SEMINAR ON RECENT INTERNATIONAL DEVELOPMENTS TO COUNTER TAX AVOIDANCE AND EVASION, FEBRUARY 18, 1982 pdf

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What Can Be Done? Sam Wyly is a rich Texas businessman. Sam is a major philanthropist: He is also an avid Republican. But Sam Wyly is now bankrupt. In , a hearing of the U. He began by transferring stock options from his various companies to the trusts, which were managed by Isle of Man trustees. In the meantime, the trusts were free to exercise the stock options and use the stock for investments, with the understanding that ten years down the road they would have to make annuity payments to Sam. Sam obtained an opinion from a law firm that this arrangement worked to defer taxes on the income gained from exercising the options until he began receiving annuity payments years later. But the linchpin of the legal opinion was that the offshore trusts were independent actors when, in fact, Sam exercised total control over the trust assets, secretly using the investment profits to operate businesses and buy real estate, jewelry, and artworks in the United States. In , a jury found him liable. We will probably never know. Every time a Swiss banker talks, many billions in U. And this is only for illegal tax evasion by individual taxpayers. Corporations are another story, because what they are doing is legal tax avoidanceâ€"manipulating their books to avoid taxationâ€"and therefore the magnitudes can be better quantified. As of the end of , U. The Corporate Tax Dodge How do the multinationals do it? A couple of examples can suffice. Most of its billions in profits relate to intellectual property developed at its headquarters in Cupertino, California. The idea behind cost sharing is this: Then, if the project is successful, the parties share the profits in the same proportions. For example, if Apple Ireland contributed 80 percent of the costs of developing the iPhone 6, it would get 80 percent of the profit. Importantly, none of the actual work is done by Apple Ireland. Apple just gives Apple Ireland the money and Apple Ireland pays it back as its contribution to the research costs. Why would the IRS regulations permit this? Because if the research failed, then the taxpayer would lose its ability to deduct the costs sent offshore. The more of the cost sent offshore, the more deductions would be at risk. So the IRS thought there was a natural limit to taxpayer willingness to share costs with offshore affiliates. That analysis may have been true for Big Pharma, which usually waits to enter into cost sharing with an offshore affiliate until a drug has passed its initial trials and is well on its way to a patent, and then battles the IRS over valuation issues at the time the cost-sharing agreement was executed. But the same analysis makes no sense for Apple, since if there is anything certain in business, it is that a new version of the iPhone will sell. Another portion of its profits derive from countries where Apple sells the iPhones. Those affiliates in turn pay Apple Ireland hefty royalties, which operate to shift the sales profits gained in those countries to Ireland. Before , such a scheme would not have worked, because the royalties received by Apple Ireland would have triggered a tax in the U. The result is that, for U. But by its next budget in , the administration recanted under pressure from the multinationals. Finally, the Senate hearing revealed two Irish-specific tricks used by Apple. Ireland has a tax rate of But Apple did not want to pay even Its solution was ingenious: As a result, Apple Ireland claimed it was a tax resident nowhere. On top of that, it negotiated a sweetheart tax deal with Ireland for its Irish income, which resulted in its paying a tax rate of less than 2 percent. Caterpillar and PricewaterhouseCoopers executives testified. If the primary driver of value of a U. But what if the value derives from more traditional, tangible items? But others try to avoid tax nevertheless. Caterpillar does not make a lot of money on the heavy equipment it manufactures. But it makes a bundle on replacement parts, because once you buy a Caterpillar bulldozer, you will need parts, which you can obtain only from Caterpillar at a huge markup. Caterpillar prides itself on its ability to deliver parts within 24 hours anywhere in the world, including the Arctic tundra where its equipment is used in mineral extraction. Before , Caterpillar bought the parts from unrelated manufacturers and stored them at its warehouse in Morton, Illinois. Much better, PwC said, would be if the parts were sold by the manufacturer directly to the Swiss subsidiary, which could then sell them to the dealer. Fine, said

Caterpillar, but we do not want to change our operations. The result was that Caterpillar continued to run its parts business from the U. A grand jury has issued subpoenas under a criminal investigation for tax fraud. But the disturbing fact is that the whole story would not have come to light but for a whistleblower, who alerted both PSI and the IRS. Addressing Tax Evasion What might be done to reform this massive loss of revenue? Consider first outright tax evasion. FATCA has real teeth, as the chorus of complaints by foreign banks and their governments shows. It also led to real developments. Treasury has negotiated with various countries. Under the IGAs, the foreign banks can disclose the information about U. This avoids legal problems from the banks dealing directly with the IRS, which is illegal in most countries. Even Switzerland has signed an IGA. In addition, more than 80 countries including the U. In addition, its disclosure obligations apply only to larger accounts and can be avoided by tax cheats opening smaller accounts at multiple banks. So secret offshore accounts are still possible, although the cost of tax evasion and the risk of discovery have increased. Second, these agreements depend on compliance by long-standing tax havens, an outcome that is far from certain. In addition, the IGAs require reciprocity from the U. Finally, the entire edifice rests on an uncertain foundation. For exchange of information to work, every single tax haven needs to cooperate, because otherwise the funds will flow to the non-cooperating havens. Total tax haven cooperation seems unlikely, to say the least, absent stiff sanctions that go beyond the U. In the past, world leaders have threatened sanctions against uncooperative tax havens, but never actually imposed them. Economists like to imagine universal solutions to the tax-evasion problem such as the global tax on wealth proposed by Thomas Piketty, or the universal registry of financial assets advocated by Gabriel Zucman , but in the world we have, such solutions are utopian. Automatic universal exchange of information is likewise a nice ideal that may be implausible in practice. There is an easier solution. The key observation is that funds cannot be invested in tax havens because they are too small even Switzerland is a small economy if one ignores the banking sector. And they must be invested in the U. Therefore, if the U. Using a 30 percent tax the U. What prevents this obvious solution from happening is that the U. This reflects the political power of corporations on both sides of the Atlantic. In contrast, Japan already imposes such a tax, demonstrating its feasibility. What may change the status quo is that both sides have come to realize that U. To stop the tax cheating, the EU is willing to impose anonymous withholding taxes on foreign account-holders; even Switzerland entered into such an agreement with the U. Importantly, given likely Republican control of Congress, no change in law is necessary: The Obama administration could apply this provision tomorrow if it had the political courage to do something about tax evasion. Battling Tax Avoidance Ideally, the solution to tax avoidance by multinationals is for each country to tax the value that was economically generated by them in their locale. Many such proposals have been advanced. The most recent proposal along those lines is from the European Commission. Moreover, unitary tax would require rewriting more than 2, tax treaties that are based on treating each company in a corporate group as a separate taxpayer. This is a tall order. Some progress along these lines can be made under BEPS, such as the new requirement that multinationals reveal to tax administrations but not to the public how much profit they made in each jurisdiction they operate in. But it will take many years to develop a workable unitary tax proposal. The EU proposal is only for operations within the European Union. While unitary taxation is technically feasible and may be the best long-term solution to taxing multinationals, the fierce political opposition means that it is not likely to happen in the near term. The multinationals themselves are clear: They want to be able to bring this money back to the U. But this makes no sense. Even if the U. For the future, the best solution is for the U.

2: International Tax Evasion: What Can Be Done?

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