Department of Economics and Centre for Macroeconomics public lecture

The Hidden Wealth of Nations

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Hashtag for Twitter users: #LSEwealth
The Hidden Wealth of Nations
The Scourge of Tax Havens

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How big are offshore tax avoidance and evasion & what can be done about them?

A growing policy concern, yet hard to quantify:
For some observers, considerable tax revenue losses
For others, most of the activities in tax havens are legitimate
On both sides, generally limited empirical evidence

A number of recent initiatives:
FATCA, automatic exchange of bank information, BEPS

What can we expect from these policies?

In the book I try to explain how published macro statistics can be used to shed light on these issues
The book is based on a number of recent research papers


...But much more research needed to offer definitive answers

All figures and data available online at http://gabriel-zucman.eu/hidden-wealth

4. Will also talk about ongoing work “Tax Evasion & Inequality” (with Niels Johannesen and Annette Alstadsæter), 2016
Tax evasion by wealthy individuals
A growing fraction of wealth is being managed by offshore financial institutions.

In 2012, 9% of the U.S. listed equity market capitalization was held by tax haven investors (hedge funds in the Cayman Islands, banks in Switzerland, mutual funds in Luxembourg, individuals in Monaco, etc.). Source: author's computations using US TIC data.
What do offshore centers do?

A great deal of activities, many of which legal and legitimate:

- Investment funds (Luxembourg, Ireland...)
- Shadow banking (Caymans...)
- Treasury management (U.S.-Cayman...)
- Personal wealth management (Switzerland, Singapore...)

But some offshore centers, institutions and instruments also facilitate tax evasion by wealthy individuals.
How offshore tax evasion works

Shell companies
Fake invoices
Offshore accounts
Disconnecting legal and beneficial ownership
What do we know about the magnitude of offshore tax evasion?

Monthly statistics by the Swiss National Bank

Systematic anomalies in the international investment positions of countries caused by offshore portfolio wealth

Central bank data on foreign-owned bank deposits

HSBC leaks and Panama Papers on who owns shell companies

Swiss data on what fraction of offshore wealth is undeclared (≈ 90-95% prior to 2008, down to ≈ 80% today)
8% of the world’s financial wealth is held offshore, costing at least $200bn

<table>
<thead>
<tr>
<th>Region</th>
<th>Offshore wealth ($ bn)</th>
<th>Share of financial wealth held offshore</th>
<th>Tax revenue loss ($ bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>2,600</td>
<td>10%</td>
<td>75</td>
</tr>
<tr>
<td>USA</td>
<td>1,200</td>
<td>4%</td>
<td>36</td>
</tr>
<tr>
<td>Asia</td>
<td>1,300</td>
<td>4%</td>
<td>35</td>
</tr>
<tr>
<td>Latin America</td>
<td>700</td>
<td>22%</td>
<td>21</td>
</tr>
<tr>
<td>Africa</td>
<td>500</td>
<td>30%</td>
<td>15</td>
</tr>
<tr>
<td>Canada</td>
<td>300</td>
<td>9%</td>
<td>6</td>
</tr>
<tr>
<td>Russia</td>
<td>200</td>
<td>50%</td>
<td>1</td>
</tr>
<tr>
<td>Gulf countries</td>
<td>800</td>
<td>57%</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,600</strong></td>
<td><strong>8.0%</strong></td>
<td><strong>190</strong></td>
</tr>
</tbody>
</table>
Who conducts tax evasion?

Widespread view that tax evasion has become more “democratic”, and that the super-rich do not evade as they can easily avoid

View largely based on randomized audit data. Problem: audits do not capture offshore evasion

New micro data from amnesties, crackdowns, and leaks shed new light on evasion behavior of the wealthy

With Johannesen and Alstadsæter we use such data in Scandinavia to study how tax evasion varies with wealth
In Norway, the probability to disclose hidden assets rises sharply with wealth.
12% of households with wealth > $36m used the Norwegian amnesty

Percent of households who disclosed hiding wealth, by wealth group

- Wealth group (million of US$): < 0.1, 0.1 - 0.5, 0.5 - 0.7, 0.7 - 1.4, 1.4 - 2.0, 2.0 - 6.4, 6.4 - 10.5, 10.5 - 36.3, > 36.3
- Percent of households who disclosed hiding wealth: 0%, 2%, 4%, 6%, 8%, 10%, 12%, < 0.1, 0.1 - 0.5, 0.5 - 0.7, 0.7 - 1.4, 1.4 - 2.0, 2.0 - 6.4, 6.4 - 10.5, 10.5 - 36.3, > 36.3
Similarly, the probability to appear in the Panama Papers rises sharply with wealth.
In Sweden too, evasion rates rises very sharply at the top.
At the top-end, the use of offshore accounts is widespread.

Composition of the top 0.1% wealth share in Norway (including offshore wealth)

This figure depicts the share and composition of the wealth held by families in the top 0.1% of the wealth distribution, after taking into account unreported offshore wealth. Source: Appendix Table B5b.
Tax evasion can erase half of the secular decline in wealth concentration.

Figure: Top 0.1% wealth share in Norway: including vs. excluding hidden wealth.
Despite recent policy initiatives, much remains to be done

Automatic exchange of bank information will become global standard by end of 2010s: big progress.

Three obstacles:

- Incentives of offshore bankers
- Financial opacity
- Incentives of tax havens

What is missing: well defined sanctions (FATCA) and a world financial registry
How Swiss bankers torpedoed previous attempts at curbing tax evasion

Accounts held through sham corporations

Accounts directly held by Europeans

EU Saving Tax Directive

% of Swiss accounts amounts

0%  10%  20%  30%  40%  50%  60%  70%

The case for a world financial register

The companies Clearstream, Euroclear, etc. feed the world financial register. Tax authorities can verify that tax-payers indeed declare all the financial securities included in the register.
Tax avoidance by multinational corporations
The taxation of multinationals is based on 3 principles adopted in the 1920s

**Source-based taxation**

Taxes are to be paid to countries where profits have been made.

Not to countries where shareholders live (i.e., residence taxation).

But how to determine where the profits have been made?

**Arm’s length pricing**

Subsidiaries of a same group must compute their profits as if unrelated.

I.e., trade goods and services internally at market prices.

**Bilateral agreements**

No multilateral agreement like GATT.

Instead, thousands of bilateral tax treaties.
The choices made in the 1920s are coming back to haunt the tax authorities.

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author's computations using NIPA data, see Online Appendix.
Each of the 3 core principles for international taxation raises its own issues

**Bilateral agreements**
Treaty shopping to generate stateless income

Example: Google

**Arm’s length pricing**
Easy to manipulate transfer prices

Reference prices often do not exist

**Source-based taxation**
Artificial profit shifting

Tax competition for real investments
What is the cost of multinational corporate tax avoidance?

Hard to quantify: double-counting issues, tax laws vary across countries, etc.

My approach: use national accounts & balance of payments data

Focus on the United States: what is happening to the profits of US-owned companies?

Latest data show offshore tax avoidance is sizable and growing fast
A growing fraction of US corporate profits are made abroad

The share of profits made abroad in U.S. corporate profits

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author's computations using NIPA data, see Online Appendix.
More than half of the foreign profits of US firms are booked in tax havens

The share of tax havens in U.S. corporate profits made abroad

Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about $500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.
20% of all US corporate profits are booked in tax havens

The share of tax havens in U.S. corporate profits

Notes: This figure charts the ratio of profits made in the main tax havens (Netherlands, Ireland, Switzerland, Singapore, Luxembourg, Bermuda and other Caribbean havens) to total US corporate profits (domestic plus foreign). Source: author’s computations using NIPA and balance of payments data, see Online Appendix.
The effective rate paid by US corporations has been reduced by 1/3 since late 1990s

Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). In 2013, over $100 of corporate profits earned by US residents, on average $16 is paid in corporate taxes to the U.S. government (federal and States) and $4 to foreign governments. Source: author's computations using NIPA data, see Online Appendix.
Reforming the corporate tax

**Formula apportionment**

Works reasonably well for US States

Based on final sales to remove incentives to move real activity

It’s the best way to levy taxes efficiently and fairly

Can be done unilaterally

But international cooperation always better: ideal would be joint move to formula apportionment as part of free-trade talks