Department of Economics and Centre for Macroeconomics public lecture

# The Hidden Wealth of Nations


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# 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?

$\Downarrow$

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

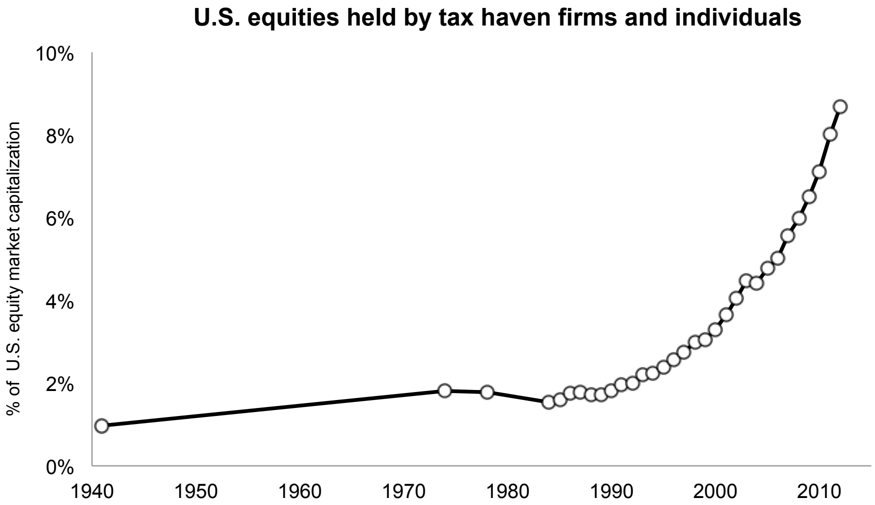
...But much more research needed to offer definitive answers

All figures and data available online at `http://gabriel-zucman.eu/hidden-wealth`

4. Will also talk about ongoing work "Tax Evasion & Inequality" (with Niels Johannesen and Annette Alstadsæter), 2016

# 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

Central bank data on foreign-owned bank deposits

HSBC leaks and Panama Papers on who owns shell companies

Swiss data on what fraction of offshore wealth is undeclared ($\approx$ 90-95% prior to 2008, down to $\approx$ 80% today)

# 8% of the world's financial wealth is held offshore, costing at least $200bn

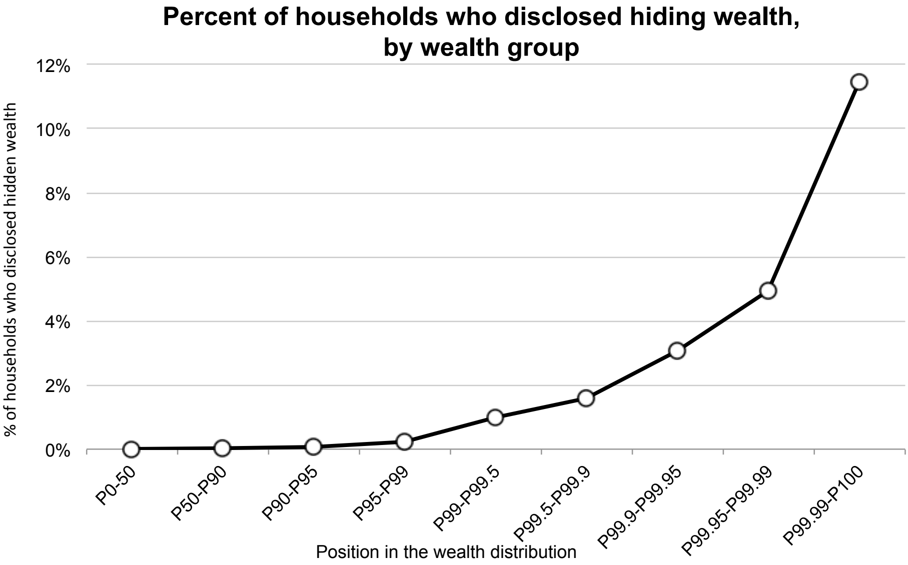
| | Offshore wealth ($ bn) | Share of financial wealth held offshore | Tax revenue loss ($ bn) |
|---|---|---|---|
| Europe | 2,600 | 10% | 75 |
| USA | 1,200 | 4% | 36 |
| Asia | 1,300 | 4% | 35 |
| Latin America | 700 | 22% | 21 |
| Africa | 500 | 30% | 15 |
| Canada | 300 | 9% | 6 |
| Russia | 200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

# Who conducts tax evasion?

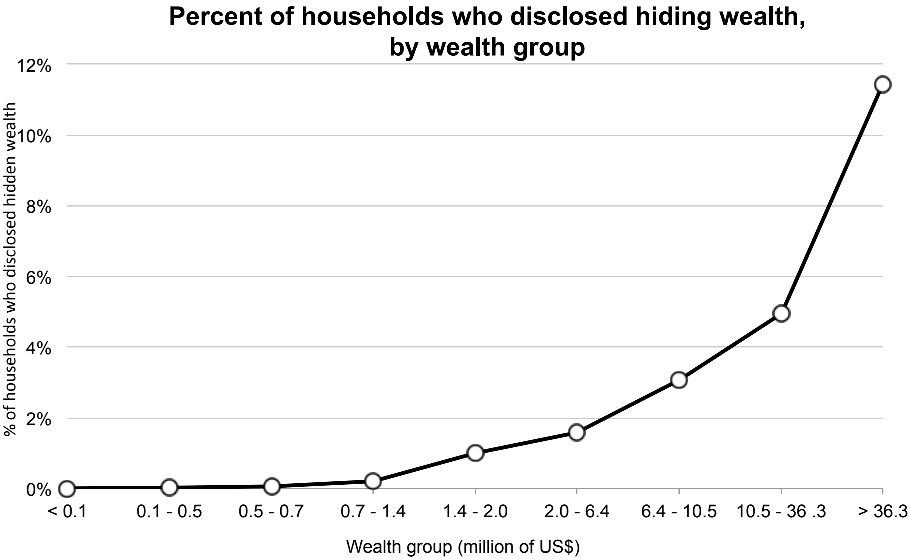
Widespread view that tax evasion has become more "democratic", and that the super-rich do not evade as they can easily avoid

- View largely based on randomized audit data. Problem: audits do not capture offshore evasion
- New micro data from amnesties, crackdowns, and leaks shed new light on evasion behavior of the wealthy
- With Johannesen and Alstadsæter we use such data in Scandinavia to study how tax evasion varies with wealth

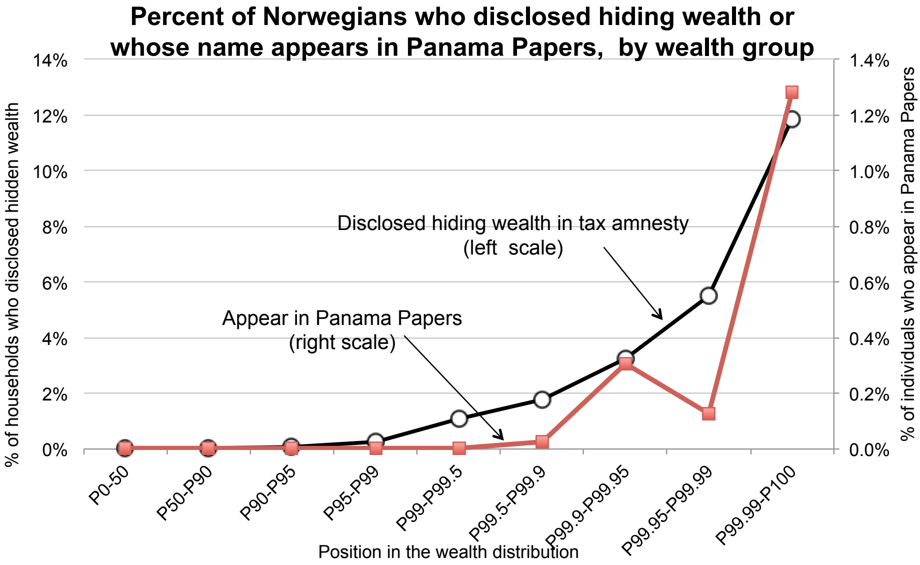
# In Norway, the proba to disclose hidden assets rises sharply with wealth



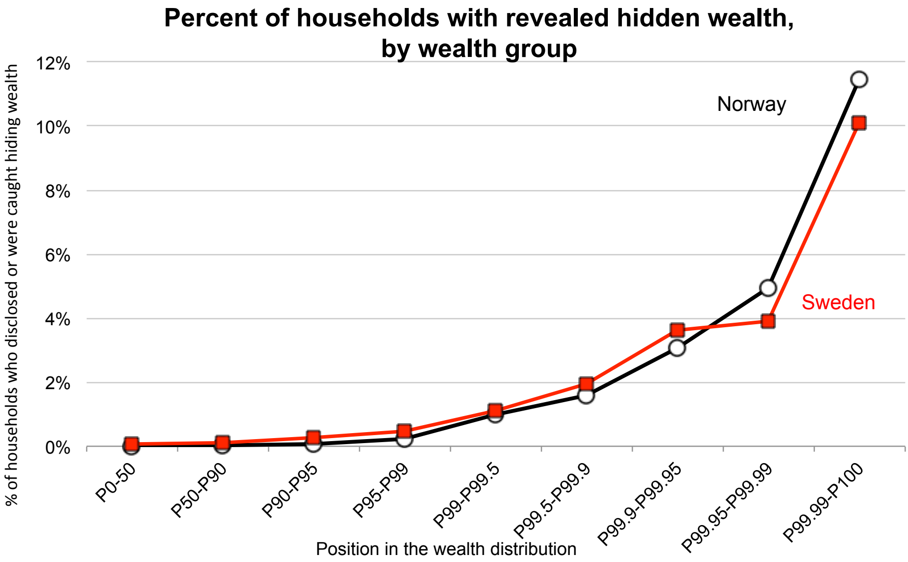
# 12% of households with wealth > \$36m used the Norwegian amnesty



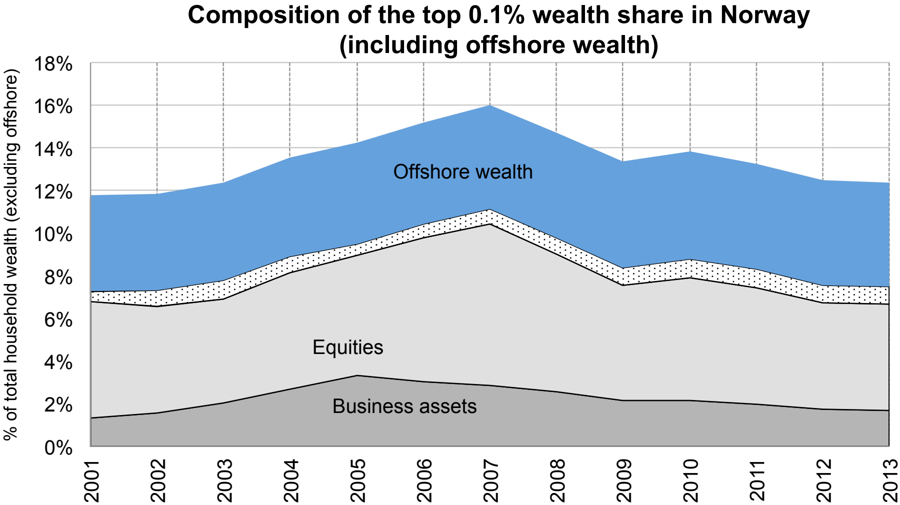
# Similarly, the probability to appear in the Panama Papers rises sharply with wealth



# In Sweden too, evasion rates rises very sharply at the top

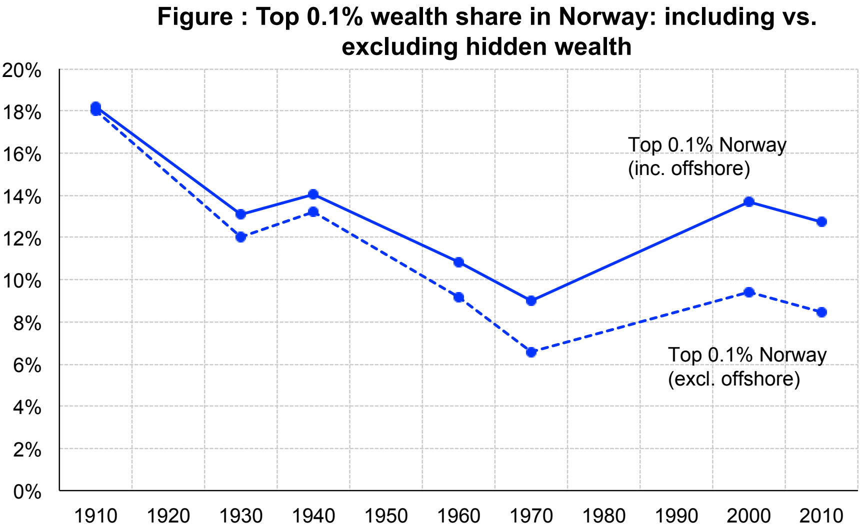


# At the top-end, the use of offshore accounts is widespread




This figure depicts the share and composition of the wealth held by families in the top 0.1% of the wealth distribution, after taking into account unreported offshore wealth. Source: Appendix Table B5b.

# Tax evasion can erase half of the secular decline in wealth concentration



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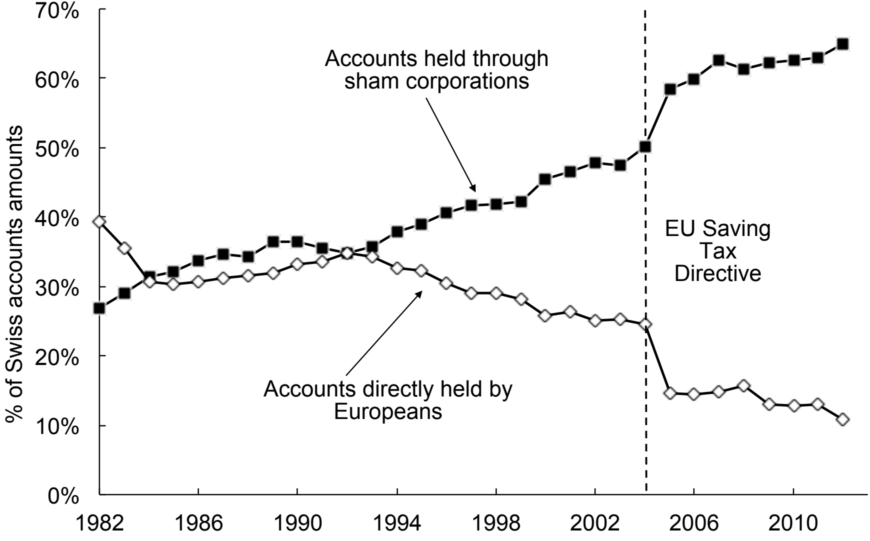
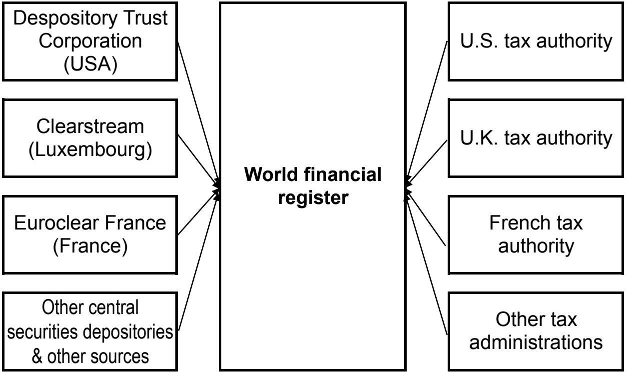
**What is missing: well defined sanctions (FATCA) and a world financial registry**

# 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



# Tax avoidance by multinational corporations

# 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

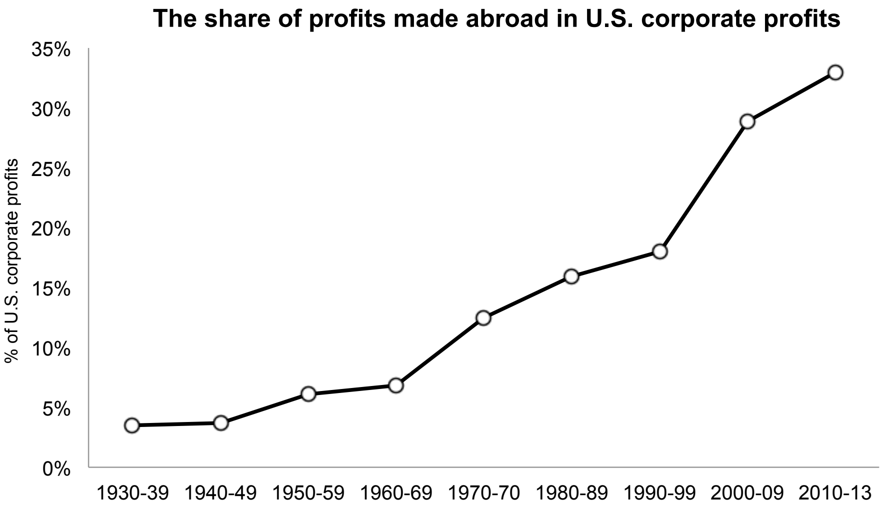
I.e., trade goods and services internally at market prices

**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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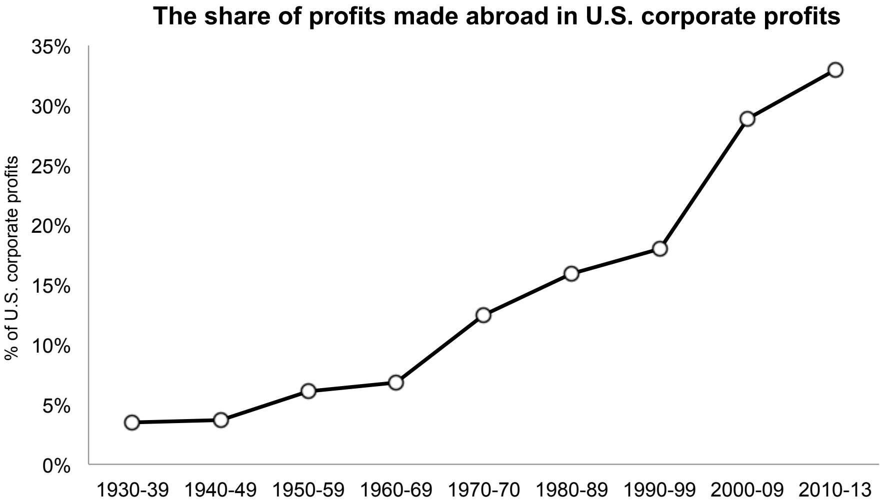
**Latest data show offshore tax avoidance is sizable and growing fast**

# A growing fraction of US corporate profits are made abroad

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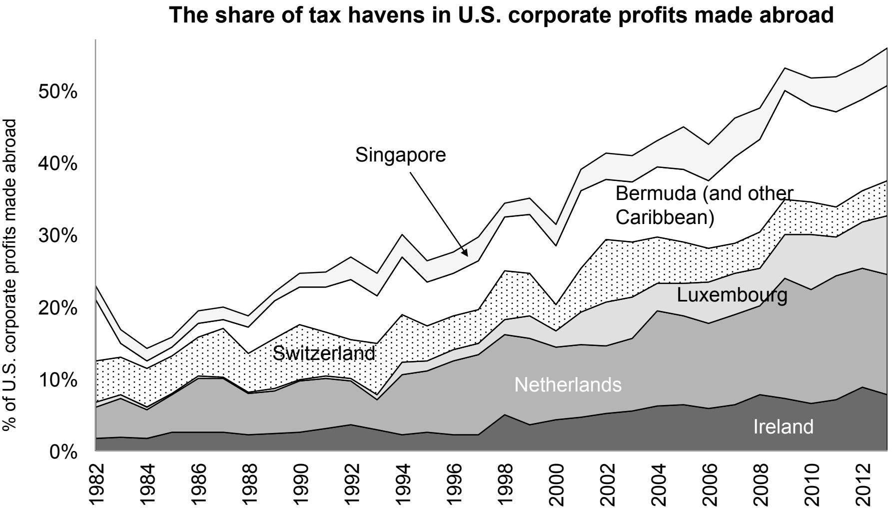
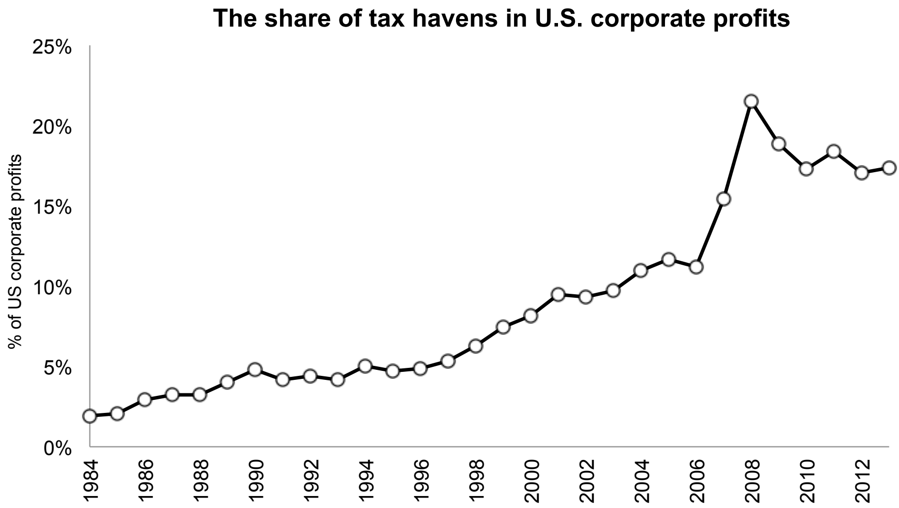
# More than half of the foreign profits of US firms are booked in tax havens



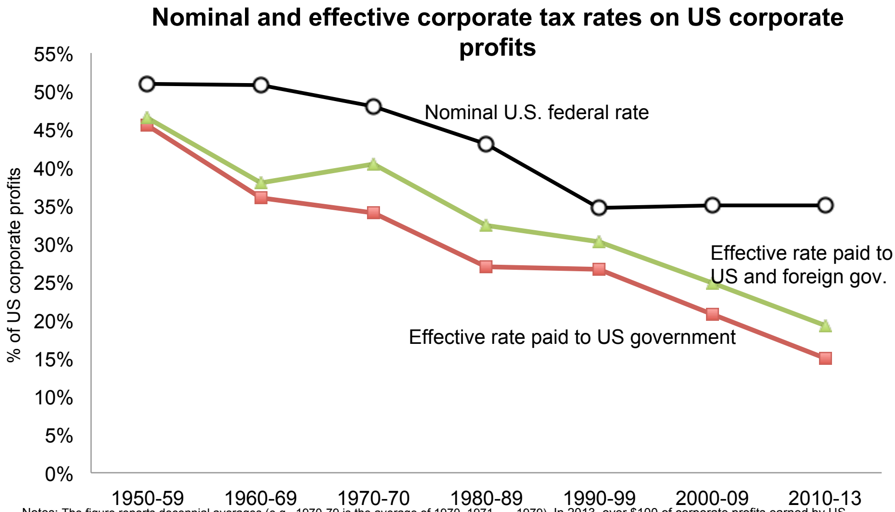

Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about $500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

# 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 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

Can be done unilaterally

But international cooperation always better: ideal would be joint move to formula apportionment as part of free-trade talks