The Hidden Wealth of Nations
The Scourge of Tax Havens

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How big are offshore tax avoidance and evasion & what can be done about them?

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?

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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

1. "The Missing Wealth of Nations: Are Europe and the US net Debtors or net Creditors?", *QJE* 2013

2. "The End of Bank Secrecy?" (with Niels Johannesen), *AEJ* 2014

3. "Taxing Across Borders: Tracking Personal Wealth and Corporate Profits", *JEP* 2014

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

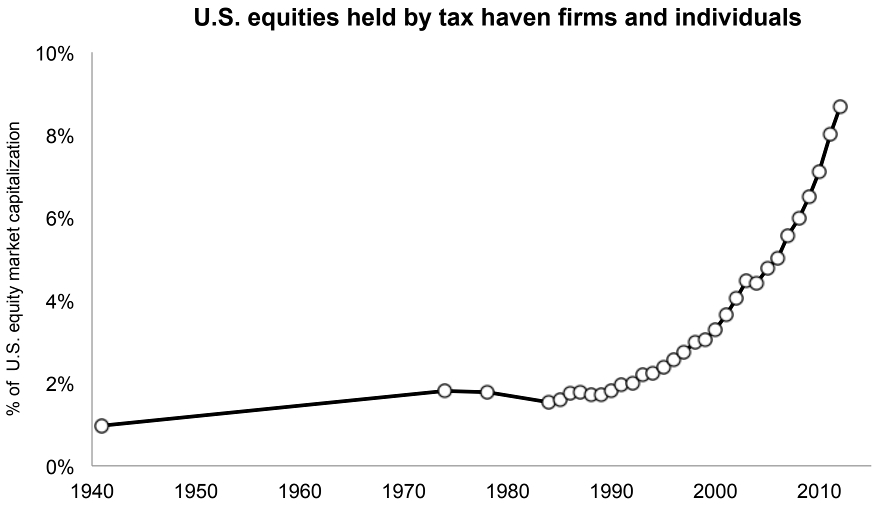
Exploiting the loopholes of corporate taxes

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

	Offshore wealth ($ bn)	Share of financial wealth held offshore	Tax revenue loss ($ bn)
Europe	2,600	10%	75
USA	1,200	4%	36
Asia	1,300	4%	35
Latin America	700	22%	21
Africa	500	30%	15
Canada	300	9%	6
Russia	200	50%	1
Gulf countries	800	57%	0
Total	**7,600**	**8.0%**	**190**

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

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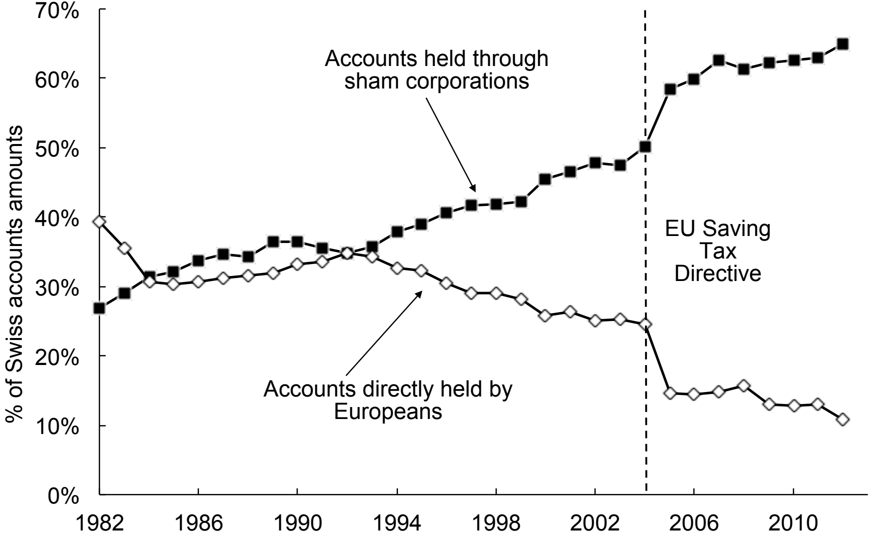
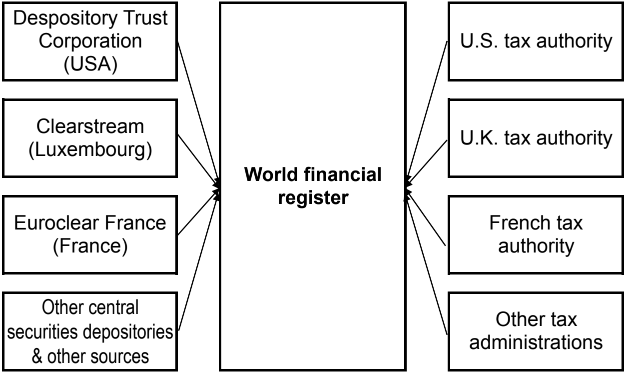
What is missing: well defined sanctions (FATCA) and a world financial registry

How Swiss bankers torpedoed previous attempts at curbing tax evasion



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



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

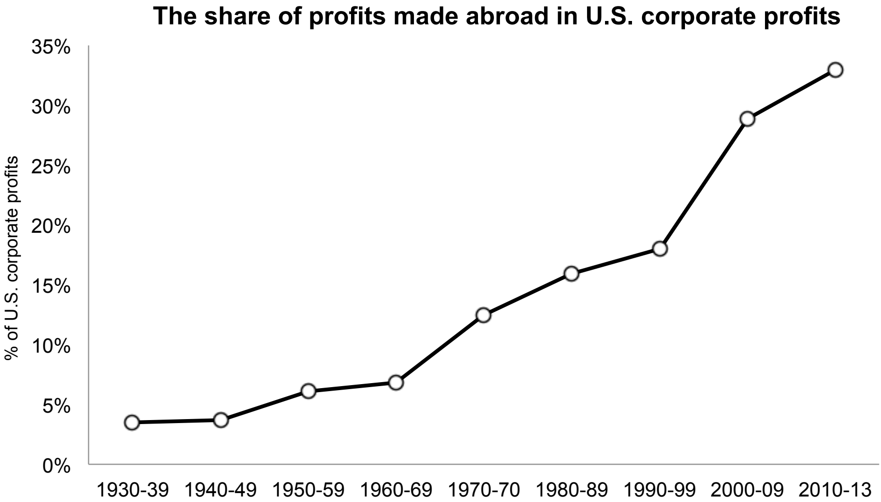
I.e., trade goods and services internally at market prices

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



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?

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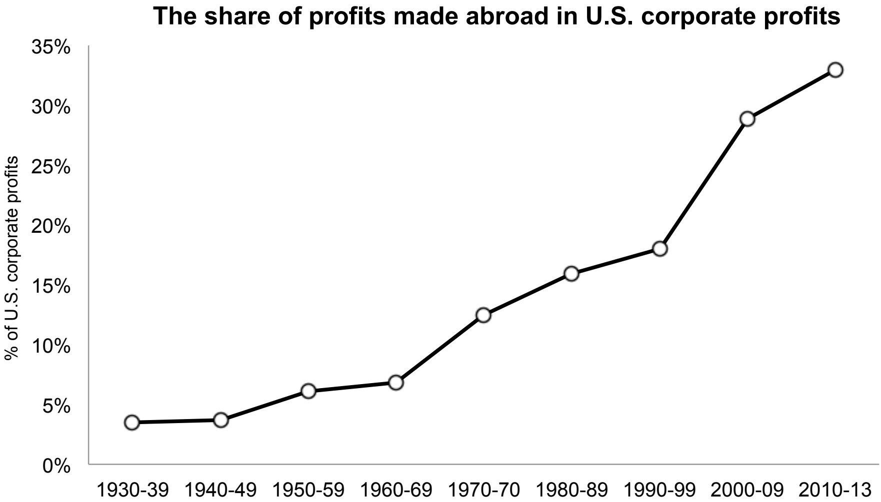
Latest data show offshore tax avoidance is sizable and growing fast

A growing fraction of US corporate profits are made abroad



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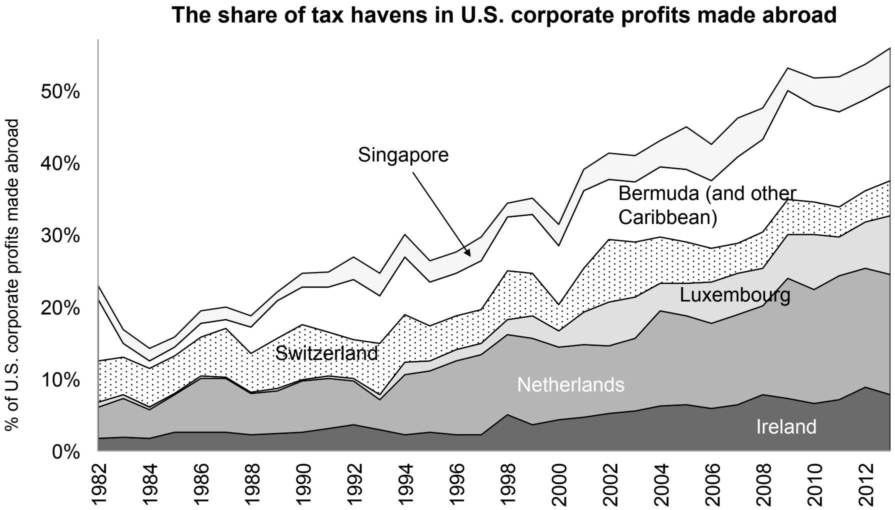
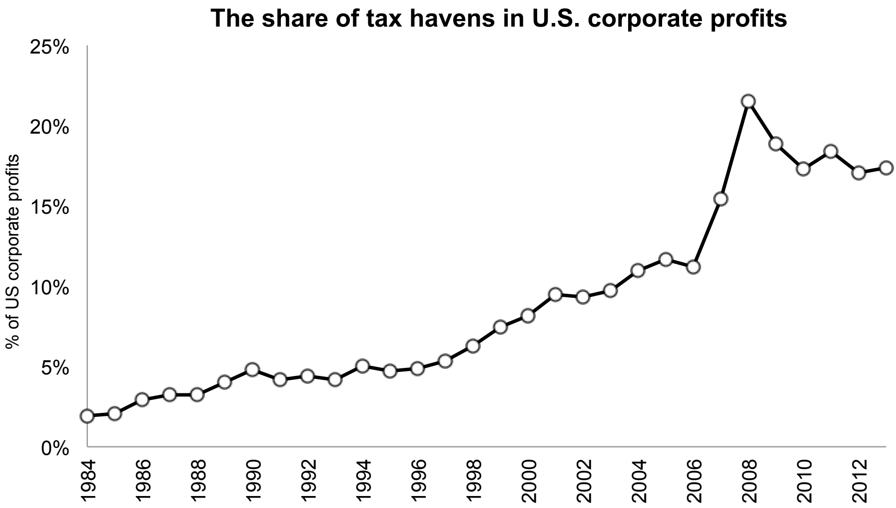
More than half of the foreign profits of US firms are booked in tax havens



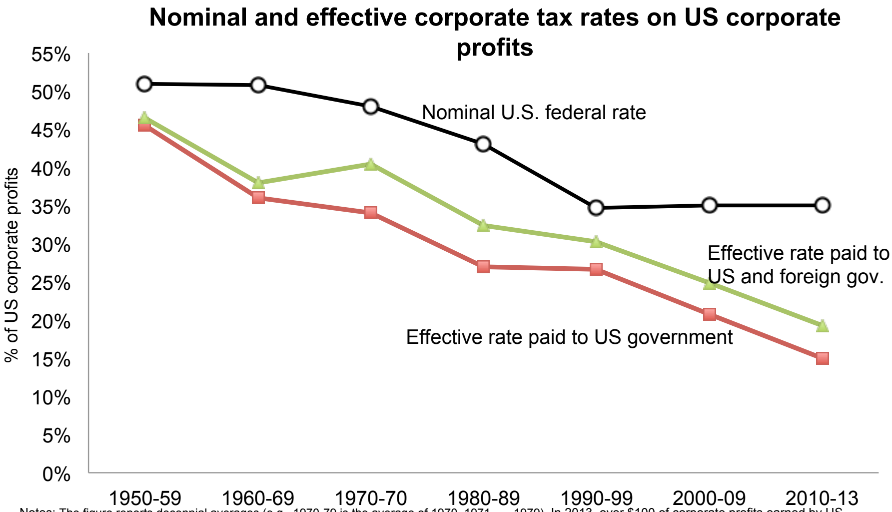
Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about $500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

20% of all US corporate profits are booked in tax havens



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

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)