The Challenge of Offshore Tax Havens

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What do offshore tax havens do?

Help multinational firms obtain low taxes on profits ("profit shifting")

Help wealthy individuals evade taxes on personal income ("offshore tax evasion")

Help criminals and corrupt elites hide and launder illicit funds ("money laundering")

Research agenda for economists

(#1) Measure the scale of the undesirable activity through tax havens and its consequences

(#2) Assess the effectiveness of the policies enacted to curb the use of tax havens

This lecture

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Is there a development gradient in exposure to offshore tax havens?

(#2) Assess the effectiveness of the policies enacted to curb the use of tax havens

Are the new global policy designs fit for developing countries?

This lecture

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Three robust findings about offshore tax evasion

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#1 Significant share of global household wealth owned through tax havens

#2 Offshore assets are extremely concentrated at the top of the wealth distribution

#3 A large share of offshore assets are tax non-compliant

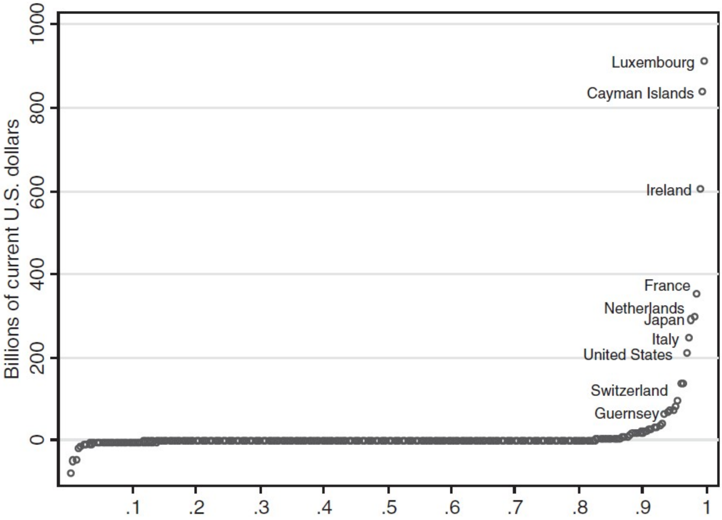
#1 Significant share of global household wealth owned through tax havens

Zucman (QJE, 2013) combines macro statistics to show that household financial assets in tax havens amount to around $6,000 billion

Main idea: When households hide assets in tax havens, international financial statistics capture liabilities but not assets

The scale of hidden wealth can be inferred from the global liability-asset gap

The global liability-asset gap clearly associated with offshore financial centers



#2 Offshore wealth is extremely concentrated at the top

Alstadsæter, Johannesen and Zucman (AER, 2019) combine leaked customer data from Swiss private bank and tax records from Scandinavia

Around 50% of offshore wealth belongs to the top 0.01% of the wealth distribution

Subsequent research has found similar pattens in other countries
[Argentina (Londoño-Vélez and Tortarolo, 2022), Colombia (Londoño-Vélez and Ávila-Mahecha, 2021), South Africa (Johannesen, Larsen and Riedel, 2023)]

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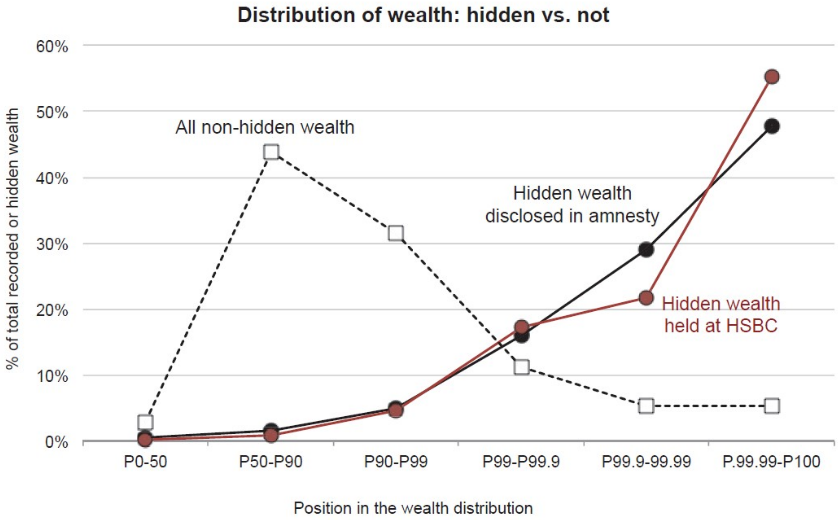


#3 A large share of offshore assets are tax non-compliant

Micro: In leaked samples of offshore accounts, the compliance rate is typically low ($\approx 10\%$)

Macro: Tax amnesties combined with credible detection risk induce large declarations of offshore accounts
(e.g. Londoño-Vélez and Tortarolo, 2022)

Caveat: Compliance responses to recent policies are still not well understood.

Is there a development gradient in exposure to offshore tax havens?

Why should we care?

Much of the current policy development happens at the international level, e.g. OECD / Global Forum

Different policy designs are possible and preferences may differ with administrative resources / development

The development gradient in offshore exposure informs the "optimal balance" between these policy preferences

What should we expect?

More offshore exposure in developing countries:
- more inequality
- less enforcement on foreign income
- weaker domestic financial sector
- more corruption

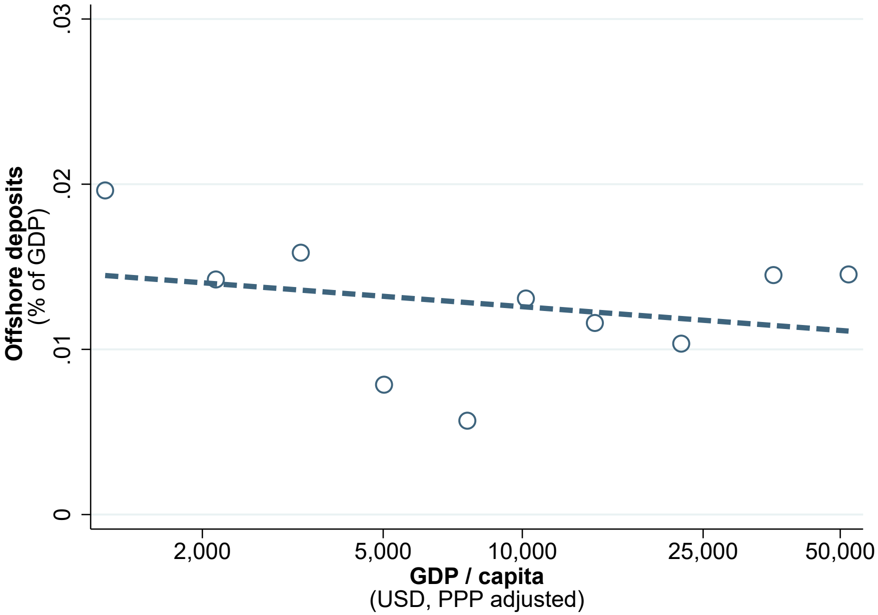
Less exposure in developing countries
- less enforcement on domestic income
- lower tax rates
- geography

Deposits in tax havens

Bank for International Settlements collects information about cross-border deposits in 49 financial centers

Limitations:
- only asset class is deposits
- not all tax havens allow data to be published
- no looking through holding structures

Slightly negative development gradient in tax haven deposits

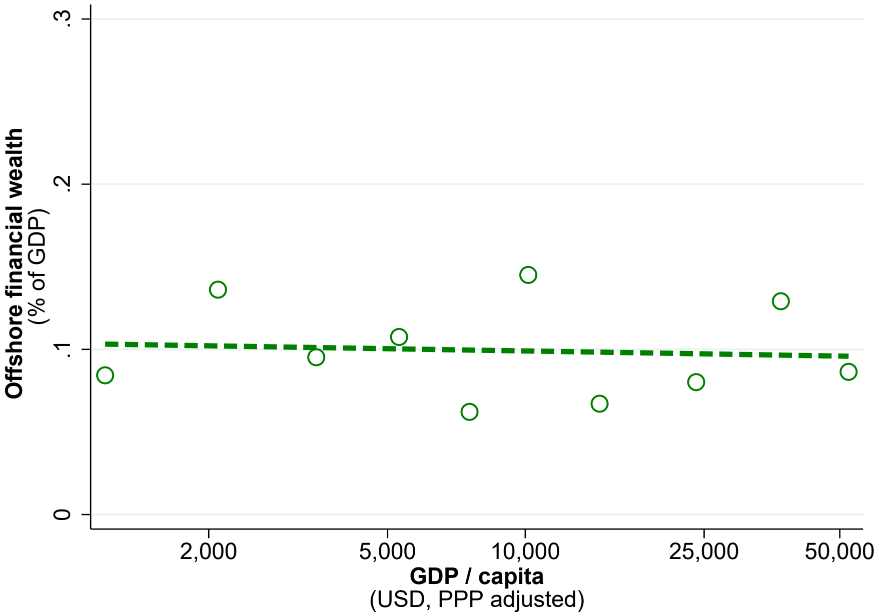


Financial assets in tax havens

Alstadsæter, Johannesen and Zucman (2018) attempts to allocate *all* financial assets in *all* tax havens looking through holding structures

Limitations:
- strong assumptions
- uses 2007 data

No development gradient in tax haven financial assets

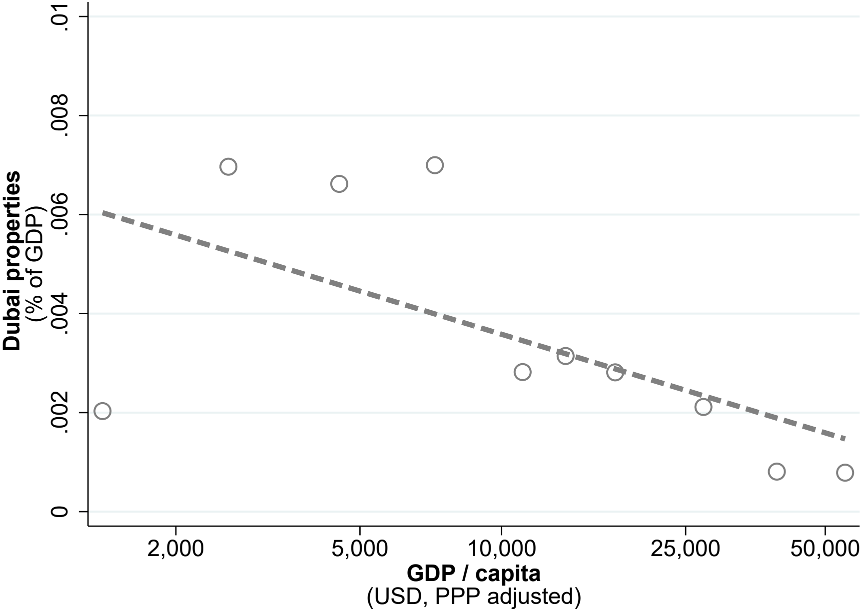


Offshore real estate

Alstadsæter, Plantrose, Zucman and Økland (2022) use leaked data to allocate ownership of Dubai properties

Limitations:
- only one property market
- confounds offshore evasion and housing

Clear negative development gradient in Dubai properties

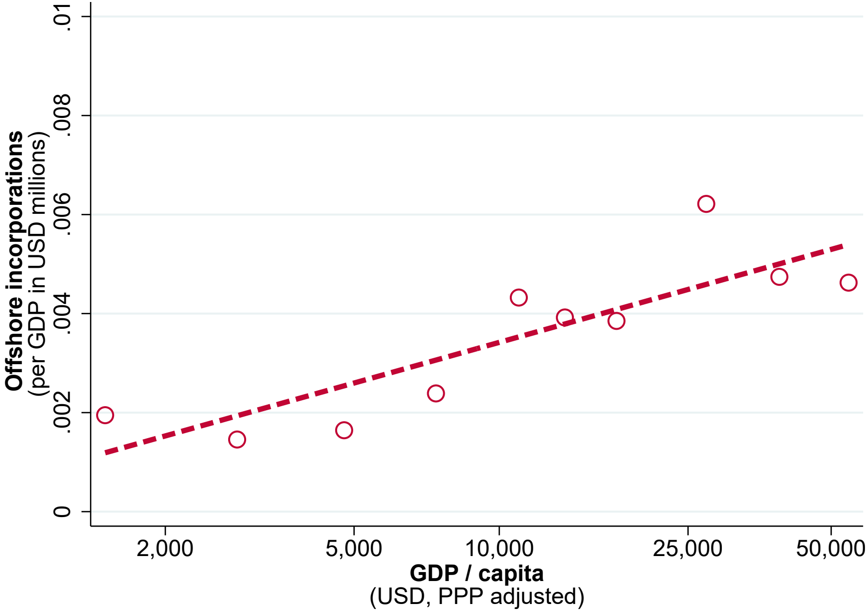


Incorporation in offshore tax havens

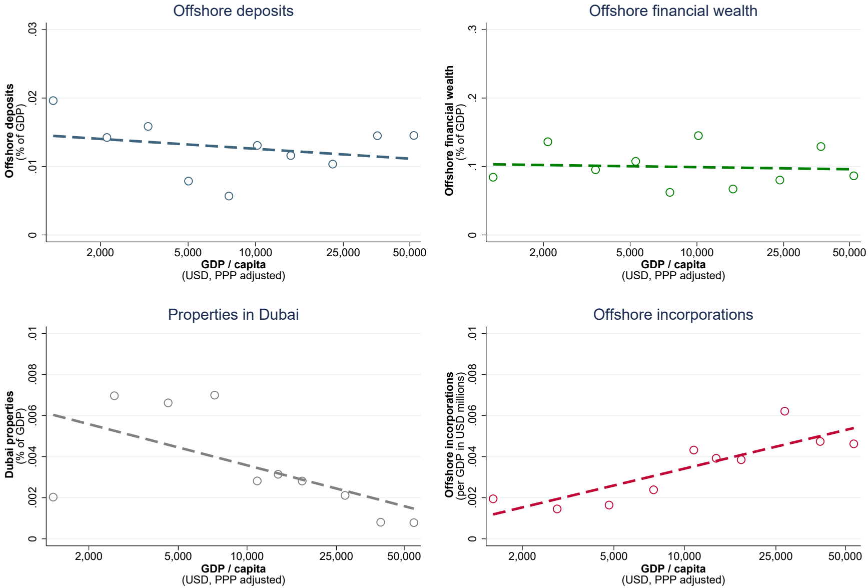
International Consortium of Investigative Journalists (ICIJ) publish leaked micro-data for offshore incorporations

Limitations:
- only subset of jurisdictions and providers
- confounds legitimate and illegitimate uses
- no information about assets

Clear positive development gradient in offshore incorporations



The full picture is somewhat mixed



Are the new global policy designs fit for developing countries?

Policies to fight offshore tax evasion

A series of policy initiatives over the years spearheaded by the OECD

Prevailing paradigm: Cross-border exchange of information
- key enforcement challenge is the lack of information about offshore income
- if tax authorities can obtain this information, they can enforce taxes perfectly

Policy efforts have focused on making offshore tax havens deliver information

Ever higher global standards of information exchange

Comprehensive and automatic information exchange
- banks identify beneficial owners of accounts
- banks collect account information
- banks share with home country of account owner

Today, more than 100 countries engage in this form of information exchange

(including major financial centers such as Switzerland, Singapore and Cayman Islands)

Information exchange in theory and practice

In theory, information exchange is ideal because it allows governments to treat domestic and foreign income identically

In practice, the difficulties are considerable:
- matching foreign information to domestic taxpayers
- mapping foreign information to domestic categories
- handling foreign source taxes

The new information flows constitute an enforcement tool
$\rightarrow$ using it requires significant administrative resources

An alternative policy design?

First EU policies to address offshore evasion relied on anonymous withholding rather than information exchange:
- banks identify foreign-owned accounts
- banks impose withholding tax on income
- revenue is sent to owner's home country

Home countries have less flexibility in terms of tax rates etc, but need not expend administrative resources

The two policy designs could potentially co-exist

If one design does not fit all?

The policies aiming to combat offshore tax evasion are designed in international bodies (e.g. OECD) and rolled out more or less uniformly

Main conjecture: Policy designs revolving around information exchange may be well-suited for developed countries but less so for developing countries.

Is it desirable to adopt a flexible policy menu that accommodates others but the most advanced tax administrations?

Discussion

An analogue in corporate taxation?

Key policy innovation: **Global Minimum Tax** of 15%
- assume Google's profits in Bermuda taxed at 1%
- the U.S. can impose a top-up tax of 14%

Will this policy effectively benefit countries with low capacity in tax administration?

- Not so much: Top-up taxes rely on information exchange

- Yes: Tax havens may respond by raising tax rates

Conclusion

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Developing countries appear to be as exposed to offshore tax havens as developed countries

New global policy standards to counter the offshore challenge often rely heavily on information exchange

Risk that countries with low administrative capacity do not reap the benefits of these policies - alternatives exist