The Hidden Wealth of Nations
The Scourge of Tax Havens

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A growing policy concern, yet hard to quantify:

For some observers, considerable tax revenue losses

For others, most of the activities in tax havens are legitimate

On both sides, generally limited empirical evidence

A number of recent initiatives:

FATCA, automatic exchange of bank information, BEPS

What can we expect from these policies?

In the book I try to explain how published macro statistics can be used to shed light on these issues
The book is based on a number of recent research papers


Extended, improved, updated, and better explained in the book...

...But much more research needed to offer definitive answers

All figures and data available online at
http://gabriel-zucman.eu/hidden-wealth
Offshore avoidance and evasion are sizable

Tax evasion by wealthy individuals in offshore banks

8% of world’s financial wealth offshore

A large fraction undeclared

Automatic exchange a progress, but need a financial registry

Profit-shifting by multinationals

Exploiting the loopholes of corporate taxes

Growing fast: 55% of foreign profits of US corp. booked in tax havens

Main reason why effective tax rate of US firm has gone down
I- Tax evasion by wealthy individuals
A growing fraction of wealth is being managed by offshore financial institutions.

In 2012, 9% of the U.S. listed equity market capitalization was held by tax haven investors (hedge funds in the Cayman Islands, banks in Switzerland, mutual funds in Luxembourg, individuals in Monaco, etc.). Source: author's computations using US TIC data.
What do offshore centers do?

A great deal of activities, many of which legal and legitimate:

- Investment funds (Luxembourg, Ireland...)
- Shadow banking (Caymans...)
- Treasury management (U.S.-Cayman...)
- Personal wealth management (Switzerland, Singapore...)

But some offshore centers, institutions and instruments also facilitate tax evasion by wealthy individuals.
How offshore tax evasion works

Shell companies
Fake invoices
Offshore accounts
Disconnecting legal and beneficial ownership
What do we know about the magnitude of offshore tax evasion?

Monthly statistics by the Swiss National Bank

Systematic anomalies in the international investment positions of countries caused by offshore portfolio wealth

8% of the world’s financial wealth offshore

If anything lower bound

Limited data on what fraction evades taxes: evidence suggesting 90-95% prior to 2008, down to 80% today
8% of the world’s financial wealth is held offshore, costing at least $200bn

<table>
<thead>
<tr>
<th>Region</th>
<th>Offshore wealth ($ bn)</th>
<th>Share of financial wealth held offshore</th>
<th>Tax revenue loss ($ bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>2,600</td>
<td>10%</td>
<td>75</td>
</tr>
<tr>
<td>USA</td>
<td>1,200</td>
<td>4%</td>
<td>36</td>
</tr>
<tr>
<td>Asia</td>
<td>1,300</td>
<td>4%</td>
<td>35</td>
</tr>
<tr>
<td>Latin America</td>
<td>700</td>
<td>22%</td>
<td>21</td>
</tr>
<tr>
<td>Africa</td>
<td>500</td>
<td>30%</td>
<td>15</td>
</tr>
<tr>
<td>Canada</td>
<td>300</td>
<td>9%</td>
<td>6</td>
</tr>
<tr>
<td>Russia</td>
<td>200</td>
<td>50%</td>
<td>1</td>
</tr>
<tr>
<td>Gulf countries</td>
<td>800</td>
<td>57%</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,600</strong></td>
<td><strong>8.0%</strong></td>
<td><strong>190</strong></td>
</tr>
</tbody>
</table>
Despite recent policy initiatives, much remains to be done

Automatic exchange of bank information will become global standard by end of 2010s: big progress.

Three obstacles:

- Incentives of offshore bankers
- Financial opacity
- Incentives of tax havens

What is missing: well defined sanctions (FATCA) and a world financial registry
How Swiss bankers torpedoed previous attempts at curbing tax evasion

Accounts held through sham corporations

Accounts directly held by Europeans

% of Swiss accounts amounts

EU Saving Tax Directive

The case for a world financial register

The companies Clearstream, Euroclear, etc. feed the world financial register. Tax authorities can verify that tax-payers indeed declare all the financial securities included in the register.

Despository Trust Corporation (USA)
Clearstream (Luxembourg)
Euroclear France (France)
Other central securities depositories & other sources

World financial register

U.S. tax authority
U.K. tax authority
French tax authority
Other tax administrations
II- Multinational corporations tax avoidance
The taxation of multinationals is based on 3 principles adopted in the 1920s

**Source-based taxation**
Taxes are to be paid to countries where profits have been made
Not to countries where shareholders live (= residence taxation)
But how to determine where the profits have been made?

**Arm’s length pricing**
Subsidiaries of a same group must compute their profits as if unrelated
I.e., trade goods and services internally at market prices

**Bilateral agreements**
No multilateral agreement like GATT
Instead, thousands of bilateral tax treaties
The choices made in the 1920s are coming back to haunt the tax authorities.

The share of profits made abroad in U.S. corporate profits

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author's computations using NIPA data, see Online Appendix.
Each of the 3 core principles for international taxation raises its own issues

**Bilateral agreements**
- Treaty shopping to generate stateless income
  
  Example: Google

**Arm’s length pricing**
- Easy to manipulate transfer prices
  
  Reference prices often do not exist

**Source-based taxation**
- Artificial profit shifting
  
  Tax competition for real investments
What is the cost of multinational corporate tax avoidance?

Hard to quantify: double-counting issues, tax laws vary across countries, etc.

My approach: use national accounts & balance of payments data

Focus on the United States: what is happening to the profits of US-owned companies?

Latest data show offshore tax avoidance is sizable and growing fast
A growing fraction of US corporate profits are made abroad

The share of profits made abroad in U.S. corporate profits

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author’s computations using NIPA data, see Online Appendix.
More than half of the foreign profits of US firms are booked in tax havens.

The share of tax havens in U.S. corporate profits made abroad

Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about $500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.
20% of all US corporate profits are booked in tax havens

The share of tax havens in U.S. corporate profits

Notes: This figure charts the ratio of profits made in the main tax havens (Netherlands, Ireland, Switzerland, Singapore, Luxembourg, Bermuda and other Caribbean havens) to total US corporate profits (domestic plus foreign). Source: author's computations using NIPA and balance of payments data, see Online Appendix.
The effective rate paid by US corporations has been reduced by 1/3 since late 1990s

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). In 2013, over $100 of corporate profits earned by US residents, on average $16 is paid in corporate taxes to the U.S. government (federal and States) and $4 to foreign governments. Source: author's computations using NIPA data, see Online Appendix.
Reforming the US corporate tax

**Formula apportionment**
- Works reasonably well for US States
- Based on final sales to remove incentives to move real activity
- It’s the best way to levy taxes efficiently and fairly

**Integration with the personal income tax**
- Removes incentive to dodge corporate tax
- Existed in Europe for a very long time
- Can work internationally: reciprocal crediting Europe/US as part of transatlantic free trade agreement (TTIP)