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The United States as the Ultimate Tax Haven

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Chairman Pascrell, Ranking Member Kelly, members of the subcommittee: Thank you for inviting me.

The US is the world's leading investment destination for offshore wealth. Our laws enable foreigners—through offshore intermediaries—to invest anonymously in the US and to grow their wealth tax-free. We are, in this respect, the world's ultimate tax haven.

The Pandora Papers spotlight Panama, source of 2 million documents in that leak. But most offshore wealth booked in Panama won't stay there. According to the IMF, 51 percent of outbound portfolio investment from Panama pours into the US. We're also the number-one destination for portfolio investment from other offshore financial centers, including the Cayman Islands, Ireland, Jersey, Luxembourg, and Switzerland.[1]

The US never deliberately decided to become the world's ultimate tax haven. But whether we continue to play this part is very much within Congress's control. Lawmakers can either acquiesce to our tax-haven status or catalyze change.

Countries involved in offshore tax evasion fall into three groups. First are origin countries, where owners of offshore wealth reside. Second are intermediary countries, where wealth hides in bank accounts and trusts. Third are destination countries, where offshore wealth is ultimately invested in stocks, bonds, and other assets. The US is occasionally an origin country, sometimes an intermediary country, and very often the destination country.

Start with our origin-country role. U.S. households own 30 percent of global wealth, but we account for only 7 percent of shell-company shareholders identified in the Panama Papers and 3 percent of offshore wealth in secretive Swiss banks.[2] We're doing a relatively good job of preventing offshore tax evasion by Americans.

As for our intermediary status: A recent article in the *Journal of Public Economics* estimates that 7 percent of the world's offshore wealth is booked in the US. That still puts us behind Switzerland, Hong Kong, Singapore, the UK, Luxembourg, and the Cayman Islands.[3]

What makes us unique is our leading role as the investment destination for offshore wealth. Offshore wealth holders want to earn reliable returns, and we let them do it here tax-free. Since 1984, the US has not taxed foreigners on portfolio interest—such as interest on corporate bonds. And while we still nominally impose a 30 percent withholding tax on dividends, we exempt stock buybacks.[4] Buyback gains are taxable in a shareholder's home country. If the shareholder successfully hides her assets from home-country authorities, she won't pay tax anywhere.

In recent years, buybacks have replaced dividends as the primary channel through which large U.S. corporations return cash to shareholders. Of the 10 largest U.S. companies by market cap, five pay no dividend, and four pay dividend yields below 1 percent.[5] Foreigners can invest offshore wealth in those companies essentially tax-free.

To illustrate, consider two companies—AT&T and Facebook. A foreigner who holds $1 million of AT&T stock in an offshore account would pay $27,000 per year in U.S. tax.[6] By contrast, a foreigner who holds $1 million of Facebook stock offshore would pay zero. The reason is that AT&T returns cash to shareholders primarily through dividends while Facebook returns cash to shareholders exclusively via buybacks.

The offshore wealth that flows into the US brings real benefits. It finances corporate investment, mortgage loans, and government debt. But these benefits pale next to the costs.

First, our choice to exempt foreigners from U.S. tax on portfolio interest and buyback gains imposes a massive revenue cost on the federal fisc—hundreds of billions of dollars each decade.[7] Second, by helping other countries' citizens evade taxes, we compromise our own national security and foreign policy interests. The global rule of law depends upon a network of capable national governments. We subvert other members of that network when we aid and abet tax evasion by their citizens.

So what to do?

First, we either need to apply our withholding tax to buybacks or push U.S. corporations back to dividends. The excise tax on buybacks in the Build Back Better Act is a modest first step in the right direction.

Second, we ought to reconsider the withholding tax exemption for portfolio interest. Especially if interest rates rise in the coming years, the revenue costs of this exemption will mount.

Third, we need to work multilaterally with other countries that are home to strong and stable capital markets: especially Japan, the UK and EU, Canada, South Korea, and Australia. If these countries all agree to impose comprehensive withholding taxes, offshore wealth holders who want to earn reliable returns will no longer have the option to evade tax entirely. By contrast, trying to shut down every offshore intermediary will be a game of whack-a-mole, because dozens of countries can play the intermediary role.

We cannot rue the problem of offshore tax evasion without recognizing the United States' central part. Hopefully this hearing and the legislative efforts that come out of it will move us closer toward shedding our status as the world's ultimate tax haven. Thank you again for the opportunity to share these views.

Endnotes

[1] International Monetary Fund, Coordinated Portfolio Investment Survey (CPIS), https://data.imf.org (last updated Oct. 8, 2021).
[2] Credit Suisse Research Institute, Global Wealth Databook 2021, at 24 tbl.2-1 (2021), https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/global-wealth-databook-2021.pdf; Annette Alstadsæter, Niels Johannesen & Gabriel Zucman, Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality, 162 J. Pub. Econ. 89 (2018) (online appendix at tbl.A3, tbl.A4), https://gabriel-zucman.eu/files/AJZ2017bAppendix.pdf.
[3] Alstadsæter et al., supra note 2 (online appendix at tbl.A2c).
[4] Daniel J. Hemel & Gregg D. Polsky, Taxing Buybacks, 38 Yale J. on Reg. 246 (2021).
[5] As of this week, the 10 largest U.S. corporations by market capitalization were Apple, Microsoft, Alphabet (Google), Amazon, Tesla, Meta (Facebook), NVIDIA, Berkshire Hathaway, JPMorgan Chase, and Visa. Of these, only Apple, Microsoft, NVIDIA, JPMorgan Chase, and Visa paid any dividend, and only JPMorgan Chase paid an annual dividend in excess of 1 percent.
[6] As of the close of trading on December 7, the dividend yield on AT&T stock was 9 percent. 9 percent x 30 percent x $1 million = $27,000.
[7] Daniel J. Hemel & Gregg D. Polsky, Equalizing the Tax Treatment of Stock Buybacks and Dividends (Univ. of Chi. Pub. Law Working Paper No. 771, Apr. 19, 2021), https://ssrn.com/abstract=3827117.