore structures were created (again solely owned by the husband), and the onshore companies (owned by the both of them) paid these new structures significant sums for 'management consulting services'. This example demonstrates that there are no limits to the creativity and methods used for moving assets offshore. On top of strategies that are available for everyone, a privately held business (preferably turning a profit) gives even more

[263] IRS, 2016d.

[264] Note that there is a 30% withholding tax on US source income for foreigners (Internal Revenue Code § 871 a.1) and France imposes withholding tax (21-24%) on interest and dividends at source (French Property, 2017a), so it is not possible to evade all capital income taxes on domestic investments by simply changing the residence of the investor.

[265] Confessore, 2016.

complexity and flexibility to the design. This increases the chances of tax evaders getting away with their loot. The following section gives a bit more detail about one of the safety methods at their disposal, if things start getting wrong in their home jurisdictions.

6.3.3 *Asset Protection Trusts*

All trusts are essentially created for asset protection, beginning from the original uses for protecting knights' estates during their Crusades. Asset Protection Trusts (APTs) take this to a new level, though. Whereas during the Middle Ages it was not possible for the knight to remain in control of his estate while traveling far away, the central feature of asset protection trusts is that the settlor continues to remain in control of the trust assets throughout the existence of the trust. They are also called self-settled trusts, as the same individual is both the settlor and the beneficiary. It is possible that the settlor is one of the beneficiaries in a traditional trust as long as creditors can access the settlor's beneficial interest. It is not possible, however, to settle a trust where the settlor is the sole beneficiary. Courts in onshore jurisdictions offer some protection from abusive use of trusts: The courts can examine the structure of the domestic trust and assess whether the settlor remains in control of the trust assets. For example, if the trust is deemed self-settled, they are considered fraudulent and invalidated.[266] Similarly, a trust can be invalidated if the settlor had settled the trust shortly prior the settlor became indebted, even if they would not include themselves as one of the beneficiaries.[267]

Although they are traditionally admonished, several jurisdictions have introduced APTs into their legislation since the 1980s. These legislations have three main features: 1) validating self-settled trusts, 2) weakening measures to claim fraudulent transfers, and 3) neglecting foreign judgements against the trust or at least making legal action against the trust cumbersome.[268] The first two makes it possible for the foreign settlor to establish trust structures that are not available onshore, nor for the citizens of the offshore jurisdiction. The third makes it very difficult if not impossible to force the settlor to tap into their assets held in an offshore trust, as the settlor's domestic courts do not have jurisdiction over it.

The Cook Islands, a group of islands on the Pacific that gained (partial) independence from New Zealand in 1965, was the first one to introduce such a regime with the International Trusts Act in 1984.[269] As the name suggests, the aim of the Act was to attract foreign investment and the novel trust

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266 IRS, 2016e.
267 Sterk, 2000, pp. 1043-7.
268 *Ibid.*, p. 1050.
269 International Trusts Act (Cook Islands), 1984.

vehicles are not available to Cook Islanders.[270] Similar legislations were passed in short succession in the Bahamas, Belize, Nevis and Anguilla.[271] Asset Protection Trusts are not only offered in these 'exotic' jurisdictions – several US states followed suit, led by Alaska, Delaware and Nevada. States having Asset Protection trusts usually have ring-fencing features included – creditors from their own state can access funds in such trusts while the out-of-state creditors are left out cold.[272] This is a domestic version of one of the most popular offshore trust jurisdiction strategies.

Asset protection trusts have been especially popular in the US, perhaps because the country's legal system is known to foster litigation.[273] In fact, there are twice as many law suits filed in the US compared to France, and five times as many lawyers.[274] Other practitioners of law have not failed to see the business opportunity here, and advertise asset protection trusts as the way to guard yourself from unwarranted litigation. But the fear of litigation is not the only reason to settle asset protection trusts. As a part of their advertising, many trust service providers warn future customers about the dangers of creditors, "over" taxation and claims by divorcing spouses.[275] The stated benefits of using asset protection trusts are two-fold: When assets are hidden in a trust, the prospective litigators cannot establish how wealthy the individual really is, which might dampen their eagerness to sue. Secondly, even if the plaintiff would be successful, assets placed in a trust would stay out of reach of the claimants.[276] There is some evidence that asset protection trusts are frequently used by medical practitioners in the US to protect their wealth against malpractice lawsuits.[277] If the settlor (through the trustee or themselves) discloses information about such trusts to the IRS and pays potential taxes, there is no harm done from the point of view of tax law.

Although Americans can resort to domestic asset protection trusts, there are some advantages to using offshore jurisdictions. First, it is difficult to find proof of existence of domestic trusts but it is even more difficult for trusts settled on the other side of the world. Second, the litigation costs increase when assets are situated offshore. For example in the Cook Islands, the domestic courts do not recognise foreign judgements, and any claim on assets held in a Cook Islands trust has to be hand-delivered to a judge in the

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[270] The Act was later revised in 1989 to include further asset protection measures. At that point one of the co-authors was a Denver based lawyer specialised in asset protection for wealthy clients. See Wayne, 2013 and *International Trusts Act*, 2nd Amendment (Cook Islands), 1989.

[271] *Trusts Act* 1992 (Belize), ss7(6), 12(4); *Fraudulent Dispositions Act*, 1991 (Bahamas), No 1 of 1991; *Trusts Ordinance* 1994 and *Fraudulent Dispositions Ordinance* 1994 (Anguilla). See also Hofri-Winogradow, 2015, p. 26.

[272] Hofri-Winogradow, 2015, pp. 26-7.

[273] Wayne, 2013.

[274] Ramseyer & Rasmusen, 2010, p. 6.

[275] See e.g., PT Shamrock, 2017a; Offshore Company, 2017.

[276] See e.g. this website of a law firms that has specialised in asset protection for physicians and other "high risk business owners": Mintz, 2017.

[277] Sitkoff & Schanzenbach, 2005, p. 384.

Cook Islands.[278] Nevis, that basically copied the Cook Islands legislation in 2015, provides the same protection.[279] Often the creditors give up at this point as it is more expensive to fly lawyers to the Pacific islands than what they could hope to receive in the litigation process.[280] Third, offshore provides stronger walls of secrecy. If asset protection trusts are used for evading taxes, the domestic asset protection trusts become undesirable as it is easier for the tax authorities to detect them: In most cases the state legislation requires using licensed trust service providers for establishing asset protection trusts. These providers would presumably act according to the tax laws and file tax returns for the trusts they administer in order not to lose their licenses. Even though some asset protection trust jurisdictions have similar registration requirements, they would not disclose this information to foreign tax authorities.

Offshore trust service providers advertise the Cook Islands, Nevis and Belize having the most suitable legislation for asset protection.[281] One of the main selling points used by Cook Islands service providers is that the tiny island has twice successfully prevented the US government from accessing funds placed in Cook Island asset protection trusts.[282] The Cook Islands financial supervisor authorities provide good information on their reports and on their website: There are only seven trustee companies that can establish an international trust in the Cooks, and they have to register all trusts to the financial authorities. [283] In 2015, the latest year figures are available, there were 2,373 international trusts registered in the Cook Islands.[284] The International Consortium of Investigative Journalists, the same outfit that published the Panama Papers leaks, revealed how several individuals have successfully used Cook Island trusts to protect assets they earned in an unlawful manner in the US.[285]

To sum up, there are various ways in which trusts can be used to either avoid or evade taxation in home jurisdiction. Although trust jurisdictions such as the US can have domestic trusts to achieve some of the tax advantages, offshore trusts are better suited for illegal activities that are meant to be hidden. Firstly, offshore trusts are extremely difficult to detect, as they might not require any registration and even if they did the offshore jurisdiction would not share information about them to other jurisdictions. Secondly, asset protection trusts fill the role of the last line of defence for the

[278] *International Trust Act* (Cook Islands), 1984, §§ 6.2.c; 13 B.1; B.3, C, D, E, F and I; and 20; as cited in Knobel, 2017, p. 38.
[279] *International Exempt Trust Ordinance* (Nevis), 1994, §§ 5, 6, 9, 13, 24, 28, 29 and 47; as cited in Knobel, 2017, p. 38.
[280] Wayne, 2013.
[281] Offshore Company, 2017.
[282] Rosen, 2013.
[283] Financial Supervisory Committee of the Cook Islands, 2017.
[284] Financial Supervisory Committee of the Cook Islands, 2016, p. 9.
[285] Higham, Hudson, & Walker Guevara, 2013.

settlor's assets in case their offshore operations come to light and creditors (including tax authorities) start demanding a seizure of the settlor's assets through legal means. This chapter was about *how*, the next one is about *who* and *how much*: *Chapter 7* discusses the trust users and planners, and what is the extent of the trust use for hiding wealth.

7 Trust Users

The final chapter of analysis focuses on what we know about trust users and to what extent they are used. Trust users include all parties to a trust, the settlors, beneficiaries, as well as trust planners who either act as the trustee or just aid in setting the trust up and provide the settlor with an external trustee. As there are no numbers about trusts and the funds they hold, I will discuss some estimates about the offshore financial system in general for an indication to the extent of offshore trust use.

7.1 Who Uses Trusts?

One way to assess trusts' inequality impact is to look at who is actually using them. Are they widely used or do they provide a suitable legal vehicle for only a niche audience? From a historical point of view, trusts were created for the needs of English freeholders – a tiny but wealthy minority in the country. Naturally, there would not have been much use for a wealth management instrument if there was no wealth to manage, but there were also other obstacles for using trusts in the early days. The only court of equity (the court to hear trust cases, see *Chapter 2*) during the first centuries was the King's audience. To legally protect your trust, you needed to have access to the King which of course was not the case for the vast majority of subjects. After the Court of Chancery was established in the 14th century to rule on equity cases, accessibility was still an issue – it took time and money to get a case in front of the Court of Chancery.[286] As Dicey, quoted by Hudson, put it: "[T]he daughters of the rich enjoyed for the most part the consideration and protection of equity; the daughters of the poor suffered under the severity and injustice of the common law."[287] Trusts were not designed to be used by everybody, although in theory they were accessible for all citizens.

Today there is no need for royalties' attention for fully using trusts but the usage has not spread that much wider. In the cradle of trusts, the UK, there were approximately 150,000 domestic registered trusts in 2014-15.[288] Unsurprisingly, there are even fewer trusts registered to the French authorities. In 2016, the French government stated there are 16,000 entities recognised as trusts with a French connection point.[289] Trusts are more common in the US, where the IRS reported that 2,9 million domestic trusts filed a tax return for tax year 2009.[290] The number of domestic trust has doubled since the mid 1970s, presumably due to changes in the Tax Code in 1980s discussed in *Chapter 6*. According to the most recently published

[286] Hudson, 2016, p. 14.
[287] *Ibid.*, p. 61.
[288] HM Revenue and Customs, 2017, p. 19. Note that only trusts with domestic tax consequences are required to register to the HMRC.
[289] Gouvernement, 2016; Borenstein, 2016, p. 1137.
[290] IRS, 2016f.

Survey of Consumer Finances, 4,3% of the responding households reported having a trust or other kind of managed investment account.[291] Even if the registered use of trust is more frequent in the US than France or the UK, it is still not possible to say that the average Joe and Jane would have one. It is critical to note that these numbers only include registered trusts. When offshore trusts are used for tax evasion purposes, the point is not to disclose any information about them to tax authorities. Therefore, it is impossible to know how many American or French citizens are parties to a trust but do not want the tax authorities to know it.

As mentioned above, to use trusts, one needs to have something to put in them. In the previous chapter, we learned that for tax avoidance and evasion purposes, the best sorts of assets to place in a trust are financial assets: They are intangible and can be moved across borders effortlessly. Moreover, using a trust for investment management does not differ much from normal investment banking from a customer point of view, which could also indicate that trust funds mainly consist of financial assets. In the US, this assumption is supported by survey data: In 2013, 88,5% of trusts include financial assets. For comparison, only 11% contained real estate.[292] Considering this, the best place to search for potential trust users is among the people who own financial assets. As discussed in detail in *Chapter 3*, their ownership is very unequal both in the US and France. In the US, the wealthiest 10% own 91.5% of all equities and 90% of fixed income assets (including cash deposits).[293] In France, the wealthiest 10% owns 82.5% of all financial assets excluding cash deposits.[294] By the law of probability, (offshore) trust users are easier found at the top of the wealth spectrum.

Another reason for small numbers of trust users are the costs involved. Earlier we learned that the annual costs for even the cheapest offshore trusts runs in thousands of dollars. When the structures become more complex, this figure rises significantly. Therefore, the cost of using trusts to avoid taxation quickly becomes prohibitive for those who earn less than tens of thousands of dollars or euros in capital income per year. Usually the established offshore trust service providers target only High Net Worth Individuals ($1 million in investable assets) or Ultra-High Net Worth Individuals ($100 million in investable assets).[295] There are no limits to how much the wealth management services can cost for the ultra-rich. The Finnish-born millionaire mentioned in *Chapter 6* was allegedly using hundreds of thousands of dollars per month to hide his wealth offshore. In most likelihood, the price was appreciated due to the legal fees connected to

[291] Bricker et al., 2014, p. 33.

[292] *Ibid.*

[293] Tables B7 and B11 in the Online Appendix for Saez & Zucman, 2016

[294] Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2016.

[295] See e.g. Grasby & Bodden, 2016, the pieces of advertisement in the same publication are also illustrative, as one requires a minimum of $10 million commitment to offer wealth management services.

the ongoing divorce battle as well as his wish to create such a complex legal structure that would make him practically untouchable by Florida or US courts.[296] For another illustration for the cost of wealth management, in a job advertisement quoted by Harrington, an "Ultra-Ultra High Net Worth Individual" was looking for an experienced wealth planner who would lead the individual's private wealth management team. A suitable candidate would be compensated up to $350,000 per year.[297]

Merely having better possibilities to use offshore service providers and trusts to avoid and evade taxation does not mean that wealthier citizens would be more prone to do that. However, a recent study using a combination of two offshore data leaks and data from tax authorities' random audits and tax amnesty schemes established that tax evasion rises sharply with wealth. [298] The study used data from Denmark, Norway and Sweden and found that the 0,01% richest households evade about 30% of their personal taxes by hiding wealth offshore, while the average tax evasion rate is 2% for the whole population.[299] The ease of moving assets offshore and the low probability of getting caught was singled as the main reason why financial institutions would offer these services to their rich clients, even though the institutions knew it would violate some of their clients' disclosure requirements.[300] This is an important finding as it would implicate that the rise in tax evasion at the top of the wealth spectrum is not driven by demand but supply.

7.2 Trust & Estate Planners

The profession of trust and estate planners (or wealth managers, I use the terms interchangeably) is a relatively new one. In fact, the term covers professionals from different fields, including lawyers, accountants, tax specialists and financial advisors, who are working on private wealth management industry. The group's only professional body, the Society of Trust and Estate Practitioners (STEP), was established in 1991 in the UK. The group quickly branched out to the rest of the UK, Switzerland and the Crown Dependencies, and then to Europe, North America and the Caribbean. Today STEP spans 95 countries with more than 20,000 members.[301] Managing wealth is not an easy task, and the trust and estate planners must be well acquainted with legislation, tax rules, accounting practices, and investment opportunities in several countries. Therefore, a trust and estate planner usually employs a team of advisors and the planner's role is to act

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[296] Confessore, 2016.
[297] Harrington, 2012, p. 831. The ad did not specify what was meant by Ultra-Ultra High Net Worth Individual.
[298] Alstadsæter, Johannesen, & Zucman, 2017.
[299] *Ibid.*, p. 25
[300] *Ibid.*, pp. 18-21.
[301] STEP, 2017a.

based on the advice received from them. The relationship between a trust user and their estate planner tends to be deeper than a normal business relationship. On top of relying on the planner's advice and recommendations, the planner can have the legal title to large parts of the client's fortune by acting as the trustee. According to one study, trust and estate planners often serve a family for more than one generation.[302] Sometimes they do not see themselves as managing a single client's wealth so much as maintaining and protecting the whole family dynasty.[303]

As a professional body comprising mostly of lawyers, STEP does not advocate for breaking the law, including tax evasion. However, the group's attitude towards taxation is not thoroughly warm-hearted, as this quote from a STEP text book on accounting indicates: "Onerously high, some may say unethical, tax demands to finance generous government spending clearly act as a chill upon the entrepreneur as a creator of wealth".[304] On the other hand, uttermost client confidentiality is regarded as one of the key virtues of trust and estate planners.[305] Consequently, it is not unethical to avoid the taxes to the extent possible by the letter of the law. Finding and using these loopholes is the core business for trust and estate planners, but they have not only passively stood by when new changes to the law have been debated. Palan et al. go as far as saying that "as far as we can tell, they [trust and estate planners] were present at each and every legislative innovation designed to avoid tax and regulation''.[306]

Trust and estate planners and other financial intermediaries have been flying under the radar for a long time. Although a Massachusetts court decision acknowledged trustees as a professional class already in 1830, they did not organise as a professional body until 160 years later.[307] After STEP was established, it has grown steadily by approximately 1000 new members each year. Along with the numbers and resources, the group's influence has grown too. It was pivotal in fending off the first coordinated international efforts to blacklist tax havens (a concept which included offshore trust centres) at the turn of the millennium.[308] Only due to the recent offshore leaks, such as the Swiss leaks and the Panama Papers, has the profession come under increased scrutiny. Although several actors, such as the European Parliament, NGOs and academics have started to make noise about their role in the offshore financial system, it remains to be seen how effective the proposed legislative measures are in curtailing the most aggressive tax avoidance schemes trust and estate planners sell for their clients. Until now these have been based on the principle of establishing

[302] Marcus & Hall, 1992.
[303] Harrington, 2012, pp. 834-4.
[304] Parkinson & Jones, 2008, p. 267, as quoted in Harrington, 2012, p. 839.
[305] Harrington, 2012, p. 827.
[306] Palan, Muprhy, & Chavagneux, 2010, p. 12.
[307] *Harvard College v. Amory*, 1830.
[308] Sharman, 2006, Ch 3.

"hallmarks" for tax planning schemes and requiring their users to self-report their use to tax authorities.[309] Considering the success of trust and estate planners depends on discretion and finding creative loopholes to circumvent the letter of the law, this might not be the most efficient solution to the problem.

7.3 Extent of Use

The secretive nature of offshore trusts and their purpose to hide from tax authorities means there are no satisfactory statistics about their numbers and the assets held in them. However, there are some proxy figures that can give a hint to the extent trusts and other offshore structures are used today. The rise in the STEP membership could indicate that the trust industry is steadily growing, or that at least there is more demand for professionals in the field. However, it could also indicate that wealth management professionals who have previously discreetly worked for their clients have seen there are growing benefits from belonging to a professional body and have joined STEP years after establishing themselves on the field.

Perhaps a better way to assess the extent of offshore trust use is to look at the estimates of wealth held offshore in general. Boston Consulting Group produces annual global wealth studies, and their most recent estimates for offshore wealth exceeded $10 trillion in 2016. This includes all personal financial assets individuals hold in a foreign country.[310] Gabriel Zucman estimates that $7,6 trillion was held offshore in 2013, which represented 8% of global household financial assets that year, or 10% of the global GDP.[311] He further calculated that 80% of this amount is not declared to the relevant tax authorities, creating annual tax revenue losses to the tune of $190 billion. There are differences in wealth held offshore between countries: 4% of the total US private wealth is held offshore while the figure jumps to 10% for France (and other European countries).[312] Research done by the Bank of Italy supports Zucman's aggregate estimations, finding that the unreported capital stood between $6 and $7 trillion at the end of 2013.[313] The following figure illustrates Gabriel Zucman's findings about unreported offshore assets 2001-2013 and the evolution of STEP membership since it was established in 1991 in two trendlines. It is not possible to draw any definitive conclusion from the two graphs, except that wealth held offshore and the members in STEP have been steadily growing for the past two decades.

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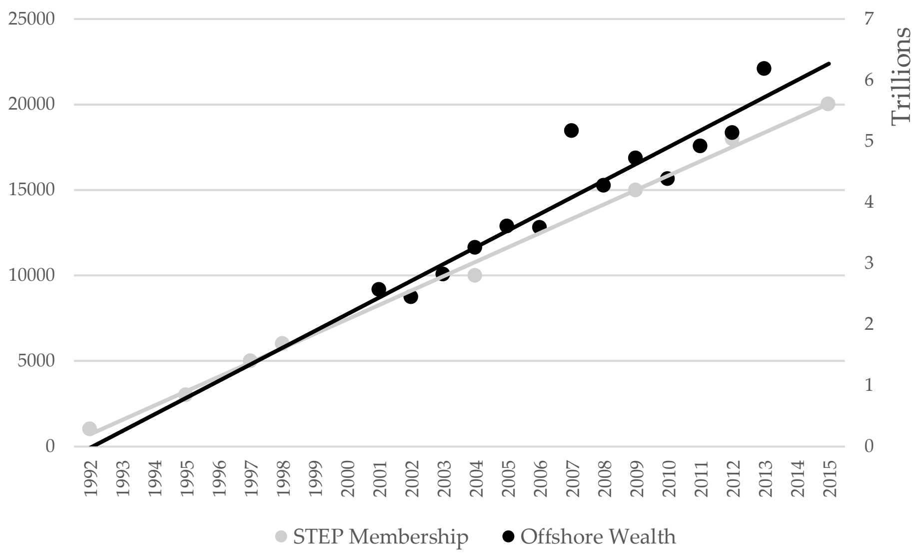
309 See OECD, 2015b; European Commission, 2017.
310 Beardsley, et al., 2017, p. 14.
311 Zucman, 2015, p. 39; World Bank, 2017.
312 The Online Appendix of Zucman, 2015.
313 Pellegrini, Sanelli, & Tosti, 2016.

Figure 18 Offshore Wealth & Professional Trust and Estate Planners[314]



The estimates about offshore wealth do not tell much about how frequently trusts are used, as the figure includes all wealth held through all kinds of legal vehicles, including companies, foundations and trusts. But dividing the wealth to different categories according to what legal vehicle holds them would miss the point, and probably be impossible. The experience from the IRS tax evasion investigations and the recent evidence from several offshore leaks indicate that offshore wealth is likely to be held through a complex ownership structure that includes both trusts and other legal entities such as companies and foundations, as discussed in *Chapter 6*.[315] If anything, the use of trusts could be growing, as found in the report by the Italian Committee on Financial Security.[316]

As more money is finding its way offshore, international efforts to try to curtail the most aggressive practices have been ramped up. The OECD launched its first offensive against tax havens at the turn of the millennium, but it was quickly parred by an influential PR campaign based on the sentiment of big rich countries attacking their less developed and less powerful peers.[317] Suffering a PR loss, the OECD laid low for several years before trying to address the problem again. The US introduced their unilateral solution for offshore tax evasion in the form of FATCA in 2010, and the OECD tried with a new approach, emphasising cross-border cooperation and co-opting the financial offshore centres (tax havens had

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[314] STEP, 2017b; Zucman, 2015, p. 35.
[315] IRS, 2016d; ICIJ, 2016.
[316] Italy's National Assessment of money-laundering and terrorist financing risks states that the abuse of trusts "for illegal purposes, in particular for tax crimes, money laundering, bankruptcy, market abuse and concealment of illegal assets of organised crime" is growing. See Committee on Financial Security, 2014, p. 27.
[317] Sharman, 2006, Ch 3.

vanished from the OECD vocabulary in early 2000s) to address the problem. A platform for exchanging information on request was established and in 2010 the OECD started its first peer review process to assess whether jurisdictions have the required laws in place to collect and exchange relevant information about financial accounts.[318]

Although this was a big step forward, it soon became apparent that it would have a negligible impact on the use of offshore finance. The jurisdictions were slow to update their legislation and even after they did, there were big problems with the actual implementation and enforcement. Firstly, many jurisdiction sill did not require collecting sufficient information about the beneficial owners of accounts, companies nor trusts. It is difficult to exchange information if you do not have it in the first place. Secondly, if the requirement existed, it was sufficient that the trustee would give information about trust parties' identity when requested by national financial intelligence units. There were no requirements to establish national registries of trusts or their beneficial owners. If a participating country had an ongoing investigation about a case involving a foreign trust, the process for getting beneficial owner information went as follows: The investigators had to show evidence that the trust was used for financial crimes before requesting information from the trust's home jurisdiction. If the latter would agree to provide information, they would have to go to the trustee to ask about identities of other for other trust parties. In other words, they would kindly ask the culprits whether they would be so kind to turn themselves in.[319] Unsurprisingly, this was not a very efficient approach to the problem. Especially trusts remained elusive: The trust deed could mandate the trustee to relocate the trust the moment an information request concerning the trust was lodged, leaving investigators none wiser.[320]

The political pressure to step up the response to offshore tax evasion and avoidance increased after several leaks demonstrated how widespread the phenomenon was.[321] Once again, the OECD was tasked with coming up with a solution to the problem. The information exchange platform was changed from request basis to automatic, meaning the participating jurisdictions would automatically exchange information with each other once a year about the accounts of each other's citizens without need for requests or proof of misconduct.[322] The first exchanges are scheduled to take place in 2017 and 2018. Many of the trust jurisdictions have signed up on the information exchange platform and it remains to be seen how effective it is. However, many of the problems riddling information exchange on request continue to hinder the new platform too. They assume that all participating countries

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[318] OECD, 2016.
[319] Tax Justice Network, 2009.
[320] See *Chapter 5.2.5 Fast Relocation*.
[321] ICIJ, 2014; ICIJ, 2016.
[322] OECD, 2014.

fully follow and enforce the FATF anti-money laundering recommendations, which require all financial institutions to identify the true controlling persons (or beneficial owners) behind each of the accounts they operate. However, as recent as 2016, the FATF reported that many countries inside and outside the OECD (including the US) are non-compliant with the rules and lag behind in implementation and especially enforcement.[323]

The information regarding offshore trust users remains very patchy and is mainly based on investigative journalism. The international community has taken many important steps to curtail offshore finance but at least for now without significant impact: The amount of wealth held offshore is rising, as well as the number of professionals moving the wealth around. The new automatic exchange of information could help the situation, but offshore researches remain sceptical:

> "Briefly, the new measures will limit tax evasion for small investors, but they could not be equally effective for the bigger and more sophisticated ones who will be able to use more complex structure to conceal their wealth. This issue is a challenge in terms of both horizontal and vertical equity of national tax systems."[324]

Once again it seems like if you can afford to use trusts, the rules of equity will benefit you but if you cannot, you are left to suffer.

[323] FATF, 2016.

[324] Pellegrini, Sanelli, & Tosti, 2016, p. 38. See also Zucman, 2014, p. 144.

8 Concluding Remarks

In this paper, I have drawn from several strands of historical, economic, legal and sociological literature in search for evidence about links between economic inequality and trusts. In addition, I wanted to investigate whether trusts would fit in the discussion about globalisation's supposed inequality effects. I started this assessment by looking at the history of trusts. Trusts were introduced to the English legal system during the Middle Ages and went on to spread all over the world during the following centuries. This was supported by the economic dominance of the British Empire, and the subsequent US hegemony. Right from their inception, trusts were designed to be used by the very wealthiest segments of the English society to manage their assets in an orderly fashion and to avoid some of the 'unjust' common laws in place. Originally, trusts were predominantly used for managing land ownership but when the nature of wealth transformed after the industrial revolution, the trust institution went through incremental changes to be better equipped to handle the wealth landscape. Today, the main part of private trust funds consists of financial assets, such as equity and bonds, and only a fraction has real estate or land in them. Because this kind of wealth needs more management than looking after land estates, the role of trustee changed from a benevolent and responsible guardian to an active professional who had to be skilled in making the right investment decisions and minimising the tax exposure of the trust fund. The flexible and evolving nature of trusts helped them to find a place in the commercial sphere as well. Trust structures were introduced to real estate investments and joint investment schemes, and to execute creative transactions in structured finance, acting as special purpose vehicles.

Based on the work by the researchers at WID.world, *Chapter 3* established that economic inequality in the US and France has grown steadily since the early 1980s, when it was at the record lowest level in both countries. The disparities in incomes and wealth are more pronounced in the US than in France, which underlines the fact that domestic policy decisions can still have an impact on inequality levels even if the country would be fully linked to the global economy. The strength of the WID.world measures lies in their granularity: It is possible to dissect what wealth consists of and what are the main sources of income for people in different wealth segments. We learned that although wealth is distributed unequally, this is even more pronounced in the case of financial assets. The wealthiest 1% in the US owns 62% of all bonds and deposits and 69.3% of equities.[325] In France, the wealthiest 1% own 50% of all financial assets (excluding deposits).[326] Naturally this means that the same groups received disproportionate share of capital income: 41.7% in

[325] Data from Tables B7-B11 in the Online Appendix of Saez & Zucman, 2016.
[326] The Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2017.

the US and 35% in France.[327] Although the wealthy punch above their weight in labour income as well (8.9% of total in the US, 6% in France), it is clear that they do not maintain the high wealth inequality levels through their wage earnings. Another key finding in the WID.world data is that there is a sizeable difference in the relative weight of financial assets in the two countries, although their share in the total aggregate wealth has risen on both sides of the Atlantic since the early 1980s. This share grew from around 50% to 70% in the US and from around 30% to 40% in France. Considering financial assets are more concentrated than other sources of wealth, this could explain some of the difference in the overall wealth inequality levels in the two countries.

In *Chapter 4*, we turned the focus to the "usual suspects" of increased inequality. Although globalisation, more precisely free international trade, technological development and integrated financial markets, have made 'winners' and 'losers' in the US and France, it does not go the whole way to explain the increased inequality disparities evidenced in both countries. It looks like taxation policies have had their role to play as well: Both countries have lowered tax rates on top incomes and the tax systems in general do not seem to have as big of a redistributive effect than what they had prior to the 1980s. Moreover, capital gains and dividends have faced a preferential tax treatment for decades and since these income forms have become increasingly concentrated since the early 1980s, this feature in the tax systems have mainly benefitted the very top of the wealth spectrum. Tax policies are not an automatic outcome of globalisation but decision makers have often blamed it for not giving them any other alternative than taking part in the "race to the bottom" and lowering tax rates for capital, including personal and corporate income taxes.

After having established the upward trends in economic inequality and the possible macro level causes for them, *Chapters 5* and *6* turned back to the original research questions: How do trusts fit in with all this? *Chapter 5* depicted how trusts and open capital markets are a match made in heaven. Trusts provide a legal vehicle for moving financial assets around the globe in a heartbeat, enabling complex ownership chains to utilise different bilateral trade and tax agreements in place between countries. Although companies are more frequently used to arrive at the same outcomes, there are situations where trusts offer some distinctive advantages. Not burdened by some of the taxes and regulations that companies are, trusts provided the original legal platform for joint investment schemes in the US, such as pension funds and mutual funds. The fiduciary duties embedded in the trust agreement meant that investments requiring prudency and carefulness were preferred to be structured with trusts. For this reason, pension funds in the US are required to be based on a trust form to this day.

[327] The Online Appendix of Garbinti, Goubille-Lebret, & Piketty, 2017; Tables B28 and B29 in the Online Appendix of Saez & Zucman, 2016.

As noted in *Chapter 4*, capital mobility brought new challenges to domestic fiscal policies as collecting taxes on capital became markedly more difficult. Most countries have a residency based taxation system and integrated financial markets enabled taxpayers to change the residency of their mobile assets easily. The boost that trusts gave to this phenomenon is the key for understanding their inequality impact. For French taxpayers, managing investments through offshore trusts is just one way in many to move income generating assets to jurisdictions having lower tax rates. This is perfectly legal but as it is only the wealthiest that have mobile assets to move offshore, the tax benefits accrue to the top. The US has an exceptional tax system as it is not based on residency but worldwide income. However, trusts are so adept to moving assets around that they effectively hide them from the privy eyes of tax authorities. This has become a major phenomenon, as the estimates suggest that as much as $6-7 trillion was held offshore undeclared worldwide. The easy availability of offshore trusts encourages illegal tax evasion in two ways. First, detecting an offshore trust is extremely difficult, making it unlikely that the tax evader will ever get caught. There are tested ways in which the settlor can still access the trust funds located offshore while living onshore. Providing offshore services to those who can afford them is not done by shady and obscure offshore actors: They could be offered by investment advisors of some of the biggest international banks, as the Panama Papers scandal evidenced. In addition, the Swiss banks UBS and Credit Suisse have been prosecuted and made to pay fines to authorities in the US and European countries multiple times in past years for selling their customers offshore financial vehicles to evade taxes.[328] Second, some of the offshore jurisdictions have specialised in offering shelter to the trust assets from any onshore creditors, including tax authorities, without asking any questions about the original source of the funds. If a tax evader has prepared for getting caught, some of their assets could be safely deposited in these jurisdictions as a sort of a "rainy day fund".

It is not only income taxes that can be avoided or evaded with trusts. The US has a long history of trust use in succession planning, and there are several ways in which domestic trusts can be used to minimise estate taxes. Although only a fraction of the US estates has to pay federal estate taxes due to high exemptions, based on several high-profile cases and the fact that the number of domestic trusts has been increasing since the 1970s, it looks like those estates are eager to use the loopholes in the tax code. France has very strict legislation considering trusts in inheritance planning, rendering them not useful for inheritance tax minimisation there.

The US has trusts and higher levels of economic inequality than France, where there are no trusts in domestic legislation. Moreover, looking at the OECD's inequality statistics, the traditional trust jurisdictions (common law countries) tend to be more unequal than their civil law counterparts. Only

[328] Browning, 2008; Noonan & Atkins, 2017.

Canada and Ireland are below the OECD average, and the US is the fourth unequal country of the group after Mexico, Chile and Turkey. The UK follows closely behind, being fifth right after the US. France, on the other hand, is well below the OECD average and has a smaller Gini coefficient (the OECD's chosen inequality measure) than any of the common law countries.[329] Can we deduct that the inequality levels are higher in the US than France due to the availability of domestic trusts? There is a number of reasons for avoiding the jump to such a conclusion. First, trusts are not only available to the citizens of trust jurisdictions, and the rise of the offshore trust industry has made sure it is possible to enjoy the benefits of trusts no matter where the users are resident. Second, although the US tax code enables the use of trusts to escape some of the estate taxes legally, trust income is taxed either on par with personal income or even more heavily. On the other hand, the French legislation has closed all the benefits trusts could bring to succession planning but enables the simple transfer of assets to another jurisdiction to enjoy the lower tax rates there. Considering that capital income taxes form a far more significant portion of fiscal revenue than inheritance/estate taxes, the French could lose even more tax revenue to trust use than the US. Relatedly, the estimate of the share of the total private French wealth held offshore is more than two times that of the American wealth (10% vs 4%). Moreover, the recent findings about the extent of offshore tax evasion "suggest that tax data may significantly under-estimate the rise of wealth concentration over the last four decades, as the world was less globalized in the 1970s, it was harder to move assets across borders, and offshore tax havens played a less important role."[330] The question whether the US is more unequal than France for this or that reason is not so relevant as we cannot be sure what the corrected inequality measures would be if all offshore wealth could be precisely allocated to their real owners.

Although trusts have gone through major transformations from the days of the Crusaders, the core of their existence has remained the same. Today, trusts are still predominantly used by the wealthy to manage their assets, to plan their succession and to avoid some of the 'unjust' societal rules in place, mainly high domestic taxation. Some legal researches say that the trust institution is the main achievement of the Anglo-American legal tradition, offering flexibility in asset management beyond anything civil law legal vehicles can muster up. Trusts have indeed enabled several financial innovations, arguably making financial markets more efficient. But is the price the society pays for this increased efficiency proportionate? This paper has depicted some of the threats trusts pose to the functioning of economic governance and especially domestic fiscal policies. Introducing efficient policies to prevent tax avoidance and evasion could offer alternative ways to remedy public finances, that have been ailing since the Great Recession of

[329] OECD, 2017e.
[330] Alstadsæter, Johannesen, & Zucman, 2017, p. 26.

2007. The focus here was on tax issues, and I have mentioned only fleetingly how the reports from financial crime units and the offshore leaks have indicated that trusts are commonly used by traffickers, smugglers and the corrupt to launder money back to the financial system so they can enjoy their ill-gotten gains. Trust and non-trust societies alike would benefit from a broader discussion about trusts and their potential impacts on their domestic fiscal policies and the integrity of the financial system. At the very least, it could help in understanding how 'globalisation' cannot be singled out automatically as the sole reason for all contemporary economic maladies.

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