Treasure Islands—Offshore Aggressive Tax Avoidance and Evasion

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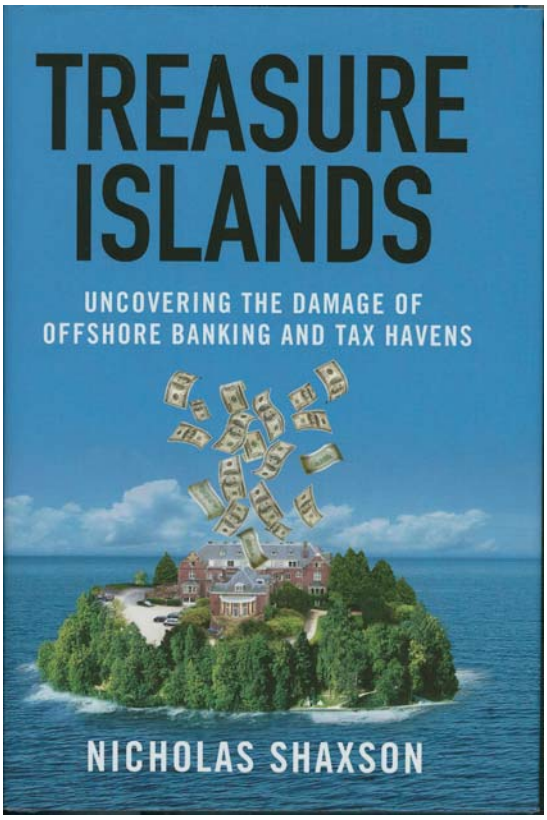
Treasure Islands: The Book

By Nicholas Shaxson

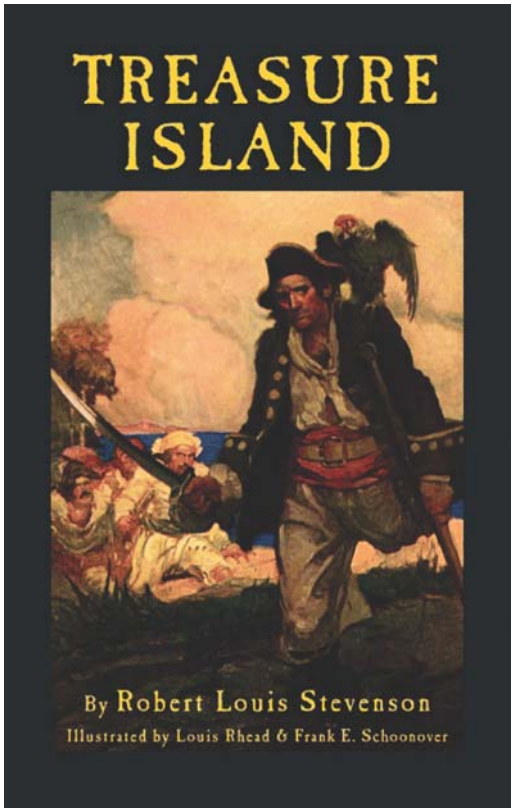
- Describes the use of tax havens by individuals and companies to avoid tax and government regulations, and explains that the City of London was central to the development of offshore and remains the major player.
- For **Individuals**, the game is mostly *fraud*.
- For **Companies**, the game is aggressive tax avoidance that sometimes falls over the line into fraud.


TREASURE ISLANDS
UNCOVERING THE DAMAGE OF OFFSHORE BANKING AND TAX HAVENS
NICHOLAS SHAXSON

Objective of My Comments

Not Really a Book Report

- Set forth, with occasional updates, some of the main issues raised in Treasure Islands (2011).
- Focus on my own recent work on exchange of information by treaty and otherwise.


TREASURE
ISLAND
By Robert Louis Stevenson
Illustrated by Louis Rhead & Frank E. Schoonover


Treasure Island
N
Smuggler's Cove
Pirate's Retreat
Black Forest
Blue Lake
Cutlass Beach
Bloody Boulders
Death Creek
Hangman's Tree
BURIED TREASURE
Shipwreck Island

How Big Is Offshore?

No one really knows, but some Recent Estimates

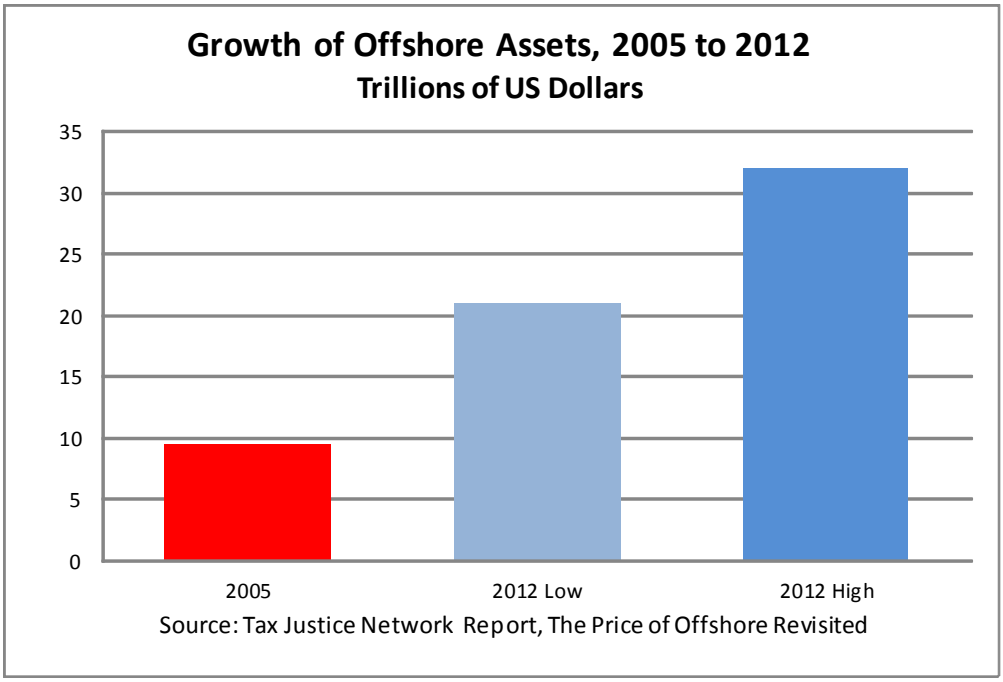
- Most recent estimate (July 2012) by James Henry of *Tax Justice Network* is $21-$32 trillion of assets held in tax havens worldwide. At a 3% return and a 30% tax rate, the annual lost tax revenue would be between $190 to $280 billion.
- Senator Carl Levin (D-MI) has suggested (2006) that offshore abuses reduces Federal tax revenues by $100 billion annually. That implies around $11 trillion in assets of U.S. taxpayers, using Henry's numbers in reverse.

Offshore Is About the Very, Very Rich

84% OF TOTAL WEALTH HELD BY 0.141% OF POPULATION

*"By our estimates, at least a **third of all private financial wealth**, and nearly half of all offshore wealth, is now owned by world's richest 91,000 people, or just 0.001 percent of the world's population. The **next 51 percent of all [financial] wealth** is owned by the next 8.4 million, another trivial 0.14 percent of the world's population."*

James Henry, Tax Justice Network Report, THE PRICE OF OFFSHORE REVISITED (2012)


Growth of Offshore Assets, 2005 to 2012
Trillions of US Dollars
35
30
25
20
15
10
5
0
2005
2012 Low
2012 High
Source: Tax Justice Network Report, The Price of Offshore Revisited

Shaxson's Take on Offshore

THE OFFSHORE WORLD IS ALL AROUND US

*"**Over half** of world trade passes, at least on paper, through tax havens. **Over half** of all bank assets, and **a third** of foreign direct investment by multinational corporations, are routed offshore. Some **85 percent** of international banking and bond issuance takes place in the so-called Euromarkets, a stateless offshore zone. . . . Nearly every multinational corporation uses tax havens, and the largest users — by far — are on Wall Street."*

What is a Tax Haven

Check Goggle: We are Not a tax haven!

- **Shaxson:** A tax haven is "a place that seeks to attract money by offering politically stable facilities to help people or entities get around the rules, laws, and regulations of jurisdictions elsewhere."
  - Low or zero tax rates on foreigners.
  - Offer secrecy, in substance if not form.
  - "ring fencing" — preventing locals from enjoying benefits meant for foreigners.
  - No significant local opposition to the "offshore business model" — i.e., "politically stable".

Cayman Islands

Under British Control

Luxembourg

Major center for Apple's iTunes

Singapore

Fast growing secrecy regime

Belize

Looks like a tax haven should look

US as Tax Haven

Test under Shaxson's definition

- **Zero Rate**. Yes, on interest paid on bank deposits of foreigners (§ 871(i)) and portfolio bonds held by foreigners (§ 871(h)).
- **Secrecy**. Yes. Limited information exchange on interest from bank deposits.
  - Recent Treasury Regs. provide information exchange with many countries. Bill passed House July 26 to postpone regs.
- **Ring Fence**. Yes.
- **Politically Stable**. We shall see.

Two Categories: People and MNEs

Tax Fraud (people) and Aggressive Tax Avoidance (MNEs)

- **People**. US citizens and residents are taxable on their worldwide income, so earning income through a tax haven provides no legal benefit.
  - The game is to hide assets and income illegally, often through a chain of legal entities, especially trusts or their equivalent.
- **Multinational Enterprises**. MNE's generally are allowed to defer income earned through foreign affiliates. Their game is to use the secrecy provided by tax havens to make audits difficult.

Catching Individual Tax Cheats

Also catch their enables — tax advisors, banks

- Federal government catches individual tax cheats mostly by serendipity — distressed spouse gets revenge, UBS forced to reveal US clients, etc.
  - Sometimes tax cheats get caught trying to bring the money back — e.g., credit card scam.
- In theory, the Federal government should get information on offshore under its treaty network.
  - As discussed below, rarely happens..

One Solution: Information Exchange

So far, mostly a charade

- The OECD is giving cover to tax havens by treating information exchange on request as the standard.
  - In fact, information on request is nearly useless.
  - The proper goal is automatic information exchange (AIE).
- Of course, tax havens, unless they intend to go out of the tax evasion business, will not agree to effective information exchange. It has to be imposed on banks and others dealing with tax havens.

FATCA, The New Best Hope

Complex, but worth the effort, starting Jan. 1, 2013

- The Foreign Account Tax Compliance Act (FATCA) targets certain taxpayers holding either foreign financial assets or offshore accounts.
- US taxpayers holding foreign financial assets worth more than $50,000 must report certain information about those assets to the IRS.
- Foreign financial Institutions must report annually on US persons and on foreign entities with substantial US ownership and must withhold at 30% on payments to noncompliant persons.

Aggressive Avoidance by MNEs

How MNEs get profits to tax havens

- The MNEs deflect income to a tax haven much the way they deflect State income to a domestic tax haven, such as Delaware, Nevada, and Wyoming.
- A major method is through transfer-pricing abuses, which governments seem powerless to stop.
- Another is earnings stripping by shifting deductions to the high-tax state and the gross income to the tax haven (not my topic).

Dealing with Transfer Pricing Abuses

Minimizing the harm from the arm's length method

- Recent conference in Helsinki, June 13-15, where I presented, suggested that arm's length works poorly or not at all. Taxation by negotiation, not rule of law.
- I'm a proponent of combined reporting with formulary apportionment (as used by a slim majority of U.S. states).
  - I made the case for CR/F in a recent paper presented at the Helsinki conference.

Recent MJM Publications

All of Below Available On Line

Challenging the Status Quo: The Case for Combined Reporting, *Tax Management Transfer Pricing Report*, Vol. 20, No. 22, pp. 1165-1173 (March 22, 2012).

Identifying the New International Standard for Effective Information Exchange, in *Tax Treaties from a Legal and Economic Perspective*, IBFD (2011).

How to End the Charade of Information Exchange, 56 *Tax Notes Int'l* 255-268 (October 26, 2009), reprinted in 125 *Tax Notes* 695-707 (November 9, 2009).

Questions and Discussion