Offshore Tax Havens

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A tax haven is a state, country or territory where certain taxes are levied at a low rate or not at all. Individuals or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas with reduced or nil taxation levels relative to typical international taxation. This creates a situation of tax competition among governments. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people or companies. It is a game that revolves around reporting as little as possible by relocating your assets from one country to the next. Companies achieve this by transferring their intellectual property to a Dutch mailbox company. After that, they arrange for their subsidiary abroad (UK) to pay royalties on it. This reduces profits for the patenting company and their royalties are taxed with a rate dependent on the deal the company has with the officials. Normally it is close to nothing. For example, Starbucks paid $1.6 million in corporate tax for the last 14 years while being the largest coffee chain in the world with 20,891 stores in over 62 countries. In 2013 alone Starbucks had almost $2.5 billion in operating income.

Incentives to build a tax haven include money laundering, avoiding paying taxes, creating a front company to conceal activities, hiding assets from the government, keeping your property or investments secret, and opening a bank account in a name other than your own. For this secrecy to be possible, bankers, lawyers, and accountants are needed. Without these three groups of people, tax havens do not exist. Investing in an account is minimal compared to what it will return. An average account cost $1000 and takes only 3 days to build. The core existence of where tax havens are located is in the British Virgin Islands. Half a million offshore companies reside there. This is 40 percent of the world's offshore companies. Other hot spots for offshore accounts are the Cayman Islands, Cyprus, South Africa, and the UK, Today 91 out of the 100 largest companies in the world have their cash flow through Amsterdam and eventually ends up in a Swiss bank account.

With the majority of the world's most successful companies withholding their earnings in offshore tax havens, it creates a black hole in the global economy. Tax Justice Network conducted the first legitimate research analysis of offshore tax havens and concluded that an estimate of $21 to $32 trillion dollars are currently stashed away. The top three private banks handling the majority of the assets offshore are UBS, Credit Suisse, and Goldman Sachs. In recent years, tax haven growth has risen substantially with 50 banks managing $5.4 trillion in 2005 compared to $12 trillion in 2010. This represents an annual growth rate of more than 16 percent.

With an estimated 1/3 of the world's wealth not being circulated throughout the economy, distribution of wealth is a core drawback concerning offshore tax havens. Legislators and lawmakers are trying to prevent tax abuse by ending incentives for companies to shift profits offshore, closing the most egregious offshore loopholes, strengthening tax enforcement, and increasing transparency.

Offshore tax havens intrigued our team because several U.S. corporations and other companies around the world have grown in wealth to become larger than countries. Yahoo is bigger than Moldova, which would rank Yahoo as the world's 138th largest country. General Electric is bigger than New Zealand, which would rank General Electric as the 52nd largest country. And the largest U.S. Corporation Walmart is bigger than Norway, which would rank Walmart as the 25th largest country. Walmart employs 1.4 million people in the U.S. If Walmart was an army it would have the second largest military in the world. China ranks number one.

When a company has annual revenues of $421 billion, a 35 percent corporate tax is something the CFO wants to avoid. Any U.S. multinational company that has annual revenues of a billion dollars or more wants to avoid a system where they pay U.S. tax on their worldwide income. Many CEOs of multinational companies argue that the current worldwide system, puts U.S. firms at a competitive disadvantage since they are forced to pay U.S. corporate tax rates on repatriated profits earned by their affiliates in low tax countries. Mitt Romney and the chairs of the President Obama's 2010 fiscal commission, Erskine Bowles and Alan Simpson suggested pivoting from a system where U.S. firms pay U.S. tax only on what they earn at home, a structure known as a territorial system.

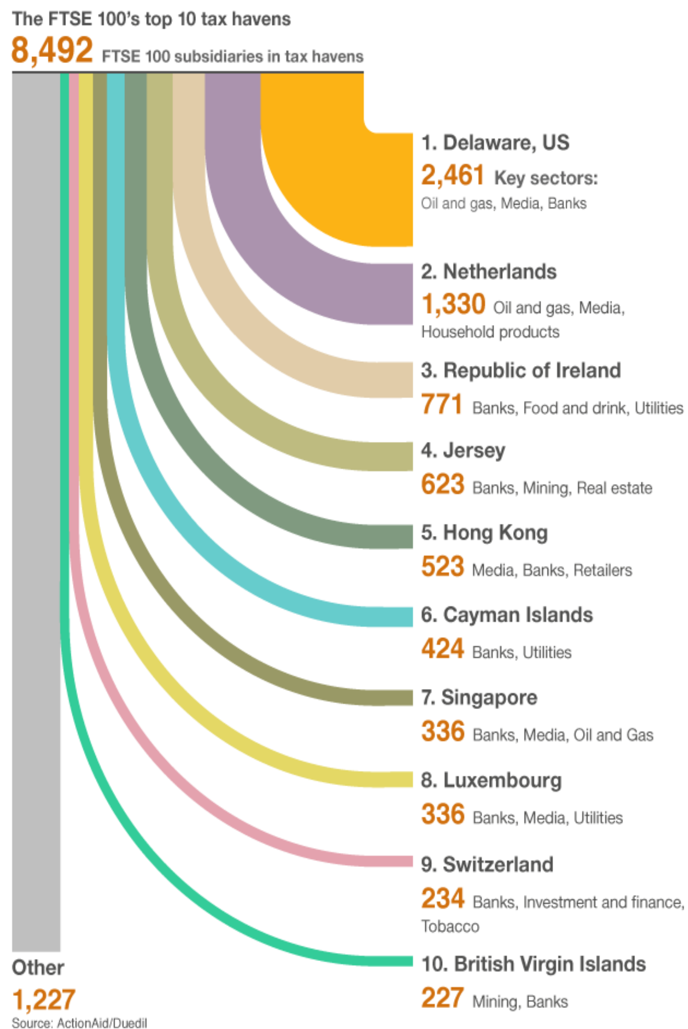
Table ES-1. Total Annual Income Tax Revenues Lost to Tax Havens (Individual and Corporate Income Taxes Combined)

Rank	State	Revenue Losses (Millions)
1	California	$7,147
2	New York	$4,275
3	New Jersey	$2,833
4	Illinois	$2,545
5	Pennsylvania	$2,105
6	Minnesota	$1,953
7	Massachusetts	$1,688
8	North Carolina	$1,049
9	Florida	$979
10	Maryland	$966

To cope with current operations and hold some competitive advantage and maximize profits, U.S. companies have 1 trillion dollars in Bermuda. That money cannot go to the shareholders because it would have to go through the patenting company. The shares in those companies are overvalued because if the offshore value would eventually get to the shareholders, extra tax bills would

be paid causing the share price to drop. Market distortions are a result of this. The only good news occurring is the money has to be spent and it is being lent to governments to pay for the deficits that most countries are running around the world.

As a result, tax havens are funding the deficits that governments are running because they cannot collect enough tax in the form of cash from companies that are holding it in offshore tax havens. Taxpayers are charged higher income tax rates to try and make up the deficit. The ultra wealthy are hurting the less fortune simply because of the current laws regarding U.S. corporate tax rates. The largest companies in the nation should be flourishing our economy, not holding it back from development and employment opportunities. Private wealth held offshore represents a great void in the world economy and clearly displays a vicious cycle that needs new policies designed for transformative change to encourage companies to pay their proper share of taxes.



Because of the current state of the U.S. corporate tax system, the EU and other countries suffering similar situations, we wanted to research what strategies are these corporations exercising to reduce corporate tax rates and keep as much profit as possible? We knew tax havens existed to help this matter but we desired to know more on how to build our own, where to locate it at, who else is doing it, to what scale is this being done globally, and how can people in power change these rules?

The demand for tax havens began in the 1920's. Wealthy individuals and a limited amount of companies raised a demand for a secure tax-free loophole. At the time, Europe was facing some political instability, labor movements, and political pressure to raise capital to fund these new movements. Switzerland provided a convenient loophole at the right time. Switzerland industrialists were fairly weak; therefore Swiss bankers easily got their way. In the UK, the Treasury and the revenue authorities were much more powerful. Creating a policy or

loophole for a secure tax-free bank account was out of the question. Switzerland went forward though and stands today as a major hub for tax havens. Private banks started in Switzerland centuries ago. Wegelin & Co., established in 1741, was the first bank in Switzerland and it still stands today. In Switzerland banks located in Geneva and Zurich served as major hubs for secure tax havens that stored the wealth of dictators, mobsters, arms dealers, corrupt officials, and tax frauds of all kinds.

In past decades, Delaware has grown in popularity and holds drop boxes for those same types of people. Viktor Bout, a Russian arms dealer held a Delaware address and was recently sentenced to 25 years in prison. Delaware is located only 100 miles from Washington, D.C, and at 1209 North Orange Street holds legal addresses of 285,000 businesses. Its occupants are corporate giants such as American Airlines, Apple, Bank of America, Cargill, Coca-Cola, Ford, General Electric, Google, JPMorgan Chase, and Walmart. These companies do business activities all over the world but in Delaware they simply have a drop box. Certain officials say Delaware is playing ball faster and loser than offshore jurisdictions like the Cayman Islands. Delaware is outlandishly popular to U.S. corporations. It is home to 945,326 businesses, while the population is only 925,749. However, most of the companies incorporated in Delaware are legitimate and use legal means to reduce tax bills.

Switzerland gained its popularity because of its ability to keep things private. They even amended a law around privacy called The Federal Act on Banks and Savings Banks also known as the Banking law of 1934. It created the current regimen of bank secrecy that Swiss banks are famous for. Under the Banking Law of 1934, it is a criminal act for a bank to reveal the name of an account holder. Enacting this law allowed Swiss banks to climb to the top and after several years accumulated offshore assets valued at $2.1 trillion in 2010.

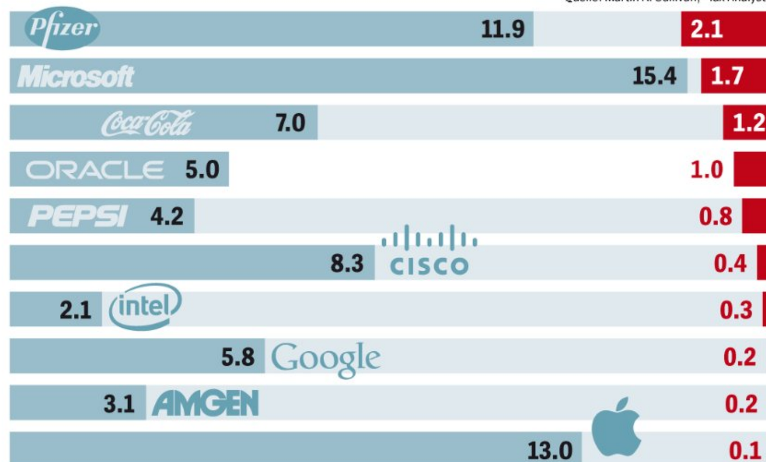
However, the law was amended in 2009 due to the UBS tax evasion scandal. The United States government and Western European governments, who were concerned with tax evasion by their citizens using numbered accounts, added pressure and demanded Switzerland to hand over bank account names. The U.S. took the toughest stance desiring 11 Swiss banks to hand over their American clients. UBS agreed to pay a $780 million fine for aiding tax evasion and handed over data on more than 4,400 accounts.

Certain legislators are striving to reduce tax evasion but others such as accountants are landing jobs to regulate these tax laws and design them in favor for themselves. The big 4 accounting firms that help enable tax evasion are Price Waterhouse Coopers, Deloitte, Ernest & Young, and KPMG. In the UK, the new chairman of tax authority is the former senior partner from KPMG. This is also happening in Australia where accountants are being appointed to positions of power that regulate tax laws and rules.

Designing laws that enable companies and individuals to distribute their wealth offshore creates disasters that effect millions of people. Without offshore tax havens, the Enron scandal would not have been possible or the massive fraud pulled off by Bernie Madoff or the Greek debt crisis. These events cost the global economy billions of dollars. Recently, a tax evasion strategy that Apple

and other billion-dollar companies use called the “Dutch Sandwich” has proposals for revisions. It will treat incorporated nonresident (INR) companies as tax-resident in Ireland beginning January 1st, 2015. The goal is to shut down the use of the “Double Irish” and “Double Irish Dutch Sandwich” strategy that manipulates royalties derived from the abuse of intellectual property.

In 2010, Apple earned $13 billion in profits while only paying $0.1 billion in taxes. Without the “Double Dutch” what would Apple do to keep their capital outside of the U.S. market? Apple holds the most assets in tax havens at $111.3 billion. Offshore tax havens are directly correlated to hiding capital overseas in markets that have close to zero tax rates. The money sits in a bank account instead of being reinvested to further company development. Certain individuals take it a step further by concealing illegal obtained money from transfers involving foreign banks or legitimate businesses. This is known as money laundering, either way the money is not distributed back in the economy. Therefore, the burden goes to the citizens forced to provide a larger percentage of their income to decrease the deficit that should have been provided by the corporations. 362 of the 500 companies on the Fortune 500 have an offshore bank account. These companies can have hundreds of subsidiaries to transfer money from one account to another. Bank of America has the most tax havens at 264 and tied for second at 226 is Morgan Stanley and AES. What does it say about the U.S. tax system when big banks are hiding profits from their own government? Every dollar in taxes that corporations avoid by using tax havens must be balanced by higher taxes on individuals, cuts to public investments and pubic services, or increased federal debt.



Offshore wealth is creating a global economic black hole. If the $21 trillion in offshore earned a conservatively estimated 3 percent rate of return, and that income was taxed at 30 percent, it would generate tax revenues close to $200 billion. That is nearly twice the amount Organization for Economic Co-operation Development (OECD) countries spend on international development assistance. But even the OECD has rules that prevent success, they say you must already know the precise information your are looking for, the name of the tax evader, their bank account details, and what they are suspected of doing.

In 139 high impact developing countries, the richest citizens have amassed $9.3 trillion of offshore wealth that local tax authorities cannot seize. Only a few individuals hold this money and without reinvesting that capital their markets are slow to grow. Wealth distribution hinders because of tax havens, 0.14 percent of the population holds 95 percent of the offshore wealth. That means the top 10 percent of the top 1 percent have $18 trillion dollars in assets that are not being used as capital to reinvest in companies and jobs in the global market.

Tax havens also corrupt and distort financial markets with fraud and insider trading. Bernie Madoff was able to steal billions of dollars because of his offshore account. It functions through collusion between private sector financial intermediaries and the governments of states, which host offshore tax haven activities. The forthcoming struggle deals with forcing civil society to address major flaws in the global financial architecture and change behavior of self-interests. What will it take to have tax havens be something of the past and what would our global economy look like without them?

One strategy to make tax havens a notion of the past is to change the laws and rules. As we spoke about above, the “Double Irish Dutch Sandwich” is being revised. We looked deeper into this subject because it was relevant to our project researching offshore tax havens. The Double Irish procedure is a tax avoidance strategy that has been around since the 1980’s. Apple pioneered the procedure of using payments between related entities in a corporate format to shift income from a higher-tax country to a lower-tax country. This is possible because Irish tax law does not include U.S. transfer pricing rules. Ireland is a territorial tax system; therefore they do not levy taxes on income retained in subsidiaries of Irish companies that are outside the state.

It is called a Double Irish Dutch sandwich because the strategy requires a combination of Irish and Dutch subsidiary companies. It is also called the Double Irish because it requires not one but two Irish companies. One of the companies is a tax resident in a tax haven, for example the Cayman Islands or Bermuda where there is no corporate income tax. Irish tax law currently provides that a company is a tax resident where its central management is located, not where it is incorporated. This first subsidiary company owns a second subsidiary company that operates in, and is a tax resident of Ireland. Most of the profits of the second company are paid as royalties, and so a tax deductible expense, to its parent company. Any profits that are not paid to the first company are taxed at

Ireland’s corporate rate of 12.5 percent. As the parent company is not a tax resident of Ireland, the money transferred as royalties from the subsidiary is not taxed there, but is instead taxed in their headquarter country. There are various complications on top of the Double Irish. The Dutch Sandwich, for example, adds a third subsidiary in the Netherlands in the middle of the two Irish subsidiaries, reducing companies’ tax burdens even more giving the full name as “Double Irish With A Dutch Sandwich.

Apple was the first major known company to use this strategy. Others have followed suit including Adobe Systems, Facebook, General Electric, Google, IBM, Johnson & Johnson, Microsoft, Oracle, Pfizer, Starbucks, and Yahoo. The list goes on and on. Showing this strategy is an enormous success. However, it is just one of several comparable international tax avoidance outlines. Similar plans involve arranging transactions between subsidiary companies to take advantage of the characteristics of a diverse scope of tax codes.

While other strategies are still legal this one has come to an end. After consistent remarks by the EU and the U.S. government, Ireland gave in to the pressure. On January 1, 2015, the law will be redesigned requiring companies residing in Ireland to also be a tax resident of Ireland. Companies like Google and Facebook have until 2020 to comply. Ireland will still stand as a favorable place for multinational companies, however there will be one less legal strategy available for pursuing an offshore tax haven.

On the whole we believe that it will be years, if not decades, before any significant paradigm shift will take place in the world of corporate taxation. For many countries, like Ireland for instance, favorable tax policies have been an integral ingredient to economic success over the last decade. Caving to pressure from other countries like the U.S. could be detrimental in the short term for tax haven countries even though in the long term it might be necessary to maintain good relations with global powerhouses like the U.S. In the meantime though, recent pressure and increased scrutiny on corporate tax haven abuse hasn’t stopped countries, like Ireland, from introducing new tax leniency programs to further entice multinationals to set up shop within their borders.

One example of a tax leniency program is the “knowledge box” program that Ireland recently announced, which would allow companies to receive reduced tax rates on earnings generated as a result of IP created/located within the country. So while multinationals may not be able to take advantage of tax schemes like the “Double Irish” or “Double Irish with a Dutch Sandwich” after 2020 in Ireland, it seems as though favorable tax schemes will still play a major role in the country’s economic policy as it continues to court multinational firms.

Multinationals are also currently spending enormous amounts of money lobbying foreign governments and international organizations to slow down the repeal of favorable tax policies. Lobbyists have the power to sway and influence even at a global level, so presumably any strict tax legislation abroad will be slow to take place.

The odds are all in all not favorable towards “fixing” the problem of multinationals heavily employing tax havens. Corporations do not want to pay

U.S. tax rates because they believe they are too high, therefore citizens need to pay higher taxes but they too believe rates are too high. It is almost a catch 22, because the higher tax rates are, the more companies want to avoid paying taxes. But the lower taxes are, the more willing companies will be to pay their correct share and slow down use of tax havens. Ironically, we believe that to some extent the lower the tax rate, the more tax revenues the government would actually receive.

Tax havens cause numerous problems for our global economy and future developments. Here are several problems that are caused by tax havens.

1. Inefficient funds for schools, hospitals, roads, and other public services.
2. Illegal money held in secrecy from money laundering and tax fraud.
3. Illegal money held in Swiss bank accounts for dictators and criminals.
4. Banks able to dodge financial rules and regulations.
5. Corrupt markets from concealing insider dealing and tax dodging by multinational companies.
6. A private world of secrecy, impunity, and power for rich elites.
7. Inequality increasing from insufficient wealth distribution.
8. Laws implemented in secrecy that ultimately affect the global economy.
9. Degrading faith in democracy.

Without tax havens these problems might not be eliminated but they would definitely be reduced by a significant amount. We have several recommendations to help solve these problems.

1. Country by country reporting
    a. By implementing country by country reporting, multinational companies would have to simplify their information by country of operation. This includes each tax haven allowing citizens and authorities visibility to interpret what corporations are doing in their countries. Currently, when a company publishes an annual report all the information from each country concerning trading, profits, and tax payments are rolled into one large report. Government officials, the public, investors and shareholders do not know what happened where. It creates black holes in corporate accounts. With country-by-country reporting, countries could tax the companies properly, receiving appropriate funding for schools, roads, and hospitals.
2. Automatic information exchange
    a. Developing countries and developed countries will receive information to tax their wealthiest citizens properly. European countries already share some information about their citizens upfront. The OECD’s system should be dispatched and automatic information exchange should be exercised around the world requiring tax havens to sign up or else counter measures will be put in place.
3. Full disclosure of proper and actual owners of companies.

   a. A true beneficial owner has their identity available on a searchable, low cost public register. Some company directors are actually nominees who rent their name to the company. When it is time to share the company's information, they talk about the nominee directors, the trustees, and the other officials who strive off secrecy knowing their activities are safely hidden.
4. Make "looking the other way" a criminal offense
   a. Tax evasion is a criminal offense in most countries however it isn't considered a money laundering offense. Tax evaders go to jail but the accountants, lawyers, and bankers who help commit these crimes walk free. There should be harsh penalties for intermediaries who help tax evaders.
5. Unitary tax system
   a. This policy would involve taxing multinational companies according to the real economic substance of where they actually do business. Questions would be answered such as where their workforce is based, where their assets are actually held, which country's resources do they depend on to do business? Under a unitary tax system only a small portion would end up being allocated to the Cayman Islands where taxes are zero.
6. Territorial tax system
   a. Under a territorial tax system, the U.S. would tax only the U.S. income of a corporation and would exempt all foreign income. By doing this, a territorial system would allow U.S. corporations to compete with foreign corporations on a level playing field. To prevent erosion of a tax base, a territorial system still covers income from financial assets held by a foreign subsidiary that could easily be held by a U.S. company. The majority of countries in the world have a territorial system already in place. Among G-7 countries, only the U.S. has a worldwide tax system. The G-7 countries consist of France, Germany, Italy, Japan, U.K., and the U.S. It was formed in 1975 by French President Valery Giscard d"Estaing to discuss the oil crisis that threatened to turn the global economy into a recession. However, the group lost relevance because it did not include the largest emerging economics such as Brazil, China, and India. Therefore the group expanded to combine the 20 largest economies, it is now called the G20. Among OECD nations 26 have territorial systems and only eight have worldwide systems. The other 7 countries with worldwide systems have tax rates far lower than the U.S. corporate tax rate at 35 percent. A territorial system would make American firms more competitive, allowing them to bring overseas income to the U.S. without being taxed, remove the tax disincentive for domestic investment with foreign income, decrease the influence that tax considerations have on business decisions, lower compliance costs, and increase

businesses located in the U.S. A territorial system is good for globalization.

7. Worldwide full-inclusion system
    a. Many U.S. multinational companies favor a territorial system that focuses on the source of the income, however it might not be what is best for our country. If companies desire they will still be able to move operations, assets, and jobs outside the U.S. to achieve double non-taxation. A worldwide full-inclusion system would completely eliminate this incentive because double non-taxation would no longer be possible because of a current federal tax on all earnings that cannot be eliminated through any tax schemes. A worldwide system would increase the tax base and help lower the overall corporate tax rate that all U.S. multinational companies desire.

All these recommendations cannot be implemented because some overlap but it portrays a diverse range of strategies to help reduce interest in offshore tax havens. Incentives for corporations to not exercise double non-taxation strategies should flourish throughout the world. Information exchange that is accessible to investors and officials should be a norm for our next generation. Offshore tax havens are preventing our global economy from considerable growth. There are major flaws in the global financial architecture and the next President of the United States needs to take action concerning this topic. Corporate America is pushing for the United States to move to such a regime to make businesses more competitive against foreign rivals that pay no taxes on overseas earnings.

In 2012, President Obama pitched a corporate tax revamp that included cutting the top corporate tax rate to 28 percent from 35 percent. It did not pass but congress and both parties are revisiting the topic as we speak. House Republicans support comprehensive tax reform. With the Republicans winning the senate and already in favor of the House, the next two years presents exciting potential for finalizing a revised United States tax system. What will our economy look like without multinational corporations using tax havens? Independent economists estimate when combining reduced federal spending and comprehensive tax reform it will create 1 million U.S. jobs in the first year alone. Our world will be a better place without offshore tax havens. When will they be a notion of the past?

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