Attractive Tax Jurisdictions

Different views exist on how to precisely define a ‘tax haven’ and different terms may emphasize different features. Many international organizations, including the IMF and the UN, avoid using the term altogether. Recent EU and OECD initiatives use the expressions ‘non-cooperative jurisdictions’ for tax purposes.¹ Media and academics, while still referring to tax havens, occasionally use other terms such as ‘secrecy jurisdictions’ or ‘treasure islands’.²

In simple terms, tax havens — or similarly vague expressions — broadly refer to jurisdictions that impose low or no taxes on income, and imperfectly share (or not share) information with other jurisdictions thereby enabling foreigners to minimize (or escape) taxation at home or abroad.³ Despite the elusive connotation and the obvious difficulty in drawing the line, this description suffices to point at the fundamental challenges in prevailing arrangements of taxing income.

Current arrangements for taxing income, particularly capital income including but not only corporate profit, are highly vulnerable to two intertwined, yet distinct, concerns. The first concern is the incentive to (legally) avoid or (illegally) evade income and wealth taxation in relatively high tax countries using low tax jurisdictions. The second concern is tax competition between countries over productive capital and paper profits using tax systems (e.g., corporate income tax (CIT) rates, preferential tax regimes, and tax rules), which leads to inefficiently low tax rates and cross-border spillovers.

Tax Evasion and Avoidance

Individuals: Most countries tax personal income (including from dividends, interest, and capital gains) and (in a few countries) wealth based on the ‘residence’ of the taxpayer. Concealment services and opaque structures in some jurisdictions have played a critical role in facilitating tax evasion as unveiled by the 2013 Offshore Leaks and 2016 Panama Papers, among others.

Alstadsæter et al. (2018) estimate household wealth in tax havens to be about 10 percent of world GDP. Their country-by-country estimates suggest that country-specific figures vary widely from less than 5 percent of GDP in Scandinavian countries to more than 70 percent in some natural resource-rich countries. While these figures are not entirely driven by tax evasion motives, they indicate the scope of the issue. Johannesen, in this Report, surveys this literature.

Corporations: The taxation of profits requires distinguishing between the ‘source’ country of the profits and the ‘residence’ country of the corporate taxpayer. In practice, loosely, the CIT on active income is at source while on passive income can also be at residence. Precisely, legally speaking, the allocation of taxing rights is far more complex. Source countries impose cross-border withholding taxes on passive income (that can be reduced by a double tax agreement — ‘tax treaty’) and many residence countries impose taxes on active income but with mechanisms to avoid double taxation (typically by granting a foreign tax credit in domestic law or in tax treaties). The resulting global tax framework opens significant loo-

---

¹ Prepared for the Institut d’Economia de Barcelona (IEB) Report on Tax Havens. I am grateful to Michael Keen and Alexander Klemm for useful comments and suggestions. The views expressed here are those of the author and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

² In 1998, the Forum on Harmful Tax Practices (FHTP) was established to review ‘harmful tax regimes’ in OECD countries and identify non-OECD ‘tax havens’. A list of 35 tax havens was published in 2000, and eventually cleared the last three listed jurisdictions in 2009.

³ See Hines (2010), Sharman (2010), Hebous (2014), and Schjelderup (2016).

⁴ These jurisdictions tend to be relatively small and politically stable (Dharmapala and Hines, 2009).
pholes for exploiting international differences in tax systems.

The rise of multinational enterprises (MNEs), their complex worldwide ownership structure, and increased importance of hard-to-price intangibles have made the identification of the source country extremely challenging, some may say meaningless. Increasing digitalization of the economy has intensified these vulnerabilities as the physical presence—or permanent establishment (PE)—has become less (or even not) necessary for business activities in the destination economy, but it is still required for the taxing right. The potential value created by users remains untaxed while ‘ring-fencing’ a digital sector from the rest of the economy is difficult, if not impossible.

Specific profit shifting (tax avoidance) techniques are abundant, including mispricing intragroup trade violating the arm’s length principle (ALP) (Hebous and Johannesen, 2015; Davies et al., 2018); intragroup lending to deduct interest expenses in relatively high tax countries (Fuest et al., 2013); and exploiting tax treaties (Mintz and Weichenrieder, 2010). Bilicka’s contribution to this Report summarizes the findings of this research area.

Using a macro-approach, Tørslev et al. (2018) estimate that approximately 36 percent of global MNEs’ profits are shifted to tax havens in 2015 (about $600 billion). Micro-estimates of the magnitude of shifted profit tend to be smaller than macro-estimates (Dharmapala, 2014). A meta-analysis by Beer et al. (2018) suggests that a 1-percentage point lower CIT rate increases reported before-tax corporate income by 1.5 percent.

**Recent Developments**

**The G20-OECD Base Erosion and Profit Shifting (BEPS) Initiative**

Under the motto ‘taxing where value is created’, the BEPS package aims at tackling MNEs’ tax avoidance by laying out common approaches and four ‘minimum standards’, regarding i) harmful tax practices; ii) Country-by-country (CbC) reporting for large MNEs; iii) treaty abuse; and iv) treaty-related dispute resolution mechanisms. The ‘Inclusive Framework’ members —122 countries as of October 2018— are committed to implement these minimum standards.

**Tax Transparency**

Important progress has been achieved under the Global Forum on Tax Transparency (154 members) —to implement the Exchange of Information on Request (EOIR) and Automatic Exchange of Financial Account Information in Tax Matters (AEOI)— and under BEPS —to implement CbC reporting and exchange of information on tax rulings. Other initiatives include the Extractive Industry Transparency Initiative.

**Unilateral and Regional Actions**

The EU 2016 Anti-Tax Avoidance Directive (ATAD) requires EU members to implement measures beyond the minimum standards of BEPS. Moreover, unilateral measures against profit shifting, that are potentially inconsistent with ALP and the G20-OECD BEPS, are gaining popularity. Simultaneously, CIT rates continue to decline. Regarding digitalization,
the OECD interim report failed to reach a consensus whereas the European Commission is proposing a distortionary Digital Services Tax of 3 percent on gross turnover from ‘digital activities’ as an interim solution, with virtual PE as a possible long-term solution.

**Have Tax Havens Been Put Out of Business?**

The G20-OECD BEPS does not address tax competition. The perennial misconception about the notion of harmful tax practices (HTP) is not surprising. It is a mere linguistic suggestion that stopping ‘harmful’ implies less harm, but of course the challenge is how to define ‘harmful’ in practice. Currently, a country with two tax rates (e.g., a headline rate of 30 percent and a reduced rate of 15 percent on income from mobile activities) would likely be deemed as adopting a harmful regime whereas a country that has a uniform 10-percent (or zero) tax is not. The minimum standard of requiring “substantial activity” for the taxpayer to benefit from the preferential tax regime may intensity tax competition for productive capital (not only profits) with unclear welfare consequences. In the discussion on HTP and profit shifting, again, we fall victim of a language drama because words such as ‘substance’ and ‘value’ have long occupied philosophers and physicists to define them and their location—in vain.

The Global Forum’s identification of ‘non-compliant jurisdictions’ does not include a zero [or very low] tax rate as a criterion. The EU, in 2017, published a list of ‘non-cooperative jurisdictions’, which currently contains only 5 non-EU countries (all together has a negligible share in total FDI from or into the EU). Overall, the achievement of the various attempts to produce lists of jurisdictions is not clear, at least as far as tax competition is concerned.

**Concluding Remarks**

Tax avoidance/evasion, tax competition, and ‘attractive tax jurisdictions’ are the products of the current global tax framework. Thus far, multilateral initiatives have not succeeded in fully resolving these challenges, despite some progress on improving transparency and making tax avoidance more difficult. As discussed in Auerbach et al. (2017), fundamental reforms that rely on the destination principle instead of the source-residence principle (e.g., a destination-based cash-flow tax) are one way to finally eliminate incentives for profits shifting and tax competition.

---

6 Jurisdictions need to meet at least two of the three benchmarks to avoid inclusion in the list: i) At least a “Largely Compliant” rating with respect to EOI; ii) a commitment to implement AEOI; and iii) Participation in the Multilateral Convention on Mutual Administrative Assistance on Tax Matters or a sufficiently broad exchange network permitting both EOI and AEOI.
References


In this piece, I briefly review the evidence on offshore tax evasion. While empirical investigation of the offshore world is rendered difficult by institutionalized secrecy, researchers have produced a significant amount of “evidence of the invisible” (Slemrod and Weber, 2011) in recent years, often through the creative use of non-standard data sources.

I first discuss the likely magnitudes involved: how much financial wealth is held by private individuals through tax havens? I then turn to distributional aspects: how is the wealth in tax havens distributed across countries and across segments of the population within countries? Finally, I summarize the existing evidence on the effectiveness of the policy instruments employed to enforce taxes on offshore assets: legal action against offshore banks, information exchange with tax havens, protection of whistleblowers and tax amnesties.

How Much Wealth Do Households Own in Tax Havens?

Before embarking on further analysis of offshore tax evasion, it is natural to gauge the magnitude of the problem: how much financial wealth do private individuals own in tax havens?

The question is difficult given the often highly incomplete statistics of offshore financial centers, but a recently developed method provides a compelling answer (Zucman, 2013). The method exploits that assets held through secret foreign accounts leave traces in international investment statistics in the form of a global gap between assets and liabilities: when a French tax evader owns a U.S. security through a secret Swiss account, the U.S. records a foreign liability but no country records a foreign asset. The study concludes that personal wealth on tax haven accounts amounts to around $6,000 billion, or roughly 8% of all household financial wealth.

Who Owns the Wealth in Tax Havens?

Macro-data on foreign investment say nothing about which segments of the population own the wealth in tax havens — that question can only be addressed with micro-data. Alstadsæter et al. (2017) compile such micro-data for Denmark, Norway and Sweden from various sources: leaked customer information from the Swiss bank HSBC Switzerland (“Swiss Leaks”) and the Panamanian corporate service provider Mossack Fonseca (“Panama Papers”) as well as information from voluntary disclosure programs. Linking these micro-data to population-wide tax records on wealth, the study estimates how offshore assets are distributed across wealth groups.

The figure illustrates the extreme concentration of offshore wealth in the Scandinavian micro-data. Both among customers in HSBC Switzerland and among voluntary disclosers of offshore assets, around 50% belongs to the top 0.01% of the wealth distribution and around 80% belongs to the top 0.1%. For comparison, the dotted line shows the distribution of (mostly domestic) wealth recorded on tax returns: around 5% belongs to the top 0.01% and around 10% belongs to the top 0.1%. A recent paper from Colombia shows a similarly stark concentration of offshore wealth using data from voluntary disclosures (Avila and Londoño-Vélez, 2018).
The concentration of offshore assets among the wealthiest have implications for inequality: under plausible assumptions the wealth share of the top 0.01% increases by around a quarter when accounting for undisclosed offshore accounts. It also has implications for the distribution of tax evasion: while randomized tax audits display no strong wealth gradient in evasion, the amount and distribution of offshore assets suggests that evasion rates are around 10 times larger for the very wealthiest than for the national average.

Drawing on various macroeconomic statistics, Alstadsæter et al. (2018) document significant cross-country variation in offshore wealth. The patterns suggest that a significant fraction of global offshore wealth is entirely unrelated to tax evasion, particularly in the context of developing countries. For instance, tax haven banks may serve to circumvent capital controls during a currency crisis, as suggested by the exceptionally high levels of offshore wealth in Argentina, and to launder the proceeds from corruption in extractive industries, as suggested by the high levels of offshore wealth in Russia and Venezuela. The latter is consistent with the empirical finding that commodity price booms cause significant increases in the offshore wealth of resource-rich countries when democratic governance is weak (Andersen et al, 2017)

**Do Our Enforcement Policies Work?**

Over the last decade the policy activity in the field of offshore tax evasion has been prolific as discussed by Hebous in this Report. While the first waves of enforcement efforts seem to have brought only small increases in tax compliance, assessing the effects of the more recent initiatives based on automatic information exchange remains one of the most important questions for future research.

Johannesen et al. (2018) provide the first direct evidence on the compliance effects of the enforcement policies introduced in 2008-2009: court cases against Swiss banks, information exchange treaties with tax havens and a tax amnesty with reduced penalties for voluntary disclosers of offshore assets. Using U.S. administrative data, they show that the bundle of enforcement initiatives induced almost 100,000 U.S. taxpayers to disclose offshore accounts with a total value of $100 billion, around 10% of the estimated total U.S. wealth on offshore accounts.

Consistent with these modest compliance effects, a number of papers document that many offshore tax evaders, rather than becoming compliant, took actions to circumvent the early enforcement efforts. The withholding taxes on interest income in Switzerland, Luxembourg and other cooperating tax havens imposed by the Eu-
European Union, induced tax evaders to set up anonymous holding companies (Johannesen, 2014; Omartian, 2016) and the treaties allowing for information exchange with cooperating tax havens induced tax evaders to move assets to non-cooperating tax havens (Johannesen and Zucman, 2014, Hanlon et al, 2015). One paper presents evidence suggesting that whistleblowing and customer leaks in tax havens were associated with a considerable increase in tax compliance (Johannesen and Stolper, 2017).

Most developed countries now engage in automatic information exchange with tax havens: the U.S. since 2015 under the Foreign Account Tax Compliance Act (FATCA) and most other countries since 2017 through adaptation of the Common Reporting Standard (CRS). While automatic information exchange is a potentially powerful tool to fight offshore tax evasion, it is also contested because of the costs it creates for banks and compliant individuals. A number of recent papers present indirect evidence consistent with considerable compliance effects of automatic information exchange using data on foreign portfolio investments (De Simone et al., 2018) and cross-border deposits (Casi et al., 2018; Menkhoff and Miethe, 2017); however, more research is warranted to critically assess the strengths and weaknesses of this new global policy standard.

**Conclusion**

Despite empirical challenges, researchers have produced significant knowledge about tax evasion through offshore accounts. It is clear that offshore evasion remains an important challenge for tax enforcement: it creates significant revenue losses and erodes the progressivity of the tax schedule by reducing the effective taxation of the wealthiest. More research is warranted to assess the effectiveness of automatic information exchange in combating offshore tax evasion.

**References**


