# The New Hunt for Tax Havens

Congressional leaders are looking to clamp down on offshore tax havens after a Government Accountability Office ("GAP") report found that 83 of the 100 largest publicly traded U.S. corporations have subsidiaries in jurisdictions listed as tax heavens or financial privacy jurisdictions, while 63 of the 100 largest publicly traded federal contractors reported having subsidiaries in such jurisdictions.

"This report shows that some of our country's largest companies and federal contractors, many of which are household names, continue to use offshore tax havens to avoid paying their fair share of taxes to the U.S. And some of those companies have even received emergency economic funds from the government," said Sen. Byron Dorgan, D-N.D. "I think we should take action to shut down these tax dodgers and we will be introducing legislation to do just that."

Sen. Carl Levin, D-Mich., echoed Dorgan: "We must get to the bottom of activities such as the following: Citigroup has set up 427 tax havens subsidiaries to conduct its business, including 91 in Luxembourg, 90 in the Cayman Islands, and 35 in the British Virgin Islands. Hundreds more tax haven subsidiaries operate under strict secrecy laws in places like Switzerland, Hong Kong, Panama and Maurituius." Levin, who chairs the U.S. Permanent Subcommittee on Investigations, has made offshore tax abuse a major subject of its investigations.

The managing editor of WG&L Journal of International Taxation at Thomson Reuters, observed that the GAO study correctly notes that there is no agreed-on definition or list of 'tax havens.' Instead, they cobbled together their list from three old ones.

The GAO said that while there is no agreement on a definition, various governmental, international and academic sources used similar characteristics to define and identify tax havens: Some of the characteristics included no or nominal taxes; a lack of effective exchange of information with foreign tax authorities; and a lack of transparency in legislative, legal or administrative provisions.

**LISTING TO ONE SIDE?**

Basing its report on a variety of sources, the GAO said that it used three lists of tax havens or financial privacy jurisdictions: a list from the Organization for Economic Co-operation and Development; a National Bureau of Economic Research working paper; and a U.S. District Court order granting leave for the Internal Revenue Service to issue a "John Doe" summons. The auditor general combined the three lists for the purposes of the report, but did not develop its own definition of tax havens or its own list of jurisdictions.

One list of tax havens, released in 2000 by the OECD, is a list of both jurisdictions that have committed to improving transparency and effective exchange of information for tax matters, and jurisdictions that have not made such a commitment. Since that list of jurisdictions was released, however, that vast majority of listed jurisdictions have committed to meeting OECD standards of transparency and effective exchange of information.

Many of the jurisdictions on that 2000 OECD list have signed tax information exchange agreements with the United States. Thus the 2000 OECD list includes countries from which the IRS can obtain information and that have committed to establishing effective information exchange.

Many of the countries on the list continue to negotiate the information exchange agreements and the list will continue to be reduced. Many countries want to get off the list.

The GAO also used an IRS "John Doe" summons list issued in 2005 to compile its tax havens list. Use of this list is especially problematic The IRS summons lists 34 jurisdictions from which the IRS was seeking information about individuals who had signature authority over bank accounts or credit cards issued by, through or on behalf of financial institutions in those jurisdictions. The list of jurisdictions in that summons was put together for a very specific purpose and was not at all intended to suggest a general list of jurisdictions that the Treasury and IRS consider tax havens.

While the John Doe summons list concerned individuals, the GAO was using it in a report dealing with foreign subsidiaries of U.S. corporations. Because the problem identified in the draft report and the John Doe summons are so different, it is unclear what relevance the list of countries in the John Doe summons has in the context of the report. For those reasons the IRS requested the GAO not use the summons list as a source for its tax havens list.

**NO HAVEN FOR HAVENS**

It’s interesting that the Treasury asked the GAO not to use that list and they went ahead and did it anyway. The IRS put together that list to investigate individuals, not to look into problems with subsidiaries established by U.S. companies.

The use of the lists, and the study itself, are being used to create a record to pass the Stop Tax Haven Abuse Act, according to Tittle. Several bills were several years ago, and they clearly intend to re-introduce them in the new Congress. President Obama was one of the individual sponsors, and it’s clearly an issue that Dorgan and Levin are interested in.

S. 396, introduced by Dorgan, would prevent American companies from deferring the imposition of a second-layer tax on their foreign-source income if they operate in selected low-tax nations. Meanwhile, S. 681, the Stop Tax Haven Abuse Act, would establish legal presumptions against the validity of transactions involving offshore secrecy jurisdictions foreign tax havens identified in the act, and by the Treasury.

The report is careful to say that it didn’t determine if corporations or contractors with subsidiaries in jurisdictions listed as tax havens engaged in transactions in order to reduce their tax burden. It accepts that fact that subsidiaries can be established in the listed jurisdictions for a variety of non-tax business reasons. For example, many companies want to insure against a particular risk, so they establish a captive insurance company in Bermuda. It is a world jurisdiction for captive insurance companies."

Any legislation could have an adverse effect on legitimate business interests. Due to the credit crunch, U.S. companies have started to eye their foreign subsidiaries as a source of liquidity, and government has come up with some effort to help them through the tax system. In October 2008, the Treasury sent out a notice that eases foreign subsidiary lending rules under Code Section 956. The old rule allowed subsidiaries to lend to the parent for up to 30 days without the loan being considered repatriation. The new rule now allows the subsidiary to lend for up to 60 days. It's a short-term effort to increase companies' access to capital."

And as part of the stimulus packages, one proposal would allow foreign earnings to be repatriated at a tax of 5%, rather than the standard 35%. That's the affirmative use of the tax system to create additional liquidity.

Because of the high U.S. corporate tax rate, most of the rest of the world looks like a tax haven. This is an area that will continue to vex the IRS and Treasury Department.