FACTCOALITION
Financial Accountability & Corporate Transparency

FACT Sheet

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Offshore Tax Haven Abuse

Middle-Class Taxpayers and Domestic Businesses Foot the Bill for Offshore Tax Loopholes

Many Large U.S.-Based Multinationals Avoid Paying U.S. Taxes by Using Accounting Tricks to Make Profits Made in America Appear to Be Generated in Offshore Tax Havens — Countries with Minimal or No Taxes.

- The corporate abuse of tax havens costs U.S. taxpayers between $94 billion and $135 billion in lost revenue every year — meaning higher taxes, fewer services, or increased debt.[1]
- Wealthy individuals use tax havens to illegally *evade* U.S. taxes, costing an estimated $35 billion to $70 billion in lost revenue annually.[2, 3]

What Is a Tax Haven?

- A low or no-tax jurisdiction that has high levels of financial secrecy, making it a haven for tax avoiders and evaders.
- There are as many as 60 jurisdictions that fit the description of tax haven. In the Cayman Islands, for instance, a 5-story building called the Ugland House is home to 18,857 corporate "headquarters."[4]

How Do Corporations Use Tax Havens?

- There are many schemes. One common practice is 'transfer mispricing,' in which one subsidiary of a company undercharges or overcharges another subsidiary in order to move the company's profits to a low or no-tax country. Here's a simplified example: A pharmaceutical company creates a new drug. They sell the drug patent to a P.O. Box subsidiary in the Cayman Islands for practically nothing. The drug is produced, marketed and sold to U.S. customers. The U.S. company then pays most of its profits in 'royalties' or 'licensing fees' to the offshore subsidiary and, as a result, tells the IRS that it has no profits to tax. But the money has really just moved around to different parts of the same corporation.
- The profits that American corporations claimed to earn in Bermuda in 2012 equaled 1,884 percent of Bermuda's economic output.[5]

What Is a Corporate Inversion?

- A corporate inversion is when a larger American corporation merges with a smaller foreign corporation that's based in a tax haven—or at least a lower-tax jurisdiction. The company "moves" on paper to the foreign country to lower its tax bill, but the company's functional headquarters usually remains in the United States.

Our Tax Code Gives American Corporations a Powerful Incentive to Shift Profits Offshore.

- U.S. tax laws allow companies to indefinitely avoid paying U.S. taxes on profits they report are earned abroad until they "repatriate" the money to the United States — which they often never intend to do. Indeed, the Institute on Taxation and Economic Policy estimates that the largest multinational corporations have $2.6 trillion stashed offshore, on which they owe approximately $752 billion in unpaid taxes.[6]

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[1] Clausing, Kimberly. "Profit shifting and U.S. corporate tax policy reform," *Washington Center for Equitable Growth*, May 2016, http://equitablegrowth.org/report/profit-shifting-and-u-s-corporate-tax-policy-reform/.

[2] Zucman, Gabriel. "The Hidden Wealth of Nations: The Scourge of Tax Havens". *University of Chicago Press*, September 22, 2015, http://www.press.uchicago.edu/ucp/books/book/chicago/H/bo20159822.html.

[3] Guttentag, Joseph, and Reuven Avi-Yonah, "Closing the International Tax Gap," in Max B. Sawicky, ed., Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration (2006), http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1069&context=book_chapters.

[4] *Government Accountability Office*. "International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Secrecy Jurisdictions." December 2008, http://www.gao.gov/highlights/d08778high.pdf.

[5] Phillips, Richard, Matt Gardner, Alexandria Robins, and Michelle Surka. "Offshore Shell Games 2017". *Institute on Taxation and Economic Policy and U.S. PIRG Education Fund*, October 2017, https://itep.org/offshoreshellgames2017/.

[6] Ibid.

There Is a Cost to Small Businesses and Ordinary Taxpayers.

- Tax havens give large, multinational corporations a competitive advantage over small and medium-sized domestic businesses that must play by the rules and can't afford armies of high-priced tax attorneys.
- The roughly $150 billion per year in federal and state tax revenue lost to offshore tax avoidance by multinational corporations would cost each small business owner $5,186 in additional taxes to collectively pick up the tab.[7]

Policy Solutions to Stop the Worst Offshore Tax Dodging Gimmicks.

1. Stop Giving Multinationals an Advantage over Wholly Domestic and Small Businesses

We should immediately close the loophole that allows companies to defer paying taxes by moving their profits offshore. As U.S. citizens, you and I — and every domestic company — pay taxes on what we earn, regardless of where we earn it. None of us can defer our tax obligations. But multinational companies can create foreign subsidiaries, divide themselves in ways that game the system, and defer paying all or most of the taxes due on their foreign earnings. It's not fair, and it's anti-competitive. They use our roads and bridges to ship their goods, recruit from our colleges and universities, and are protected by our laws and our military. They should not, through loopholes and accounting gimmicks, defer paying their share and leave the rest of us to pick up the tab.

Also, we should not favor multinationals over wholly domestic and small businesses by giving them a special rate. Shockingly, the House tax legislation proposes a lower tax rate (as low as 0%) for those companies that shift jobs and book profits overseas.[8] That makes no sense.

2. Stop U.S. Companies from Claiming Foreign Residence Simply to Dodge Taxes

Some large U.S. companies buy up smaller, foreign companies, move their legal residence to one of the tax haven countries (a paper transaction, no moving van required) and claim they are no longer U.S. residents to avoid paying taxes. They still have access to our markets and many of the privileges they enjoyed as U.S. companies, but stop paying the taxes needed to support that access. That means you and I are left paying their share. We should strengthen 'anti-inversion' and earnings-stripping rules to prevent that type of gaming.

3. Ensure Multinationals Play by the Rules by Publicly Reporting their Profits and Taxes Paid

Multinational companies do not publicly report on where they are making their money or what taxes they are paying to whom. We have no idea exactly how they are gaming the system — what they tell us versus what they tell other countries. They should have to write it down in one place and report it on a country-by-country basis, so that the public (and investors) can see what they are really paying.[9]

4. Don't Make Things Worse

Our current system allows U.S. companies to delay paying taxes on U.S. profits they shift overseas. That's bad enough. Some in Congress have proposed allowing the profit-shifting without ever having to pay what they owe. That's the ultimate loophole. If we move toward what's called a "territorial tax system," which really means giving multinational corporations a zero tax on profits they book abroad, the only companies left paying U.S. corporate income taxes would be those too small to game the system. It also means that multinational companies would face an incentive to offshore jobs to countries with lower tax rates than the U.S. That is why more than 100 organizations sent a letter to Congress recently urging legislators to reject a "territorial tax system."[10]

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[7] Surka, Michelle. "Offshore Tax Havens Cost Small Businesses on Average $5,128 a Year". *U.S. PIRG*. November 29, 2016, https://uspirg.org/news/usp/offshore-tax-havens-cost-small-businesses-average-5128-year.

[8] Clark Gascoigne, "House Bill a Gift to Offshore Tax Dodgers and Outsourcers". *The FACT Coalition*, Nov. 2, 2017, http://thefact.co/GiRzt.

[9] *The FACT Coalition,* "FACT Sheet: Public Country-by-Country Reporting," September 27, 2017. http://thefact.co/aIdnl.

[10] Clark Gascoigne, "Over 100 Organizations Urge Congress to Reject Giant Tax Loophole for Offshoring and Tax Avoidance", *The FACT Coalition*, October 2, 2017, http://thefact.co/3Kzko.