Unfair Advantage

The Business Case Against Overseas Tax Havens

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Summary of Key Findings

Over the last two decades, there has been a marked increase in the use of international tax havens for the principal purpose of tax avoidance. Several hundred U.S. multinational banks and corporations utilize tax havens to reduce or eliminate their taxes and shift tax responsibilities onto the backs of domestic businesses and individual taxpayers. Our economy and domestic business sector is undermined when large companies are rewarded for financial manipulation rather than productive investment, innovation and job creation.

End Tax Haven Abuses Would Generate Revenue for Small Business and Job Creation

We conservatively estimate that U.S. multinational corporations and banks are using tax havens to avoid at least $37 billion in U.S. taxes per year. This $37 billion could be used to fund initiatives to support America's small businesses – the nation's biggest job creators -- by increasing their access to capital, increasing their opportunities to invest, and rewarding entrepreneurship through provisions like those found in the Small Business Jobs Act, recently introduced by Senators Max Baucus and Mary Landrieu. For example:

- We could establish a $30 billion Small Business Lending Fund to provide capital investments to small community banks (those with less than $10 billion in assets) to increase lending to small enterprises.

Multinational corporations are using tax havens and other means to shift their tax burden onto small businesses and individual taxpayers

Fifty years ago, corporate income taxes accounted for 23.2% of federal government receipts, and individual income tax payments were less than twice those of large corporations' tax payments. Today, the U.S. Office of Management and Budget estimates corporate tax receipts will account for just 7.2% of federal revenues in 2010, with large corporations contributing less than one-sixth as much as small business and individual taxpayers to the Federal Treasury (small businesses most often pay taxes according to their owner's individual tax rates). One significant reason for this shift is large corporations' ability to shift domestic income to offshore subsidiaries in tax havens. For example:

- In 2008, Goldman Sachs, with 29 subsidiaries located in offshore tax havens, reported profits of over $2 billion and paid federal taxes of $14 million, an effective tax rate of just one percent, and less than one third what they paid their CEO Lloyd Blankfein ($42.9 million).

- In 1999, TransOcean, owner of the Deepwater Horizon oil platform that exploded, killed 11 workers, and devastated the Gulf of Mexico, moved its incorporation from the United States first to the Cayman Islands and later to Switzerland, with the stated purpose of lowering its taxes.[1]

Corporate Tax Haven Cheats Use Our Infrastructure on the Cheap

U.S. multinational corporations count on roads, airports, courts, telecommunications, public education and a whole host of other infrastructure and public services that are paid for by our tax dollars. It is unfair for them to use this infrastructure for free or heavily discounted – subsidized by the rest of us.

Tax Haven Loopholes Enable an Unlevel Playing Field

Tax Havens distort the economy by favoring Wall Street and global corporations over Main Street businesses and community banks. Tax havens foster an unlevel playing field that penalizes businesses that responsibly pay their taxes. For example:

- A community bank that provides financing for local business and community development pays federal taxes yet has to compete against Bank of America or Citigroup, global banks that use tax havens to aggressively reduce their U.S. taxes.
- Local retailers compete against Big Box retailers who can take advantage of subsidiaries in tax havens to reduce their taxes.
- Domestic U.S. insurance companies are forced to compete against global insurance companies that dodge U.S. taxes through subsidiaries in tax havens such as Bermuda. Some respond by incorporating their own subsidiaries in tax havens.

Tax Havens Facilitate a Casino Economy

Offshore tax havens have enabled Wall Street to evade taxes, freeing more money for speculation and enabling them to take more extreme risks without counting them on their balance sheets. Not only does this promote a culture of risky gambling and facilitate fraud, it encourages firms to structure shadowy, complex deals to peddle toxic assets globally, and build up leverage and risk more widely across the global financial system -- leading to much more widespread, severe economic crises. For example:

- In 2007, Citigroup had 427 tax haven subsidiaries, Morgan Stanley had 273, Bank of America had 115, the collapsed Lehman Brothers had 57, JP Morgan Chase had 50, Goldman Sachs had 29 and AIG had 18.[2]

Policy Recommendations

We recommend nine different legislative and regulatory actions to level the playing field between domestic businesses and U.S. multinational corporations. The top four are:

- Block All Transfers of Intellectual Property Designed to Evade Taxes (Revenue: $10 billion per year or $100 billion over ten years).
- Ban Phony Offshore Corporations that pretend to earn profits offshore when the primary management team remains in the U.S. (Revenue: Approximately $5 billion per year, $50 billion over ten years).
- Repeal the 80/20 Rule that allows corporations to escape U.S. taxation if 80 percent of their business occurs overseas.
- Create Disincentives and Penalties for U.S. Government Contractors Using Tax Havens to Avoid U.S. Taxes.

"Whether it's Exxon Mobil or many of the Wall Street institutions we were asked to bail out, I think [tax havens are] a real problem. I think we've had a proliferation of offshore tax havens, of corporate tax dodging. I always find it impossible to explain why a pharmacist in Bastrop, Texas, or a small retail store in San Marcos is having to pay higher rates on the income that their hard-working small business owners are earning than some multinational that can duck and dodge taxes in Bermuda or the Cayman Islands."

-- U.S. Representative Lloyd Doggett (D-TX) [3]

Introduction

Over the last two decades, there has been a striking increase in the use of tax havens to enable U.S. multinational corporations to reduce or avoid U.S. taxes.

These offshore tax havens reward tax dodgers, deplete public coffers of needed revenue and shift a bigger share of tax obligations on to responsible businesses and households. Responsible and sustainable businesses are at a competitive disadvantage when other firms hide assets in tax havens and avoid paying their fair share of taxes. Tax dodging deprives our nation of revenue needed to maintain and modernize the infrastructure underpinning a strong economy. Our economic progress is undermined when companies are rewarded for financial manipulation rather than productive investment, innovation and job creation. In addition, use of tax havens allows systemic risks to be hidden, jeopardizing the U.S. and global economy.

There is no justification for tax avoidance and evasion through tax havens. Offshore tax havens provide cover for banks, hedge funds and corporations to shift taxable income from the United States to tax havens to escape taxation. They provide the secrecy that helps companies cook their books and allows wealthy Americans to hide assets.

Stopping tax haven abuse shows we are serious about taxation that is transparent, fair and responsible. It is an important step in ending the irresponsible speculation and financial manipulation putting our whole economy at risk.

I. Growth in Tax Haven Abuse

U.S. Multinational Corporations and Banks Frequently Use Tax Havens

Eighty-three of the 100 largest publicly traded U.S. corporations operated with subsidiaries in the Cayman Islands, Bermuda, Switzerland, Luxembourg and other offshore tax havens in 2007, according to the latest report from the U.S. Government Accountability Office. These included oil companies, defense contractors, health insurers, pharmaceutical companies, and failed or bailed out banks.

Sixty-three of the largest 100 federal contractors have at least one subsidiary in a tax haven country.[4] Why should companies that game the tax system through offshore tax havens benefit from contracts financed by U.S. taxpayers?

Sample of U.S. Corporations with Offshore Tax Havens

Corporation name	Number of offshore subsidiaries
Citigroup	427
Morgan Stanley	273
Bank of America	115
Wachovia	59
Lehman Brothers	57
JP Morgan Chase	50
Goldman Sachs	29
Merrill Lynch	21
American International Group (AIG)	18
Countrywide Financial	7
News Corp	152
Procter & Gamble	83
Pfizer	80
Oracle	77
Marathon Oil	76
PepsiCo	70
Caterpillar	49
Merck	44
Boeing	38
Dow Chemical	35
Fluor Corp	34
Exxon Mobil	32
UnitedHealth Group	11
Best Buy	12
Target	8

Source: U.S. Government Accountability Office, 2007. http://www.gao.gov/new.items/d09157.pdf

The High Cost of Tax Havens

The inflation adjusted value (in 2007 dollars) of U.S. corporate assets abroad has increased more than 11-fold from $1.34 trillion in 1976 to $15 trillion in 2007, before the financial meltdown. Increasingly, U.S. multinational corporations are making profits by dodging taxes rather than by making products and providing services.[5] In 1999, U.S. multinationals reported that their foreign subsidiaries located in tax haven countries generated a total of $88 billion in profits. Just three years later, in 2002, that number had grown to $149 billion – a 70% increase.[6]

What Tax Havens Cost Us

How much does the combined tax haven abuse by individuals and corporations cost the rest of us? Citing a range of studies, the Treasury Department in 2009 said that this "international tax gap" both for corporations and individuals could range from $43 billion to $123 billion per year.[7]

What could we do with those billions? $43 billion could fully fund the Department of Homeland Security. $123 billion could fully fund the Departments of Agriculture, Commerce, Energy, and Justice, plus the Environmental Protection Agency, the National Science Foundation, and the Small Business Administration.[8]

Fifty years ago, corporate income taxes accounted for 23.2% of federal government receipts, and individual income tax payments were less than twice those of large corporations' tax payments. Today, in 2010, the U.S. Office of Management and Budget estimates corporate tax receipts will account for just 7.2% of federal revenues with large corporations contributing less than one-sixth as much as small business and individual taxpayers (small businesses most often pay taxes according to their owner's individual tax rates) to the Federal Treasury.[9] One significant reason for this shift is corporation's ability to shift domestic income to low-tax offshore subsidiaries.

II. Tax Havens: The Cost to U.S. Business

Large U.S. banks and corporations use teams of lawyers and accountants to set up offshore tax havens, giving them an unfair competitive advantage compared to Main Street businesses and banks. Tax havens favor U.S. multinational corporations over fully domestic businesses, big companies over small, and irresponsible companies over ethical enterprises. They hinder innovative start-up companies in favor of established companies. Responsible and sustainable businesses are at a competitive disadvantage when other firms hide assets in tax havens and avoid paying their fair share of taxes.

U.S. Multinationals Shift Their Taxes onto Small Business

How much are multinational corporations saving by shifting profits to offshore tax havens? Our conservative estimate is more than $37 billion per year. [10]

Secrecy is one of the defining characteristics of tax havens. Up to date information about the pervasiveness of tax haven abuse is hard to find. The most recent data stems from 2004, when the Commerce Department's Bureau of Economic Analysis estimated that U.S. corporations derived $149 billion in profits from offshore tax haven jurisdictions during 2002.[11] The U.S. Government Accountability Office reported that the 2004 average effective corporate income tax rate for large corporations with positive domestic earnings was 25.2%.[12] If the $149 billion in profits shifted offshore had instead been reported and taxed as domestic income, an additional $37 billion in taxes would be owed.[13]

Among the signs that foreign income reported by US corporations continues to grow are reports by the US Treasury that the number of US corporate income tax returns containing international features has increased 87% from 2002 to 2007. The Treasury Department also indicates a 20-fold increase in the number of US multinational enterprises between 1990 and 2007.[14]

U.S. multinational corporations pay a dramatically low 2.3% effective rate on foreign income. The main reason is tax law provisions that allow U.S. investors to defer taxes on income earning outside the U.S., until those profits are repatriated. [15] Offshore tax havens, which make it easy to shift income earned in the U.S. to offshore tax havens for tax purposes, play a vital role in the meteoric expansion in the $700 billion in foreign earnings posted by U.S. corporations, and a similar key role in fueling tax avoidance strategies.

Ending tax haven abuse by U.S. multinational corporations would help level the competitive playing field between large and small businesses. In addition, the conservatively estimated $37 billion in revenue generated per year could be used to fund initiatives to support America's small businesses by increasing access to capital and opportunities to invest, and rewarding entrepreneurialism, through provisions like those found in the Small Business Jobs Act, recently introduced by Senators Max Baucus and Mary Landrieu. [16]

We should prioritize investments that support the dynamic U.S. small business sector, which is the biggest generator of new jobs. For example, we could establish a $30 billion Small Business Lending Fund to provide capital investments to small community banks (those with less than $10 billion in assets) to increase lending to small enterprises. [17]

Main Street Retailers vs. Big Box Multinationals

Small retailers in the U.S. have long faced difficult competition from the big box retailers. Huge swaths of Main Street have already been hollowed out by mega-retailers replacing locally-owned stores selling groceries, hardware, cameras, appliances, clothing and other consumer goods.

Some of these large retailers have the additional advantage of having foreign subsidiaries that make it possible to shift income and assets. For example, among the 83 out of 100 largest U.S. corporations that were identified by the Government Accounting Office as having subsidiaries in offshore tax havens there are several big retail chains including Best Buy, Target, Safeway, and Supervalu.[18]

Best Buy reports 13 subsidiaries located in tax haven jurisdictions, including Bermuda, Luxemborg, and the Republic of Mauritius. Target maintains a subsidiary in Bermuda. SuperValu, which operates several regional grocery store chains, maintains subsidiaries in the Grand Cayman Islands and Bermuda.[19] It appears that all five of their subsidiaries exist for financial and/or tax minimization purposes, since the company reports no overseas retail or distribution operations.[20] In 2009, SuperValu paid $65 million in federal taxes on $632 million in pre-tax income, for an effective rate of 10.3%.[21]

Safeway, another grocery store company, has three subsidiaries in the tax haven countries of Bermuda and the British Virgin Islands. Safeway notes that it has 48 other subsidiaries that are not listed (up from 36 in 2009) because "they are maintained solely for the purpose of holding licenses, they hold no assets or because they are less than majority owned." Companies do not have to disclose whether these subsidiaries are in tax havens or not, so there is no definitive way to determine whether these are for tax minimization.

License-holding subsidiaries are sometimes used as a tax avoidance strategy. Under this system, the parent company transfers ownership of trademarks, patents, or investments to a subsidiary located in a jurisdiction with a lower or zero tax rate, and then pays a royalty to the license-holding subsidiary to lease back the asset. The subsidiary can then send any profits tax-free back to the parent via dividends or loans.

Local retailers face enough challenges before they encounter the potential unlevel playing field created by overseas tax havens.

Case Study No. 1: Domestic Insurance Industry

Global insurance companies that have significant business in the U.S. are able to reduce or eliminate their U.S. taxes through tax havens in Bermuda, Ireland and Switzerland. These foreign based companies can shift their U.S. reserves and investment income overseas to avoid substantial U.S. taxes through reinsurance with a subsidiary located in a tax haven.

The amount of offshore affiliate reinsurance has grown from $4 billion in 1996 to $33 billion in 2008, according to Rep. Richard Neal (D-MA), a ranking member of the House Ways and Means Committee who has tracked the issue. Of the total $33 billion in reinsurance funds moving offshore, $21 billion went to Bermuda and $7 billion went to Switzerland.[22]

In order to compete, other domestic insurance companies have formed offshore companies in tax haven countries for the primary purpose of avoiding taxes. These companies maintain only the most superficial presence in these countries.

A CEO of offshore insurance company HarborPoint Limited, John Berger, told an industry publication that the tax havens were central to its business model. "If you're not in one of these [offshore] domiciles, shame on you. All things being equal, the tax advantage will win over time." Bermuda had the most advantages, according to Berger.[23]

Offshore reinsurers have argued that they pass savings along to consumers. But Brad Kading, the head of the Association of Bermuda Insurers and Reinsurers, admitted in a trade publication interview that member company profits derived from tax advantages are "going back to shareholders," not consumers.[24]

Thirteen U.S.-based insurance companies have challenged the practice by forming a national association to fight the tax breaks. They argue that domestic insurers are major investors in the U.S. economy, owning 15 percent of the domestic bond market.[25] They are pressing for legislation to level the playing field.

On May 9, nine CEOs from domestic insurance companies, including Chubb, General Re, Liberty Mutual, MBIA and The Travelers, sent a letter to *The Hill* writing, "As the CEOs of leading domestic insurance companies, we urge Congress to close this loophole and end the unfair and unintended competitive advantage for offshore insurers, once and for all. With federal deficits at historic levels, and having just experienced the gravest financial crisis since the Great Depression, it makes no sense to allow this shell game to continue."[26]

Case Study No. 2: Community Banks/Credit Unions v. Global Finance

Tax havens contribute to an unlevel playing field between community-oriented domestic banks and global banks.

Wainwright Bank and Trust is a community bank based in Boston that holds $1 billion in assets.[27] Wainwright focuses its business activities on creation of affordable housing and provides financing to community non-profits providing social services to Boston's neighborhoods. Wainwright has been awarded funding as a federally designated Community Development Financial Institution, along with a host of other awards for its efforts in the arena of corporate social responsibility.

Wainwright is also a taxpayer, reporting a 2009 federal effective tax rate of 11.8% and an effective state tax rate of 3.2% (after accounting for federal income tax benefits allowing state taxes to be deducted). Because of its strong support of affordable housing and community economic development, Wainwright received housing related tax credits equal to 11.6% of its net income. Investments in tax-exempt bonds (typically used to fund state and municipal governments) reduced taxes by an additional 9.1% of net income.[28] Wainwright has no subsidiaries in tax havens. All of its tax credits were in exchange for investments that promote federal, state and local efforts to promote sustainable communities.

In contrast, Wainwright's largest competitor, Bank of America, has been one of the leaders in using offshore tax havens to avoid payment of taxes. In 2009, Bank of America received a tax refund for more than $3.5 billion – even though it reported $4.3 billion in profits before taxes to its shareholders.[29]

Bank of America's tax situation in 2009 was complicated by the large federal bailout it received and from large mergers with Merrill Lynch and Countrywide Financial Corporation, one of the main culprits in predatory lending and the mortgage meltdown.

Bank of America generated more than $1.3 billion in tax savings from "foreign tax differential" and "loss on certain foreign subsidiary stock," according to the footnotes in its financial reports. Those foreign differential and stock items most often relate to channeling profits through tax havens. At the end of 2009, Bank of America was engaged in 10 investigations or disputes with the IRS, at least three of which appear to pertain to use of tax havens. While some of these disputes were inherited through mergers, one stems from Bank of America's use of foreign tax credits between 2000 and 2002. The IRS has disallowed these credits, a decision Bank of America is challenging through the appeals process. [30]

When U.S. multinational banks use tax havens to evade their tax obligations it distorts the economic playing field and undermines the consumer and commercial lending and community economic development that lies at the heart of the banking industry's intended mission. When Bank of America improves its financial returns by avoiding taxes, that allows it to attract lower cost of capital than a community bank, such as Wainwright. The responsible payment of taxes is one of the ways in which banks and other businesses support the communities that they ultimately rely on for their corporate existence. When Wainwright Bank pays local, state and federal taxes, it is leveraging the investments in the community that it has made through its business lending. When Bank of America drains money from the Federal Treasury through sheltering their profits in tax havens, it actually depletes the funds available for community economic development and ultimately fails to serve the communities as it says it aspires to do.

Case Study No. 3: Tax Havens Facilitate Casino Economy

In 2008, Goldman Sachs reported profits of over $2 billion and paid federal taxes of $14 million, an effective tax rate of just one percent. Meanwhile in that same year, Goldman Sachs, paid out $10 billion in compensation, a tax deductible business expense. The $14 million Goldman paid the U.S. Treasury was less than one third in taxes what they paid their CEO Lloyd Blankfein, who received $42.9 million.

How is this possible? Matt Taibbi writes, "According to Goldman's annual report, the low taxes are due in large part to changes in the bank's 'geographic earnings mix.' In other words, the bank moved its money around so that most of its earnings took place in foreign countries with low tax rates."[31] Global tax havens enabled Goldman to shift its revenues offshore and defer taxes on these revenues indefinitely – even as Goldman claims deductions for such expenses as bloated executive compensation.

Tax havens also helped Goldman make "heads we win, tails you lose" bets on subprime mortgages. In a special investigative series, McClatchy reported how working through Cayman Island subsidiaries, Goldman Sachs "peddled billions of dollars in shaky securities tied to subprime mortgages on unsuspecting pension funds, insurance companies and other investors when it concluded that the housing bubble would burst."[32]

In January 2010, McClatchy reported it had "obtained previously undisclosed documents that provide a closer look at the shadowy $1.3 trillion market since 2002 for complex offshore deals… The documents include the offering circulars for 40 of Goldman's estimated 148 deals in the Cayman Islands over a seven-year period, including a dozen of its more exotic transactions tied to mortgages and consumer loans that it marketed in 2006 and 2007, at the crest of the booming market for subprime mortgages to marginally qualified borrowers. In some of these transactions, investors not only bought shaky securities backed by residential mortgages, but also took on the role of insurers by agreeing to pay Goldman and others massive sums if risky home loans nose-dived in value — as Goldman was effectively betting they would."

Goldman's Cayman Islands deals "became key links in a chain of exotic insurance-like bets called credit-default swaps that worsened the global economic collapse by enabling major financial institutions to take bigger and bigger risks without counting them on their balance sheets," McClatchy observed. "Taxpayers got hit for tens of billions of dollars in the Caymans deals because Goldman and others bought up to $80 billion in insurance from American International Group on the risky home mortgage securities underlying the deals. AIG, rescued in September 2008 with $182 billion from U.S. taxpayers, later paid $62 billion to settle those credit-default swap contracts" with Goldman and other firms.[33]

In April, the Securities and Exchange Commission charged Goldman Sachs with defrauding investors by making materially misleading statements and omissions in connection with a synthetic collateralized debt obligation (CDO), known as ABACUS 2007- AC1, tied to the performance of subprime residential mortgage-backed securities. Abacus investors are alleged to have lost more than $1 billion. The SEC Complaint notes that "Synthetic CDOs like ABACUS 2007-AC1 contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market."[34] Abacus 2007-AC1 was incorporated in the Cayman Islands.

On July 15, 2010 Goldman Sachs settled the SEC's civil suit with a record fine of $550 million, of which the U.S. Treasury will get $300 million and the investors who lost money on their Abacus investments, $250 million. While large in the context of SEC history, $550 million is small compared to the $13.39 billion Goldman Sachs reported in profit last year. [35]

An International Monetary Fund (IMF) Working Paper observes, "According to the June 2007 and June 2008 surveys of U.S. portfolio liabilities, the Cayman Islands were the largest foreign holder of private-label U.S. mortgage-backed securities. More information on the ultimate holders of these securities could clearly provide valuable insights on the transmission of the sub-prime shock and the financial crisis more generally."[36]

As an article in Wealth Bulletin put it, "Although the IMF is concerned about the undeclared assets held in offshore centres from a tax perspective, it is particularly concerned about how this money affects cross-border financial interaction and contributes to shocks in the global economy such as the recent credit crisis."[37]

III. Policy Solutions

Progress Toward Closing Tax Havens

Recently, Congress and oversight officials have made progress towards increasing transparency and reducing tax haven abuse.[38] In 2009, U.S. Senator Carl Levin (D-MI) and U.S. Representative Lloyd Doggett (D-TX) introduced the Stop Tax Haven Abuse Act of 2009, a comprehensive and multi-faceted bill to ban the most egregious abuses. When early attempts to advance the bill were resisted by powerful lobbies, Senator Levin and Rep. Doggett began successfully inserting key provisions of the Stop Tax Haven Abuse Act into other key pieces of legislation.

Congress passed legislation in 2009 to enhance tax haven reporting requirements and increase penalties. The Foreign Accounts Tax Compliance Act of 2009 (FATCA), introduced by U.S. Senator Max Baucus (D-MT) and U.S. Representative Charles Rangel (D-NY) expands the disclosure requirements for cross-border transactions and significantly increases the penalties for non-compliance. FATCA also requires investment advisors to report on any transactions in which they assist clients in investing in foreign entities. It also establishes withholding taxes on assets held in foreign trusts and dividends paid from foreign entities.

One of the most important provisions passed to date, the "Economic Substance Doctrine," was included as a part of the Health Care Reform bill. The Economic Substance Doctrine bars any tax-advantaged deductions undertaken for the express purpose of avoiding taxes. In other words, if shifts in assets were not made for legitimate reasons, they cannot be used to shelter earnings from taxes.

In addition to legislation, Senate and House committees have held a series of hearings exposing ongoing offshore tax abuses. Sen. Levin's Permanent Subcommittee on Investigations, for example, held hearings showing how UBS in Switzerland and LGT Bank in Liechtenstein helped U.S. clients hide their assets and cheat on their taxes. Congressman Neal exposed offshore insurance scams. Senator Baucus highlighted leasing abuses, many of which have offshore elements.

Several other legislative and regulatory actions have shaped the tax haven environment:

Corporations Must Disclose Questionable Tax Transactions -- Regulators have also taken steps likely to reduce tax haven abuse. In 2006, the Financial Accounting Standards Board (FASB) required companies in which auditors have identified questionable tax strategies to set aside financial reserves for "uncertain tax positions." That accounting requirement has forced companies to identify tax strategies, including those offshore that may not pass IRS scrutiny. This may provide roadmaps for tax authorities trying to evaluate the fairness of those tactics.

Tax Haven Banks Sued to Provide Information on Suspected Tax Evasion -- In a much-celebrated 2009 case the U.S. Department of Justice sued United Bank of Switzerland (UBS) alleging the venerable bank was colluding with more than 52,000 U.S. customers in tax evasion. Facing the threat of a criminal trial, UBS admitted facilitating U.S. tax evasion and opening accounts for U.S. clients with about $20 billion in assets that were not disclosed to the IRS. UBS then entered into a deferred prosecution agreement in which it released information on 250 U.S. customers and agreed that it would no longer open Swiss accounts for U.S. clients without notifying the IRS. This prosecution was only a partial victory, however, because UBS refused to release the names of the other 52,000 U.S. clients with Swiss accounts. After lengthy negotiations involving the Swiss Government, the Swiss signed an agreement allowing UBS to release additional U.S. client names estimated at totaling 4,450. After opponents charged that the agreement violated Swiss bank secrecy laws, the Swiss Parliament in June 2010, voted to ratify the U.S.-Swiss agreement and release the names. Tax justice advocates worry, however, that the year-long delay in disclosure has weakened and may render moot the ability to prosecute and collect the tax revenues owed.

Thousands Take Advantage of IRS Amnesty Program, Pay Their Taxes and Name Their Accomplices -- The UBS lawsuit coupled with a tax amnesty program offered by the IRS has also borne positive results, with some 14,000 taxpayers reporting assets and income that had been sheltered in tax havens and agreeing to pay the taxes owed on this hidden wealth. As a condition of amnesty, taxpayers were also required to report the tax attorneys and accountants that aided their tax evasion efforts.

Policy Agenda and Recommendations

There is still plenty of unfinished business in terms of reducing tax haven abuse. Here are our policy recommendations:

1. **Ban Phony Offshore Corporations.**

Revenue: Ending this abuse would raise approximately $5 billion in federal revenues annually or $50 billion over ten years.

Background: Another blatant tax haven abuse involves U.S. companies that establish an offshore subsidiary and pretend that its business and profits are generated offshore, when its primary management team remains in the United States. For example, TransOcean, owner of the Deepwater Horizon oil platform that exploded, killed 11 workers, and devastated the Gulf of Mexico, is a prime example of this "corporate inversion" abuse. For decades, TransOcean, the world's largest operator of offshore drilling platforms was a proud U.S. corporation. But in 1999, TransOcean moved its incorporation first to the Cayman Islands and later to Switzerland, with the stated purpose of lowering its taxes.

Status: This abuse would be eliminated by the International Tax Competitive Act of 2010 (H.R 5328) introduced by Congressman Lloyd Doggett (D-TX) in May 2010. ITCA would treat a company as a U.S. company for tax purposes if its management and officers with day-to-day control are located in the U.S., even if its paper incorporation is offshore. The same Management and Control provision is part of the Stop Tax Havens Abuse Act.

2. Block All Transfers of Intellectual Property Designed to Evade Taxes.

Revenue: Closing this loophole would add $10 billion to the Federal Treasury each year or $100 billion over ten years.

Shifting intellectual property to low or no-tax jurisdictions is one of the biggest abuses of tax havens. During early stages of product development, firms in the technology and pharmaceutical industry would often retain their patents in the United States, so that costly research and development could be expensed and used to offset other earnings. As products approached commercialization, valuable patents would be registered in a tax haven, allowing companies to evade most, if not all, of the profits associated with the product.

Status: The International Tax Competition Act of 2010 would tax all revenue pertaining to patent use for products sold within the United States, regardless of where the patent is physically registered.

3. Repeal the 80/20 Rule.

Background: The 80/20 rule allows corporations to escape U.S. taxation if 80 percent of their business occurs overseas. This provision is used by foreign corporations to shift income from their domestic U.S. operations.

Status: This proposal is pending as part of the current Senate Extenders bill as a "pay for" and may soon become law through that legislation. This provision is also a part of the International Tax Competition Act of 2010.

4. Repeal "Boot Within Gain Limitation" for Dividends.

Background. This loophole allows corporations engaged in certain restructurings to repatriate foreign profits without taxation.

Status: This is also in the Extenders bill under debate and may become law through that legislation.

5. Require U.S. Corporations to Declare Beneficial Owners.

Background: Though not deemed a low-tax or no tax jurisdiction, and therefore not a tax haven, lax U.S. corporate registration laws play a powerful role in maintaining the secrecy upon which tax evasion thrives. Tax Justice Network ranks the United States as having the greatest negative impact on financial transparency of any nation in the world. At the center of this lack of transparency are provisions among many states, including Delaware which has the largest concentration of U.S. corporate registrations, permitting anonymous persons to incorporate U.S. companies without disclosing the beneficial owners. The absence of ownership information greatly impedes law enforcement efforts to combat everything from tax evasion to drug running and illegal arms trading. Senator Levin has led the fight to require states to demand that all corporate registrations name their beneficial owners. This approach has received strong support from the law enforcement community, while being opposed by the U.S. Chamber of Commerce and American Bar Association which support corporate secrecy.

Status: Beneficial ownership problem would be corrected by the Incorporation Transparency and Law Enforcement Assistance Act, S. 569, introduced by Senators Levin, Grassley and McCaskill.

6. Adopt the "Special Measures" Provision Allowing the U.S. Treasury to Block Financial Transactions with Foreign Banks That Aid and Abet Tax Evaders.

Revenue: Adopting this provision would raise nearly $1 billion over ten years.

Background: This measure would allow Treasury to take a range of measures against foreign banks that are assisting U.S. taxpayers in tax evasion, including by prohibiting U.S. banks from accepting credit card transactions and wire transfers from those foreign banks.

Status: This provision would amend the Patriot Act, by adding tax evasion to the money laundering and terrorist misconduct blocked by the Patriot Act. This provision is a part of the Stop Tax Haven Abuse Act.

7. Support IRS Proposal Requiring Disclosure of "Uncertain Tax Positions"

Background: As previously noted, since 2006, FASB has required corporations to establish reserves covering questionable tax practices, including the use of tax havens. Now, the IRS has proposed that corporations complete a new tax return schedule with a narrative description of each questionable tax position it is taking and the dollar amount involved. Opponents claim the IRS should not be able to force corporations to disclose their tax strategies, but the Supreme Court recently ruled in the IRS's favor, saying tax evasion is not a game and obtaining the information about ongoing tax dodging is within the Agency's rights.

Status: The proposed new tax return disclosing uncertain tax positions is undergoing public comment, and the Administration will decide later this year whether to proceed.

8. Create Penalties for Government Contractors Using Tax Havens to Avoid U.S. Taxes.

Background: Sixty-three of the largest 100 Federal contractors have at least one subsidiary in a tax haven country. These are companies who derive income from U.S. taxpayers, while themselves avoiding paying their fair share of taxes. Congress could consider a "bidding penalty" of 5 percent for firms with tax haven subsidiaries, a penalty which would offset some of the losses when the firm shifts their share of taxes onto others.

Status: Not currently in legislative form.

9. Impose a fee on wire transfers of illicit funds.

Background: The hidden assets of the world move throughout the financial system using wire transfers. Those hiding their income and assets in tax havens move their funds frequently in order to confound the tracking efforts of tax authorities. One means of capturing some of this money is through imposing a fee on offshore wire transfers. Businesses engaging in legitimate wire transfers conducted in the course of their business would be able to claim a tax deduction for this expense.

Status: Not currently in legislative form.

Resources

For more research and advocacy on tax havens:

• Citizens for Tax Justice: Offshore tax haven abuse archives. http://www.ctj.org/taxjusticedigest/archive/federal_tax_issues/tax_avoidance_tax_evasion_and/offshore_abuses

• Global Financial Integrity. http://www.gfip.org.

• Tax Justice USA. http://www.taxjustice.net.

• U.S. Public Interest Research Group: Overview on corporate tax loopholes, http://www.uspirg.org/issues/tax-and-budget/close-corporate-tax-loopholes.

Special reports:

• "Tax Shell Game: What Do Tax Dodgers Cost You," U.S. Public Interest Research Group, April 2010. http://www.uspirg.org/home/reports/report-archives/tax--budget-policy/tax--budget-policy--reports/tax-shell-game-what-do-tax-dodgers-cost-you

• Goldman Sachs, Offshore Tax Havens and the Economic Meltdown, McClatchy News, November 2009 and January 2010. http://www.mcclatchydc.com/2009/11/03/77844/goldman-left-foreign-investors.html

• Tax Havens: International Tax Avoidance and Evasion, Congressional Research Service, July 2009. http://assets.opencrs.com/rpts/R40623_20090709.pdf

• Capitol Hill Briefing on Tax Haven Abuse and Legislation, Global Financial Integrity, Citizens for Tax Justice and Tax Justice Network USA, July 2009. http://www.gfip.org/storage/gfip/documents/hill%20briefing%20packet.pdf

• U.S. Companies Seek New Tax Havens, Business Week, June 2009. http://www.businessweek.com/print/bwdaily/dnflash/content/jun2009/db20090628_851524.htm

• The Taxpayer Cost of Offshore Corporate Havens, U.S.PIRG, April 2009. http://www.uspirg.org/home/reports/report-archives/tax--budget-policy/tax--budget-policy--reports/tax-shell-game-the-taxpayer-cost-of-offshore-corporate-havens

• International Taxation:Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions; U.S. General Accounting Office, December 2008. http://www.gao.gov/new.items/d09157.pdf

News Articles:

• "U.S. Companies Dodge $60 Billion in Taxes with Global Odyssey," Bloomberg News, May 13, 2010. http://preview.bloomberg.com/news/2010-05-13/american-companies-dodge-60-billion-in-taxes-even-tea-party-would-condemn.html

• "U.S. Firms Dodge Billions in Taxes by Moving Profits Overseas," ABC News, May 13, 2010. A good video report based on the Bloomberg story. http://abcnews.go.com/WN/us-firms-dodge-billions-taxes-moving-profits-overseas/story?id=10641219

From the Permanent Subcommittee on Investigations:

• Report on Dividend Tax Abuse, September 11, 2008. http://www.senate.gov/Senate404.html

• Report on Tax Haven Banks and U.S. Tax Compliance, July 17, 2008. http://hsgac.senate.gov/public/_files/REPORTTaxHavenBanksJuly1708FINALwPatEliseChgs92608.pdf

• The Enablers, the Tools, and Secrecy, August 1, 2006. http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf

Legislative options:

• Summary of the Tax Haven Abuse Act (S. 506, HR.1264). http://levin.senate.gov/newsroom/release.cfm?id=308949

• Summary of Foreign Account Tax Compliance Act (S.1934, HR.3933). http://finance.senate.gov/custom404.cfm?request=/press/Bpress/2009press/prb102709a.pdf&remoteaddr=24.34.118.109

• Text of International Tax Competitiveness Act of 2010 (H.R. 5328). http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.5328:

Organizations

American Sustainable Business Council (www.asbcouncil.org) is a growing collaboration of 20 business networks working to advance policies that foster a vibrant and sustainable economy.

Business for Shared Prosperity (www.businessforsharedprosperity.org) is a network of forward-thinking business owners, executives and investors committed to building enduring economic progress on a strong foundation of opportunity, equity and innovation

Wealth for the Common Good (www.wealthforcommongood.org) is a network of business leaders, high-income households and partners working together to promote shared prosperity and fair taxation

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End Notes

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2 International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions; U.S. General Accounting Office; GAO-09-157; December 2008; http://www.gao.gov/new.items/d09157.pdf

3 Rep. Lloyd Doggett, The Wonk Room, April 13, 2010. http://wonkroom.thinkprogress.org/2010/04/13/doggett-barnacles/

4 International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions; U.S. General Accounting Office

5 Tax havens are designed to be hard to study, shielded as they are by extreme amounts of secrecy and technical complexity. Nevertheless, we know that they have grown substantially during the past few decades by tracking the growth of U.S. corporate profits generated in tax haven countries and by looking at the growth in the value of U.S. assets held in foreign countries.

6 U.S. Treasury Inspector General for Tax Administration, A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap, January 27, 2009 (Reference Number: 2009-IE-R001). Appendix VI.

7 U.S. Treasury Inspector General for Tax Administration, A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap, January 27, 2009 (Reference Number: 2009-IE-R001), Appendix VI.

8 Office of Management and Budget, FY 2011 President's Budget, Summary Tables, Table S-11.

9 Budget of the U.S. Government: Fiscal 2010; Historical Tables; Table 2.1, pp. 30ff; http://www.whitehouse.gov/omb/budget/fy2011/assets/hist.pdf

10 Estimates on the corporation "tax gap" range as high as $60 billion per year. See: Kimberly A. Clausing, "Multinational firm tax avoidance and tax policy," National Tax Journal, Dec. 1, 2009, Vol. 62, Issue 4, p. 703. Clausing's research is based on a method similar to this report, but includes some different assumptions. For instance, she uses a higher estimated $180 billion in foreign profits in tax havens.

11 The $149 billion number is from the Bureau of Economic Analysis. See op. cit. U.S. Treasury Inspector General (January 2009). "In 2004, data from the Department of Commerce's Bureau of

Economic Analysis (BEA) reported that profits of foreign subsidiaries of U.S. corporations based in 18 tax haven countries grew 70 percent from $88 billion in 1999 to $149 billion in 2002. The $149 billion reported in 2002 in the 18 tax haven countries accounts for 58 percent ($149 billion / $255 billion) of profits of foreign subsidiaries of U.S. corporations worldwide. "

12 U.S. Multinational Corporations Effective Tax Rates Are Correlated with Where Income Is Reported; US Government Accountability Office; GAO-08-950; August, 2008, http://www.gao.gov/new.items/d08950.pdf. "The weighted average U.S. effective tax rate on the domestic income of large corporations with positive domestic income in 2004 was 25.2 percent, while the median effective tax rate for this population of corporations was 31.8 percent

13 It is likely that some small tax would be collected by the tax haven nations that would reduce some of this $37 billion. This would have been more than offset by the significant growth in corporate profits passing through tax havens today.

14 See op. cit. U.S Treasury Inspector General (January 2009) "The 20-fold increase in the estimated number of multinational enterprises from 3,000 in 1990 to well over 63,000 in 2007. The Commerce Department's Exporter Data Base (EDB) shows that in 2005, the total number of U.S. firms exporting goods stood at 239,094. More specifically, the number of small and medium-sized enterprises (SMEs) that export merchandise more than doubled between 1992 and 2005. The known export revenue of SMEs rose from $102.8 billion in 1992 to $228.5 billion in 2005. SMEs were responsible for 29.1 percent of goods exported in 2005. The number of filings of Form 1120, U.S. Corporation Income Tax Return containing international features, has increased 87 percent from 2002 to 2007. This suggests that foreign income is growing not shrinking, at least through 2007."

15 U.S. Multinational Corporations Effective Tax Rates Are Correlated with Where Income Is Reported; US Government Accountability Office; GAO-08-950; August, 2008, http://www.gao.gov/new.items/d08950.pdf

16 "Baucus, Landrieu Unveil Bill to Create Jobs and Help Small Businesses Grow," US Senate Committee on Finance, June 29, 2010; http://finance.senate.gov/newsroom/chairman/release/?id=b7c67e81-801a-4485-ac7b-5582806a6191

17 This is a provision of the proposed Small Business Jobs Act. U.S. Senate Committee on Finance, "Baucus, Landrieu Unveil Bill To Create Jobs and Help Small Businesses Grow," June 29, 2010. http://finance.senate.gov/newsroom/chairman/release/?id=b7c67e81-801a-4485-ac7b-5582806a6191

18 Target maintains a subsidiary in Bermuda and 6 in Hong Kong. See: See Target Corporation, as of January 30, 2010, Schedule 10-K, Exhibit 21. http://www.secinfo.com/dVut2.r226.6.htm#1stPage.

Best Buy reports 13 subsidiaries located in tax haven jurisdictions, including Bermuda, Luxembourg, and seven in the Republic of Mauritius. See: Best Buy, 10-K, Exhibit 21.1, Subsidiaries of the Registrant at February 28, 2009.

19 Supervalu Corp, as of Feb 23, 2010, Schedule 10-K, Exhibit 21.1. http://www.faqs.org/sec-filings/100426/SUPERVALU-INC_10-K/c56441exv21w1.htm

20 Ibid. Because corporations face so little disclosure about their use of tax haven subsidiaries, it is impossible to determine exactly why businesses choose to incorporate subsidiaries in them. In addition to avoiding taxes, businesses might also use tax havens for advantageous liability or employment-related laws. All of these reasons however, alter and distort the playing field between multinational and domestic businesses.

21 SuperValu Inc. 2010 Form 10-K, Financial Statements and Supplementary Data; Income Taxes, Note 8 pp. 52-54.

22 Statement by Rep. Richard Neal (D-MA), July 30, 2009. http://www.house.gov/neal/news/news113.html

23 The Insurance Insider, February 24, 2010. http://www.insuranceinsider.com/article/View.do;jsessionid=C4476609EA355CBC3B21ACA5D5E8652D?articleId=12527

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http://www.nytimes.com/2010/07/16/business/16goldman.html?scp=1&sq=goldman%20profits&st=cse]]

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37 David Bain, "IMF finds 'trillions' in undeclared wealth," Tax Justice USA, March 15, 2010.
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