Written Testimony of Beverly Moran
for Subcommittee on Oversight Hearing: The Pandora Papers and Hidden Wealth
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I. Our message to the committee

We have two messages for you:

1. The time is now.

Tax havens are contagious. Once they enter, they spread.

2. All you can do is regulate.

Destroying tax havens is near impossible. There are too many incentives for taxpayers to promote tax havens and for governments to accommodate taxpayers' desires.

II. Consequences of tax havens and of being a tax haven

Tax havens are a plague brought about by a government's need for revenue.

At first, tax havens offer rescue from economic catastrophe.[1] Later, the promised revenue falls short.[2]

In the meantime, other jurisdictions are attracted by the economic activity they see in tax havens. Their conversion creates competition. Taxpayers use the increasing rivalry to gain ever greater concessions. The race to the bottom is now in full swing.

The money attracted to tax havens often comes from activities which have no economic nexus with the tax haven, and which are self-exiled from mainstream economies. The taxes these monies generate are paltry, and domestic revenue which should have been levied to benefit the citizens of the mainstream economies is irretrievable. Of perhaps even greater concern is that money attracted to tax havens which lack basic regulatory safeguards often comes from criminal activities. For example, the Washington Post identified nearly 30 U.S.-based trusts with assets tied to people or companies accused of fraud, bribery, or human rights abuses;[3] and Forbes reports that South Dakota collected a mere $1.5 million in fees from trust companies out of a $2.2 billion state budget.[4]

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[1] Alaska introduced tax haven legislation when the price of oil dropped. https://www.icij.org/investigations/pandora-papers/us-trusts-offshore-south-dakota-tax-havens/ New Hampshire, South Dakota and others followed suit when they needed to increase revenues. Id.

[2] For example, New Hampshire has very few people employed in the trust sector despite the great tax benefits that sector provides to the wealthy. Id.

[3] https://www.bloomberg.com/news/features/2021-10-14/where-rich-people-stash-money-to-avoid-taxes-south-dakota-holds-500-billion

[4] https://www.forbes.com/sites/howardgleckman/2021/10/14/south-dakota-turned-itself-into-a-tax-haven-but-why/?sh=660fe11d2f25

In the end, countries lose over $427 billion each year to tax evasion.[5] More than enough to fund all of the recently passed infrastructure bill and Build Back Better, combined.

Tax havens rob the citizens of mainstream economies of revenues for schools, hospitals, and roads, while they weaken sovereignty and the rule of law.

What are the consequences *for* the local economy colonized by a tax haven? After the initial euphoria wears off, they are dire in the medium term. Once captured by the finance sector, the local economy suffers from a lack of diversification, leading to the skills sterilization of an over-focused work force. There is nowhere else within the captured local economy in which to earn one's keep. Yet the work force is *unwittingly obsolescent*. Once the circus leaves town - and it always will, heading for the next new tax haven which woos it – there is nothing of any comparative commercial significance to replace it.

III. How tax havens work.

Tax havens and the legal structures that support them evolve. By the time a government figures out how to stop one, another has emerged.

In the past, tax havens offered zero tax rates plus secrecy. Think suitcases of cash arriving discretely at a Swiss bank. That kind of tax haven is out of fashion.

International pressure has finally forced secrecy jurisdictions like Switzerland to give other nations access to account information.[6]

At the same time, tax competition is so fierce that many jurisdictions offer zero tax rates.[7] These ubiquitous low rates undergird the recent push for a worldwide 15% minimum corporate tax.[8]

IV. The new tax havens

Tax havens are not mistakes. They are not discovered and then exploited by vigilant accountants. Tax havens are created in law offices for wealthy clients and sold to governments by the tax haven industry.[9]

Tax havens are difficult to combat because they constantly evolve. As governments push for greater transparency, tax havens preserve secrecy either by creating new financial instruments or using old structures in new ways.

Think of it as a game of dodgeball. One team looks to create fair tax systems where everyone pays their share. The other team is looking for every way to escape taxes by constantly shifting to new instruments of avoidance.

[5] https://www.taxjustice.net/reports/the-state-of-tax-justice-2020/

[6] https://en.wikipedia.org/wiki/Banking_in_Switzerland#Automatic_exchange_of_information_with_other_countries

[7] For example, the United Kingdom, New Zealand, and the United States all allow foreigners to use trusts to avoid taxes in their home country. http://www.radionz.co.nz/news/panama-papers/303356/nz-at-heart-of-panama-money-go-round and http://www.independent.co.uk/voices/george-osborne-is-trying-to-turn-post-brexit-britain-into-a-tax-haven-and-it-wont-benefit-anyone-a7119211.html

[8] https://www.theverge.com/2021/11/1/22756934/g20-oecd-15-percent-global-corporate-tax-rate-havens-evasion-tech-giants

[9] https://www.icij.org/investigations/pandora-papers/baker-mckenzie-global-law-firm-offshore-tax-dodging/

When banks provided complete secrecy, taxpayers shunned fancy financial structures. Once they placed monies in secret accounts, their work was done. No government could tax them because no government could find their assets.

International pressure changed the rules so that banks now reveal their depositors to taxing authorities. In turn, taxpayers dodged by altering how they made deposits. Instead of holding accounts in their own names, secure of their anonymity, taxpayers created shell companies with tangled ownership structures that were difficult to trace.

When governments increased regulations on companies to help discover the person behind the shell, taxpayers dodged again and moved their investments from corporations created by public filings to trusts created by private contracts. The Pandora Papers reveal this heavy reliance on trusts.

When regulators realized that trusts support secrecy, some reacted by requiring that trusts report their beneficial owners. The tax haven industry responded by employing new instruments that have no beneficial owners to report.

In the United States, that instrument is the non-charitable purpose trust. For now, these trusts are available in Delaware,[10] New Hampshire,[11] South Dakota,[12] and Wyoming.[13] In the near future, you can expect them to spread across the nation.[14]

V. How United States trusts help avoid taxes

The Pandora Papers focus our attention on non-charitable purpose trusts as tax avoidance vehicles. Nevertheless, non-charitable purpose trusts are not always necessary for US tax avoidance.

Foreign persons can use ordinary trusts to avoid both United States and foreign taxes in relatively straightforward ways.[15] Those ways place the United States high on lists of international tax havens.

For example, the "Financial Secrecy Index" (FSI) measures the effectiveness of a country's laws in concealing money and avoiding tax. From a total of 112 countries, the United States ranks second on that list.[16]

Further, US citizens who are beneficiaries of ordinary trusts with non-resident alien grantors, can use the US grantor trust rules to completely avoid US income tax. In addition, the non-resident alien grantor likely lives in a jurisdiction without grantor trust rules. As a result, the US beneficiary escapes US tax because of the US grantor trust rules and the non-resident alien grantor escapes foreign tax because of a lack of foreign grantor trust rules.

VI. Why non-charitable purpose trusts appeal to tax havens

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[10] Del. Code title 12, section 3556

[11] N.H. Rev. Stat. section 564-B

[12] South Dakota Codified laws section 55-1-20

[13] Wyo. Stat. s 4-10-410

[14] Appendix A has a brief description of non-charitable purpose trusts and how they operate to eliminate beneficial ownership

[15] Appendix B has a brief description of how the Internal Revenue Code’s definition of foreign trust allows a tremendous amount of income to escape United States taxation.

[16] https://www.worlddata.info/tax-havens.php

On the surface, the IRC has what it needs to attack non-charitable purpose trusts.[17] The IRS either taxes the trust itself or it taxes the person who acts as the trustee.

However, the tax rule hides a bigger problem: how to discover that a non-charitable purpose trust exists and is generating taxable income. Non-charitable purpose trusts are easy to hide because trusts are easy to hide. They exist in lawyers' offices without the benefit of public registers. Even if they are registered, most registration systems are based on the idea of beneficial ownership. Non-charitable purpose trusts have no beneficial owner. That makes reporting difficult at best. And that's the point.

"Tax havens don't just offer an escape from tax. They also provide wealthy and powerful elites with secrecy and all manner of ways to shrug off the laws and duties that come along with living in and obtaining benefits from society – taxes, prudent financial regulation, criminal laws, inheritance rules, and many others. Offering these escape routes is the tax havens' core line of business. It is what they do. … It is a place that seeks to attract money by offering politically stable facilities to help people or entities get round the rules, laws and regulations of jurisdictions elsewhere."[18]

As one commentator declared after the release of the Panama Papers: "So-called tax havens and their service providers […] are nothing short of enemies of humanity."[19]

[17] Rev Rul. 76-486, 1976-2 CB 192

[18] Nicholas Shaxton Treasure Islands – Uncovering the damage of offshore banking and tax havens (Palgrave Macmillan 2011), 11

[19] Jean Ziegler, quoted in Bastian Obermeyer and Frederick Obermaier *The Panama Papers* (Oneworld, 2016) 200

APPENDIX A

Non-charitable purpose trusts. What are they and how are they used?

A. What are trusts and how are they used?

A trust is meant to solve a problem. One person owns property (the Grantor). The Grantor wants to use that property to benefit another person (the Beneficiary). However, the Grantor does not want to give the property directly to the Beneficiary nor manage the property himself. A trust solves the problem by giving legal ownership to a person (the Trustee) who manages the property for the Grantor to benefit the Beneficiary.

Trusts are usually created by contract. Often, these contracts do not appear in any public registry. This makes trusts good vehicles for financial secrecy. Only the lawyers know the parties to the trust.

B. How do non-charitable purpose trusts differ from ordinary trusts?

An ordinary trust involves three separate legal actors.

1. The grantor who creates the trust by funding it with cash or property.
2. The trustee who has legal title to the property but may only use the property as directed in the trust instrument
3. The beneficiary of the trust who has the equitable right to the property but no legal ownership

Traditionally, a trust beneficiary is an identifiable human being. If the grantor wants to benefit an animal, or a thing, a trust is not usually available.

Legislatures responded to the problem of the non-human beneficiary with charitable purpose trusts. These trusts do not name a specific charitable organization as beneficiary. Instead, they direct their income and property to charitable purposes. Thus, in contrast to an ordinary trust, a charitable purpose trust has no named beneficial owner. Nevertheless, so long as recipients of trust property are all bona fide charities, the trust is a valid instrument.

The tax haven industry took the idea of a trust without beneficiaries and created a new instrument called the non-charitable purpose trust. Instead of a human beneficiary, the trustee holds assets for a stated non-charitable purpose. The lack of a beneficial owner helps taxpayers use non-charitable purpose trusts to maintain secrecy and avoid taxes.

Non-charitable purpose trusts only exist until their purpose is achieved. Once the purpose is accomplished, the trust's legal existence ceases.

C. Description of a transaction using a non-charitable purpose trust

Foreign person owns toxic property. Foreign person wants the toxic property off his company books.

1. Foreign person creates a special purpose company and funds the company with the toxic property. [20]

    a. The company's special purpose is to hold the toxic asset until the special purpose company stock is sold.

    b. Foreign person receives stock in the special purpose company in exchange for the toxic property.

2. Foreign person creates a non-charitable purpose trust.

    a. Foreign person funds the non-charitable purpose trust with special purpose company stock

    b. The trust's non-charitable purpose is to hold the shares until sale

3. Non-charitable purpose trust sells the shares in the special purpose company to third party

    a. The special purpose company no longer exists

    b. The non-charitable purpose trust no longer exists

    c. The proceeds from the sale go to foreign person

In European jurisdictions, these transactions are interpreted as sales without a beneficial owner. Without the beneficial owner, the tax is difficult — sometimes impossible — to lay.

In the United States, the grantor trust rules might force a United States person to recognize the tax, but it might not. Especially if the trust is not a domestic trust under the Internal Revenue Code, the likelihood of tax avoidance is high.

[20] A special purpose company — like a non-charitable purpose trust —exists only until it has achieved its purpose. Once the purpose is achieved, the company's legal existence is over.

APPENDIX B

Internal Revenue Code (IRC) treatment of foreign trusts, beneficiaries, and grantors.

The IRC taxes US source trust income to either the trust, the beneficiary, or the grantor[21]. It does not matter whether the trust, the beneficiary, or the grantor are United States citizens, resident aliens, or non-resident aliens. Absent a treaty provision, the IRC taxes everyone on their US source income.[22]

The IRC also taxes foreign source income in certain circumstances.[23] The IRC taxes foreign source income earned by a domestic trust or by a foreign trust if attributed to a United States citizen or a resident alien beneficiary or grantor.[24]

In contrast, the IRC does not tax foreign trusts on their foreign source income.[25] Nor does the IRC tax foreign source income attributed to non-resident alien grantors or beneficiaries.

Nevertheless, because of the IRC definition of a domestic trust, foreign persons can use United States trust law to avoid taxes in their home countries and in the United States.

IRC §7701(a)(30)(E) defines a domestic trust as having two elements

(i) A United States court can exercise primary supervision over the administration of the trust; AND

(ii) One or more U.S. persons have the power to control all substantial decisions of the trust.

IRC §7701(a)(31)(B) defines a foreign trust as any trust that is not a domestic trust.

As a result of these two definitions, foreign people can form a trust in the United States and yet still have a foreign trust. If the assets in the trust are foreign assets, there is no US source income to tax.

Further, because of how the IRC defines US source income, foreign people can create a trust in the United States, fund that trust with US property, and — depending on the property and the income generated by that property —still have no US tax liability. [26]

When the foreign taxpayers use a non-charitable purpose United States trust, they can often avoid paying taxes in their home country as well.

[21] When the grantor is taxed, the trust is called a grantor trust. IRC sections 671 to 679
[22] https://www.irs.gov/individuals/international-taxpayers/nonresident-aliens-source-of-income
[23] Sourcing rules are contained largely in IRC 861-863 and 865.
[24] https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-about-international-individual-tax-matters
[25] https://www.irs.gov/individuals/international-taxpayers/nonresident-aliens-exclusions-from-income
[26] For example, non-resident aliens are not taxed on portfolio interest earned from US sources. IRC 871(h) Nor are they taxed on capital gains from the sale of US stocks. IRC 871(a)(2)

APPENDIX C

Global availability of non-charitable purpose trusts[27]

Non-charitable purpose trusts are available globally, as the following sampled list shows. This includes four States.

Jurisdiction	Statute
Belize	Trusts Act 1992
British Virgin Islands	Trustee Act (Cap. 303) as amended by Trustee (Amendment) Act 2013
Barbados	International Trusts Act 1995
Cayman Islands	Introduced into the Cayman Islands via the Special Trusts (Alternative Regime) Law, 1997, now embedded in Part VIII of the Trusts Law (2011 Revision) ("STAR Trusts")
Cook Islands	International Trusts Amendment Act 1995-96, s 8
Guernsey	Trusts (Guernsey) Law 2007, s 12
Isle of Man	Purpose Trusts Act 1996
Jersey	Trusts (Jersey) Law 1984 (as amended by Trusts (Amendment No. 3) (Jersey) Law 1996 with effect from 24 May 1996)
Labuan	Labuan Trusts Act 1996 (as amended, 2010) s 11A
Mauritius	Trusts Act 2001, s 19
Niue	Trustee Companies Act 1994, s31
Samoa	Trusts Act 2014, s 66
Turks and Caicos Islands	Trusts Ordinance 2016
USA, Delaware	**Del. Code tit. 12, s 3556**
USA, New Hampshire	**N.H. Rev. Stat. s 564-B**
USA, South Dakota	**South Dakota Codified laws s 55-1-20**
USA, Wyoming	**Wyo. Stat. s 4-10-410**

[27] Paul Beckett, *Ownership, Financial Accountability and the Law: Transparency Strategies and Counter-Initiatives* (Routledge, London and New York, 2019) 205

APPENDIX D

The United States as a tax haven

Though a victim of the tax havens, it is arguable that the US is a long way along the road to becoming the world's largest tax haven itself, profiting from enhanced banking secrecy laws and less stringent disclosure requirements under the Foreign Account Tax Compliance Act than under the Common Reporting Standard promoted by the OECD.

"After years of lambasting other countries for helping rich Americans hide their money offshore, the U.S. is emerging as a leading tax and secrecy haven for rich foreigners. By resisting new global disclosure standards, the U.S. is creating a hot new market, becoming the go-to place to stash foreign wealth […] helping the world's rich move accounts from places like the Bahamas and the British Virgin Islands to Nevada, Wyoming and South Dakota."[28] The approach to corporate formations in Delaware and to banking facilities for non-residents in Florida appear little different to those of some of the bottom end tax havens.[29]

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[28] *The World's Favorite New Tax Haven is the United States* Jesse Drucker 27 January 2016 https://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states

[29] "Not all these havens are in sunny climes; indeed not all are technically offshore. Mr Obama likes to cite Ugland House, a building in the Cayman Islands that is officially home to 18,000 companies, as the epitome of a rigged system. But Ugland House is not a patch on Delaware (population 917,092), which is home to 945,000 companies, many of which are dodgy shells. Miami is a massive offshore banking centre, offering depositors from emerging markets the sort of protection from prying eyes that their home countries can no longer get away with." *The Missing $20 Trillion* The Economist 16 February 2013 http://www.economist.com/news/leaders/21571873-how-stop-companies-and-people-dodging-tax-delaware-well-grand-cayman-missing-20