April 2009

Tax Shell Game:

The Taxpayer Cost of Offshore Corporate Tax Havens

U.S. PIRG
Education Fund

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The U.S. Public Interest Research Group Education Fund
April 2009

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Executive Summary

Many of the largest corporations in our country hide profits made in the United States in offshore shell companies and sham headquarters in order to avoid paying billions in federal taxes. The result is massive losses in revenue for the U.S. Treasury – which ultimately must be made up by taxpayers. The debt of a few is transferred to many – and to future generations. The U.S. Senate confirmed in the recently-passed fiscal year 2010 budget resolution that the use of offshore tax havens by large corporations “means that honest taxpayers face a higher burden.”

Key Findings

- The cost to taxpayers due to the use of offshore tax havens is as high as $100 billion per year - $1 trillion over 10 years. U.S.-based individuals and corporations who pay taxes on their revenues must shoulder this burden for those who do not.
- Taxpayers must shoulder the burden – U.S. PIRG Education Fund calculated each state’s taxpayer contribution proportional to their yearly federal contribution to make up for the $100 billion lost (See Figure 1).
- Our allies in other nations are also calling for decisive action to reign in these abusive tax havens. The Group of 20 (G-20), which provides a forum for world financial leaders to promote global economic stability, recently issued a communique providing for sanctions against tax haven countries.
- Last year, Congress overwhelmingly passed, and President George W. Bush signed, the Fair Share Act, which closed the tax loophole that had allowed private government contractors, including Kellogg, Brown, and Root (KBR) to avoid paying almost $100 million a year in payroll taxes for its U.S. employees by setting up foreign subsidiaries. This law closed these loopholes for payroll taxes for companies applying for subsequent federal contracts.

Recommendation

- The federal government should relieve taxpayers of this unfair burden by closing the loopholes in the tax code that allow the use of offshore tax havens.

The impact of companies diverting profits to tax havens is real and it is both global and local in its reach. As American taxpayers face their yearly responsibility to report all of their earnings, policymakers should be reminded that there are many corporations who continue to hide theirs.

1. Introduction

Secrecy and gimmickry in the financial system has many victims. This has become increasingly evident as our current financial system collapsed over the last several months. Corporations that avoid taxes by using offshore tax havens can count all taxpayers as their victims – both individuals *and* other corporations. The Government Accountability Office (GAO) describes tax havens as places with no or nominal taxes and little if any reporting requirements.[1]

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 revenue is never tallied and therefore appears as though it never existed.

Taxpayers finally have some indication that this era is coming to a close, both here and abroad. According to the GAO, which is an independent, nonpartisan agency that works for Congress, over 80% of the biggest U.S corporations maintain revenues in offshore tax haven countries, where there are no or nominal taxes and minimal, if any, reporting.[2] 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 and popularity for its willingness to accommodate tax havens is the Cayman Islands. According to an official report from the Senate Finance Committee, over 12,000 U.S. companies maintained a post office box in one five story building in the Cayman Islands. That fact prompted President Barack Obama, then a candidate, to remark, “That's either the biggest building or the biggest tax scam on record.”[3] In a subsequent investigation, GAO later found this number to be over 18,000.[4]

The U.S. is not alone in its concern with tax avoidance. A G-20 summit communique issued in early April of this year declared that the “era of secrecy is over.” It called for sanctions against “non-cooperative jurisdictions, including tax havens.”[5]

Citigroup citi
2007 Revenue:
$159,229,000,000
Tax havens:
427
Number in the Cayman Islands:
90
Source: GAO

Bank of America
2007 Revenue:
$119,190,000,000
Tax havens:
115
Number in the Cayman Islands:
59
Source: GAO

Morgan Stanley
2007 Revenue:
$87,879,000,000
Tax havens:
273
Number in the Cayman Islands:
158
Source: GAO

With the world and American taxpayers watching, Congress has the opportunity to pass long-overdue reforms that would make our tax system more fair for taxpayers who currently shoulder this unfair burden.

2. The Impact of Corporate Tax Havens

Individuals and corporations who pay taxes in the United States shoulder the burden for those who do not. It's a game, where entities use companies who exist only on paper or corporations who use their subsidiaries as metaphorical shells to shift profits to avoid taxes. It has become increasingly evident that secrecy and shadow markets result in economic catastrophe and those who game the system make everyone pay.

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."[6] 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 ends up being shouldered by other companies and taxpayers and is transferred as higher debt for future generations. The recent Senate Budget resolution concluded that the problem of offshore tax havens "means that honest taxpayers face a higher burden." [7]

The $100 billion annual burden of these tax havens impacts every state in the union. We can estimate approximately how much of the burden each state must bear based on the amount that each state's taxpayers contribute to the national Treasury in tax revenues. The figure (on page 4) is generated by dividing the $100 billion according to the percent of total federal tax revenues that each state currently contributes to the Treasury.

Figure 1: Tax Burden Shifted to Taxpayers

On the next page, Figure 1 describes the burden shifted to taxpayers.

2.2 Costs on a Global Scale

The negative impact of offshore tax havens extends beyond the burden it places on other taxpayers. 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."[8]

Similar alarm has been sounded by Nobel-prize winning economist Joseph Stiglitz, who chairs the Commission of Experts of the U.N. General Assembly on reforms of the international monetary and financial system. He makes 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."[9] Mr. Stiglitz also indicated that the secrecy also assists terrorists using these shadow markets to finance their agenda.[10]

Figure 1: $100 Billion of Tax Burden Shifted To Taxpayers, By State

State	Tax Burden Shifted To Taxpayers	State	Tax Burden Shifted To Taxpayers
Alabama	$901,950,514	Nebraska	$784,564,574
Alaska	$174,365,486	Nevada	$651,890,144
Arizona	$1,315,046,611	New Hampshire	$390,718,174
Arkansas	$1,034,194,828	New Jersey	$4,499,383,172
California	$11,679,735,788	New Mexico	$362,010,535
Colorado	$1,771,964,280	New York	$8,432,456,612
Connecticut	$1,998,297,402	North Carolina	$2,714,193,086
Delaware	$792,730,760	North Dakota	$152,375,724
District of Columbia	$713,530,245	Ohio	$4,076,890,048
Florida	$4,932,770,661	Oklahoma	$1,108,991,886
Georgia	$2,536,160,967	Oregon	$959,800,617
Hawaii	$311,743,105	Pennsylvania	$4,279,786,105
Idaho	$315,797,365	Rhode Island	$426,986,005
Illinois	$4,952,350,152	South Carolina	$748,331,466
Indiana	$1,587,419,541	South Dakota	$178,478,557
Iowa	$722,759,391	Tennessee	$1,807,595,246
Kansas	$814,342,112	Texas	$8,653,820,259
Kentucky	$915,690,968	Utah	$628,813,434
Louisiana	$1,293,786,010	Vermont	$136,658,236
Maine	$247,375,426	Virginia	$2,455,244,046
Maryland	$1,987,672,340	Washington	$2,456,043,505
Massachusetts	$2,987,741,631	West Virginia	$252,785,900
Michigan	$2,446,160,934	Wisconsin	$1,673,906,154
Minnesota	$2,975,173,496	Wyoming	$188,352,941
Mississippi	$466,234,722	U.S. Armed Services overseas & Territories other than Puerto Rico	
Missouri	$1,773,460,700		$24,554,891
Montana	$173,063,922	Puerto Rico	$133,849,313

3. Restoring Fairness and Fiscal Responsibility

In the face of the extraordinary economic meltdown, President Obama and the Congress have taken extraordinary measures to inject money into the economy and stimulate economic activity. It makes it particularly important to implement changes that will generate revenues without raising taxes by closing loopholes that allow some who profit through business in American markets to avoid paying their fair share.

3.1 A First Step: Ensuring that Federal Contractors Meet Responsibilities

Last year, it was widely reported that the largest contractor in Iraq, Kellogg, Brown, and Root (KBR), a Halliburton subsidiary, managed to avoid paying hundreds of millions of dollars in Medicare and Social Security taxes for years. They did this by setting up a shell company in the Cayman Islands, claiming that its employees, half of whom were American, worked for a Cayman Island company.[11] It was soon discovered that this was a widespread problem with defense contractors who receive billions of dollars in government contracts. Using companies in the Caymans to hide from basic federal responsibilities caught the attention of the American taxpayers and of Congress. [12]

A coalition of public interest groups led an effort to end this practice. And last June, President George W. Bush signed the Heroes Earnings Assistance and Relief Tax Act, which had passed the House of Representatives and the Senate unanimously. The HEART ACT provides permanent tax relief for military families and was partially paid for by a provision, championed by Senator Kerry and then Senator Obama, and added by Senators Grassley and Baucus, that closed the tax loophole that allowed private government contractors to use offshore tax havens to avoid payroll taxes.

Starting with payroll taxes, this was an important first step in addressing the use of tax havens, but there is much more to be done.

3.2 Arguments to Keep Tax Havens Don't Hold Up

Those who support tax havens typically argue that American corporations are already taxed enough or too much. But, 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. Markets work best when companies prosper based on their productivity and ability to innovate, not on their access to sophisticated tax lawyers and to tax-avoidance schemes.

President Obama, at the Fiscal Responsibility Summit earlier this year, remarked, "On the corporate side, I at least have always maintained that if we try to think in the same ways that we thought about it in 1986, and if you closed loopholes, you could actually lower rates… and that's an area where there should be the potential for some bipartisan agreement, because I think, on the books, the rates in the United States are high." [13]

When lobbyists defend the existence of offshore tax havens, they typically refer to corporations paying a *statutory tax rate* of 35%, which is simply based on the law or "statute." However, the amount corporations actually pay is instead indicated by their *effective tax rate*, which is the percentage of their profit that they actually pay in taxes. And 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.[14] More importantly, in 2008 the GAO reported that effective tax rates end up varying greatly across corporations depending on their ability to use such tax-reduction techniques.[15] Another 2008 GAO study showed that 25% 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.[16]

3.3 Ending the Use of Offshore Tax Havens

Legislation to end tax haven abuse introduced by Senator Carl Levin in 2005 was updated in 2007 after a multi-year investigation by the Senate Permanent Subcommittee on Investigations. President Obama was an original sponsor of this legislation, which was known as the Levin-Coleman-Obama Stop Tax Haven Abuse Act.[17]

In this Congress, the Stop Tax Haven Abuse Act was again introduced, and its supporters urged President Obama to include language in his budget to address tax havens, which he did. Earlier this year, Treasury Secretary Geithner indicated to the Senate Finance Committee that the President would continue this fight in his new role, by using the budget to address the use of offshore tax havens by U.S. corporations and would "propose a series of legislative and enforcement measures to reduce such U.S. tax evasion and avoidance." [18] The budget under consideration by Congress demonstrates the commitment of the Administration and many leaders in Congress to follow through on a promise to begin the lengthy process of bringing fairness and responsibility to our fiscal policy.

Endnotes

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