

April 2010



Tax Shell Game:

What Do Tax Dodgers Cost You?

Maryland PIRG
Foundation

Tax Shell Game

What Do Tax Dodgers Cost You?

The Maryland Public Interest Research Group Foundation
April 2010

By Nicole Tichon, Federal Tax and Budget Reform Advocate



Some Rights Reserved: Maryland PIRG Foundation issues this report under a Creative Commons “some rights reserved” license. You are free to copy, distribute or display the work for non-commercial purposes, with attribution. For more information about this Creative Commons license, visit <http://creativecommons.org/licenses/by-nc-nd/2.5/>

Maryland PIRG Foundation: With public debate around important issues often dominated by special interests pursuing their own narrow agendas, Maryland PIRG Foundation offers an independent voice that works on behalf of the public interest.

Maryland PIRG Foundation, a 501(c) (3) organization, works to protect consumers, for a fair and sustainable economy and to promote good government. We investigate problems, craft solutions, educate the public and offer Americans meaningful opportunities for civic participation.

For a free copy of this report, visit our website. Or send a check for \$30 made payable to Maryland PIRG Foundation at the following address:

Maryland PIRG Foundation
3121 St. Paul Street, Suite 26
Baltimore, MD 21218
410-467-9389

Table of Contents

Executive Summary	1
1. Introduction	2
2. The Impact of Tax Havens	2
2.1 Cost to Taxpayers and Future Generations	2
2.2 Costs on a Global Scale	3
Figure 1: Tax Burden Shifted to States	4
Figure 2: Tax Burden Shifted to Individual Taxpayers, by State	5
3. Fairness and Fiscal Responsibility	6
3.1 Progress Made	6
3.2 Arguments Against Reform Don't Hold Up	7
3.3 Ending the Use of Offshore Tax Havens	8
Endnotes	9

Executive Summary

The IRS estimates that individuals and corporations currently hold \$5 trillion in tax haven countries and asserts that the United States is responsible for a large portion of these assets.¹ Many corporations operating in the United States funnel money through offshore tax havens in order to avoid paying billions in U.S. taxes. In fact, an independent study found that nearly two-thirds of corporations pay no taxes at all.² Goldman Sachs, which received a \$10 billion taxpayer bailout, managed to get their effective tax rate down to one percent by utilizing maneuvers they describe as “changes in geographic earnings mix.”³

Taxpaying households must pick up the tab for the missing revenue to the U.S. Treasury. The avoidance and evasion of taxes for a few becomes the burden for many – and for future generations.

Key Findings

- Offshore tax havens cost taxpayers revenue totaling as much as **\$100 billion per year - \$1 trillion over 10 years**. Individuals and corporations based in the U.S. who pay taxes on their revenues must shoulder this burden for those who do not.⁴
- Making up for this lost revenue **costs each taxpayer an average of \$500 per year**⁵. That’s a month’s worth of groceries for an average family of four⁶ or a year’s worth of health care for a child.⁷

Recommendation

- Congress should pass legislation to end the use of offshore tax havens and remove this unfair burden from taxpayers.

1. Introduction

Secrecy in the financial system has many victims, both in the U.S. and abroad. Individuals and corporations that avoid taxes by using offshore tax havens can count all taxpayers as their victims.

The Government Accountability Office (GAO), which is an independent, nonpartisan agency that conducts investigations on behalf of Congress, describes tax havens as places with no or nominal taxes and little if any reporting requirements.⁸ The practice of using offshore tax havens has flourished in an era of increasing secrecy and dangerous deregulation. Lobbyists for corporations with offshore tax havens have been able to count on the fact that the missing funds will never be accounted for. Many of the largest corporations have banded together to fight reform every step of the way – often with huge war chests. U.S. PIRG identified several large corporations that happily take taxpayer dollars for government contracts, make heavy use of tax havens, and then spend lavishly on campaigns and lobbying to resist reform.⁹

According to the GAO, over 80 percent of the biggest U.S. corporations maintain revenues in offshore tax haven countries.¹⁰ The names on the list are familiar: American Express, A.I.G., Boeing, Cisco, Dow, Hewlett-Packard, J.P. Morgan Chase and Pfizer – among others.

One jurisdiction that has gained notoriety for its willingness to accommodate tax havens is the Cayman Islands. According to GAO, over 18,000¹¹ companies exist in one five-story building in the Cayman Islands. President Barack Obama, as a candidate in 2008, once remarked, “That’s either the biggest building or the biggest tax scam on record.”¹²

The U.S. is not alone in its concern with tax avoidance and evasion. A key component of the G-20’s most recent meetings and publications include increasing tax transparency and information exchange across the globe. The most recent G-20 summit communique issued in November of 2009 continued the call for sanctions against “non-cooperative jurisdictions, including tax havens.”¹³

With the world and American taxpayers watching, it is time for the United States to show leadership on this issue.

2. The Impact of Tax Havens

Individuals and corporations that pay taxes in the United States shoulder the burden for those who do not. It’s a game, where individuals use foreign banks or sham companies and corporations use their subsidiaries as shells to shift revenues around to avoid taxes.

2.1 Cost to Taxpayers and Future Generations

According to the Internal Revenue Service, “It has been estimated that some \$5 trillion in assets worldwide is held “offshore” in tax havens.”¹⁴ Over ten years, an estimated \$1 trillion in revenues is lost due to the use of tax havens and the government must make up for this shortfall. This diversion is ultimately shouldered by other companies and taxpayers and is transferred as higher debt for future generations.

The \$100 billion annual revenue shortfall from tax haven use impacts every state in the union and every taxpayer.

Figure 1 is thus generated by distributing the \$100 billion according to the percent of total federal tax revenues that each state currently contributes to the Treasury. Figure 2 shows how that tax burden is then distributed across individuals who have filed a tax return within that state. On average, the additional tax burden amounts to nearly \$500. That's a month's worth of groceries for an average family of four¹⁵ or a year's worth of health care for a child.¹⁶

On the next page, Figure 1 breaks down the tax burden by state.

Figure 2 breaks down the tax burden by taxpayer.

2.2 Costs on a Global Scale

The negative impact of offshore tax havens extends beyond the United States. According to the IRS, "At least 40 countries aggressively market themselves as tax havens. Some have gone so far as to offer asylum or immunity to criminals who invest sufficient funds. They permit the formation of companies without any proof of identity of the owners, perhaps even by remote computer connection."¹⁷

A similar alarm has been sounded by Nobel-prize winning economist Joseph Stiglitz, who chaired the Commission of Experts of the U.N. General Assembly on reforms of the international monetary and financial system. He makes it clear that tax havens are a losing proposition on all sides. "Secret tax havens ... are bad for developing countries, bad for money laundering, drugs corruption – bad in every dimension."¹⁸ Mr. Stiglitz also indicated that the secrecy also assists terrorists using these shadow markets to finance their agenda.¹⁹

Figure 1: Tax Burden Shifted to States

State	Additional Tax Bill	State	Additional Tax Bill
Alabama	\$ 939,133,521	Montana	\$ 191,214,607
Alaska	\$ 215,965,217	Nebraska	\$ 598,869,312
Arizona	\$ 1,410,217,400	Nevada	\$ 624,389,262
Arkansas	\$ 954,850,942	New Hampshire	\$ 399,670,030
California	\$ 11,373,786,967	New Jersey	\$ 4,305,879,549
Colorado	\$ 1,682,120,803	New Mexico	\$ 379,382,621
Connecticut	\$ 1,901,110,034	New York	\$ 8,462,050,664
Delaware	\$ 508,527,697	North Carolina	\$ 2,661,965,850
Florida	\$ 5,077,562,092	North Dakota	\$ 188,590,297
Georgia	\$ 2,551,786,650	Ohio	\$ 4,515,635,366
Hawaii	\$ 302,617,635	Oklahoma	\$ 867,038,511
Idaho	\$ 308,988,504	Oregon	\$ 998,328,498
Illinois	\$ 4,893,233,977	Pennsylvania	\$ 4,591,048,153
Indiana	\$ 1,915,615,586	Rhode Island	\$ 397,583,623
Iowa	\$ 790,135,278	South Carolina	\$ 817,345,204
Kansas	\$ 880,656,227	South Dakota	\$ 200,531,385
Kentucky	\$ 1,064,812,848	Tennessee	\$ 1,951,472,196
Louisiana	\$ 1,629,252,879	Texas	\$ 7,754,139,140
Maine	\$ 281,600,485	Utah	\$ 638,510,592
Maryland	\$ 2,057,011,342	Vermont	\$ 151,350,673
Massachusetts	\$ 3,149,996,486	Virginia	\$ 2,505,010,024
Michigan	\$ 2,573,003,776	Washington	\$ 2,101,476,277
Minnesota	\$ 2,829,556,961	West Virginia	\$ 287,980,881
Mississippi	\$ 432,035,285	Wisconsin	\$ 1,711,903,530
Missouri	\$ 1,922,046,846	Wyoming	\$ 166,504,935

Figure 2: Tax Burden Shifted to Individual Taxpayers, by State

State²⁰	Additional Tax Bill	State	Additional Tax Bill
Alabama	\$ 336	Montana	\$ 251
Alaska	\$ 434	Nebraska	\$ 473
Arizona	\$ 376	Nevada	\$ 371
Arkansas	\$ 565	New Hampshire	\$ 425
California	\$ 483	New Jersey	\$ 802
Colorado	\$ 481	New Mexico	\$ 297
Connecticut	\$ 737	New York	\$ 692
Delaware	\$ 836	North Carolina	\$ 460
Florida	\$ 398	North Dakota	\$ 368
Georgia	\$ 447	Ohio	\$ 600
Hawaii	\$ 321	Oklahoma	\$ 378
Idaho	\$ 313	Oregon	\$ 381
Illinois	\$ 569	Pennsylvania	\$ 623
Indiana	\$ 464	Rhode Island	\$ 538
Iowa	\$ 373	South Carolina	\$ 294
Kansas	\$ 451	South Dakota	\$ 332
Kentucky	\$ 418	Tennessee	\$ 512
Louisiana	\$ 604	Texas	\$ 539
Maine	\$ 308	Utah	\$ 398
Maryland	\$ 546	Vermont	\$ 313
Massachusetts	\$ 697	Virginia	\$ 476
Michigan	\$ 405	Washington	\$ 454
Minnesota	\$ 754	West Virginia	\$ 266
Mississippi	\$ 261	Wisconsin	\$ 433
Missouri	\$ 495	Wyoming	\$ 386

3. Fairness and Fiscal Responsibility

In the face of the extraordinary economic challenges, it is particularly important to implement reforms that will generate revenues by closing loopholes that allow some who profit through business in American markets to avoid paying their fair share of taxes. We have seen evidence over the past year that the President and Congress have begun this process.

3.1 Progress Made

Over the last year, Congress and the IRS have taken some incremental steps toward ending the use of tax havens and making it less attractive to individuals and corporations.

Closing Loopholes

As Congress and the Administration addressed major domestic policy reforms, they also took initial steps to deter bank secrecy and the abuse of tax havens. The Hiring Incentives to Restore Employment (HIRE) Act (H.R. 2847), signed into law by the President in March of 2010, added new reporting requirements and penalties to discourage individuals, companies and banks that hide money in offshore tax havens. The law imposes a 30 percent tax on foreign financial institutions that fail to meet disclosure requirements on their American clients' accounts. While not as comprehensive as some other solutions, it represents a step in the right direction and a shot across the bow of tax dodgers.

In addition, an offset in the Health Care and Education Affordability Reconciliation Act (H.R. 4872) will make it easier for uniform enforcement of what's known as the Economic Substance Doctrine by making it part of the IRS Code. The purpose of the Economic Substance Doctrine is to ensure that transactions are not executed purely to manipulate tax exposure. They must have some other economic purpose. The law gives regulators a chance to get out ahead of the next set of tax tricks and gimmicks by placing the burden of proof on the tax lawyers to establish that a transaction isn't just a new scheme to help their clients avoid taxes.

Keeping New Loopholes Out of Legislation

Congress also avoided opening the doors to additional loopholes that were quietly added, and then removed from an appropriations bill last year.²¹

There has been wide support for banning inverted corporations from receiving government contracts. Inverted corporations are those that are built up in the U.S. and then move their headquarters to a tax haven country. In 2002, Congress took the first step in enacting legislation to address corporate inverters that seek government contracts with the Homeland Security Act. The law, passed overwhelmingly in the House and Senate, prohibited the Department of Homeland Security from contracting with inverted corporations. Most recently, with the Omnibus Appropriations Act of 2009, Congress broadened this restriction to apply government-wide.

During the Financial Services and General Appropriations process, a loophole was added in the Senate version that could have opened the floodgate for "inverted corporations" to access

lucrative government contracts. Fortunately, the loophole was exposed²² and removed from the final legislation.

Fighting the Battle Against Bank Secrecy in the Courts

The U.S. government won a significant victory against bank secrecy when it took on industry giant UBS in the U.S. District Court in Miami last year. The U.S. government pursued the client roster with Swiss accounts to the tune of 52,000 names. Revealing the names is against the law in Switzerland, so the two governments and UBS battled for months. The eventual settlement of the case was an agreement by UBS to pay \$780 million, admit to criminal wrongdoing and agree to reveal the names of 4,450 clients. The agreement, which is winding its way through the Swiss government for formal approvals, also requires UBS to disclose the names of any Americans suspected of owning sham companies as well as those who failed to file the required disclosure documents.

The settlement sent an effective message. In advance of the UBS reveal, the U.S. government offered amnesty with stipulations to those who would come forward voluntarily. Those who admitted to offshore accounts had to pay taxes, interest and a 20 percent penalty on the highest balance of the preceding six years (more limited penalties than they would have otherwise received by being handed over to the U.S. government, and would avoid possible jail time). The amnesty resulted in over 14,700 individuals disclosing their overseas accounts – more than in any previous effort by the IRS.

The UBS case has rattled the world of bank secrecy and offshore bankers, who anticipate a potential domino effect.²³

3.2 Arguments Against Reform Don't Hold Up

Markets work best when companies prosper based on their productivity and ability to innovate, not on their access to sophisticated tax lawyers and tax-avoidance schemes. When secrecy keeps individuals, governments and other banks from knowing exactly what is on the books and behind bank assets, it creates an inefficient marketplace that is more susceptible to the downward spiral we've seen over the last couple of years.

Those who support the use of tax havens - and maintaining the status quo - typically argue that American corporations are already taxed enough or too much. But this is beside the point. Whatever one thinks is the proper rate of corporate taxation, there should not be a parallel shadow system of tax avoidance that leaves other taxpayers shouldering the burden.

When lobbyists defend the existence of offshore tax havens, they refer to corporations already paying a *statutory tax rate* of 35 percent, which is simply the legal base rate. However, the amount corporations *actually* pay is instead indicated by their *effective tax rate*: the percentage of their profit that they actually pay in taxes.

After corporations use myriad deductions, credits for business-related expenses and depreciation allowances, the amount of profit they are taxed on decreases and the effective rate therefore decreases – in some cases to nothing at all.²⁴ Goldman Sachs, which received a \$10 billion taxpayer bailout, managed to get their tax rate down to one percent by citing “changes in geographic earnings mix.”²⁵

In 2008 the GAO reported that effective taxes rates vary greatly across corporations depending on their ability to use such tax-reduction techniques.²⁶ Another 2008 GAO study showed that 25 percent of U.S. corporations with more than \$250 million in assets or \$50 million in sales paid no federal income taxes at all in 2005, the most recent year for which such data is available.²⁷ In fact, many of the corporations that receive multi-million dollar taxpayer-funded government contracts continue to fight for the status quo.²⁸

3.3 Ending the Use of Offshore Tax Havens

Common-sense legislative reforms can address the loss of billions of dollars each year due to tax haven abuse. One of the key steps would be to tax corporations controlled and operated in the United States as domestic companies, eliminating the appeal of moving “headquarters” to a post office box in a tax haven country. Another step would be to end the practice of allowing corporations to deduct expenses for doing business overseas, which contributes to the loss of jobs here in the United States. America cannot afford to lose any more revenue or any more jobs. The time for reform is now.

Endnotes

- ¹ <http://www.irs.gov/businesses/small/article/0,,id=106568,00.html>
- ² Government Accountability Office, *Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1998-2005*. July 2008. <http://www.gao.gov/new.items/d08957.pdf>
- ³ http://www.bloomberg.com/apps/news?pid=20601110&sid=a6bQVsZS2_18
- ⁴ Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. *TAX HAVEN BANKS AND U. S. TAX COMPLIANCE STAFF REPORT*
<http://levin.senate.gov/newsroom/supporting/2008/071708PSIRReport.pdf>
- ⁵ The \$500 average is the average of all fifty states and the District of Columbia, Puerto Rico, Guam, American Samoa, Northern Mariana and U.S. Virgin Islands. The individual states' figure is derived from taking the percentage of revenues contributed by the state to the U.S. Treasury (based on IRS tables-
<http://www.irs.gov/taxstats/article/0,,id=206404,00.html>) and using that percentage to distribute the \$100 billion tax burden. That number is then distributed across the number of individual filers. The DC tax burden, while not included in the State-based table, amounted to over \$2000 per tax filer due to the size of the tax base relative to the amount of revenues collected. The other territories are combined into one within the IRS Data Book, and amounted to \$12 per tax filer.
- ⁶ <http://www.cnpp.usda.gov/Publications/FoodPlans/2008/CostofFoodFeb08.pdf>
- ⁷ <http://www.cnpp.usda.gov/Publications/CRC/crc2008.pdf>
- ⁸ Government Accountability Office, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, Dec 2008.
- ⁹ <https://www.uspirg.org/home/reports/report-archives/campaign-finance-reform/campaign-finance-reform/who-slows-the-pace-of-tax-reforms>
- ¹⁰ Government Accountability Office, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, Dec 2008.
- ¹¹ Government Accountability Office, *Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist*, July 2008.
- ¹² Transcript, *The Democratic Debate in New Hampshire*. New York Times. 5 Jan. 2008
<http://www.nytimes.com/2008/01/05/us/politics/05text-ddebate.html?pagewanted=all>
- ¹³ Communiqué - Meeting of Finance Ministers and Central Bank Governors, United Kingdom. November 2009
http://www.g20.org/Documents/2009_communique_standrews.pdf
- ¹⁴ Internal Revenue Service website. Viewed 1 April 2010
<http://www.irs.gov/businesses/small/article/0,,id=106568,00.html>
- ¹⁵ <http://www.cnpp.usda.gov/Publications/FoodPlans/2008/CostofFoodFeb08.pdf>
- ¹⁶ <http://www.cnpp.usda.gov/Publications/CRC/crc2008.pdf>
- ¹⁷ Internal Revenue Service website. Viewed 1 April 2010
<http://www.irs.gov/businesses/small/article/0,,id=106568,00.html>
- ¹⁸ "Economist calls for tax havens to be closed down." *Cayman News Service*. 26 Aug. 2008
<http://www.caymannewsservice.com/business/2008/08/26/economist-calls-tax-havens-be-closed-down>
- ¹⁹ "Economist calls for tax havens to be closed down." *Cayman News Service*. 26 Aug. 2008
<http://www.caymannewsservice.com/business/2008/08/26/economist-calls-tax-havens-be-closed-down>
- ²⁰ <http://www.irs.gov/taxstats/article/0,,id=206404,00.html>
- ²¹ http://cdn.publicinterestnetwork.org/assets/KXpECY7u1nS4WIDPoB34Dw/US-PIRG_Letter_Fin_Approps_Loophole.pdf
- ²² <http://thehill.com/homenews/senate/61925-senate-loosens-ban-on-companies-with-offshore-businesses>
- ²³ <http://www.google.com/hostednews/ap/article/ALeqM5iLihrc5RVwatmyNUJbTy1NhhL0wD9ED8SS80>
- ²⁴ Huang, Chye-Ching. *Putting U.S. Corporate Taxes in Perspective*. Center on Budget and Policy Priorities. 27 Oct. 2008
- ²⁵ http://www.bloomberg.com/apps/news?pid=20601110&sid=a6bQVsZS2_18
- ²⁶ Government Accountability Office, *Effective Tax Rates Are Correlated with Where Income Is Reported*. Aug. 2008
- ²⁷ Government Accountability Office, *Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations, 1998-2005*. July 2008
- ²⁸ <https://www.uspirg.org/home/reports/report-archives/campaign-finance-reform/campaign-finance-reform/who-slows-the-pace-of-tax-reforms#4>

