The United States as the Ultimate Tax Haven

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Testimony before the House Committee on Ways and Means, Subcommittee on Oversight
"The Pandora Papers and Hidden Wealth"
Wednesday, December 8, 2021

Chairman Pascrell, Ranking Member Kelly, and members of the subcommittee: Thank you for inviting me here today to testify on the topic of "The Pandora Papers and Hidden Wealth."

The United States is the world's leading investment destination for offshore wealth. Our laws enable foreign nationals—via offshore intermediaries—to invest anonymously in the United States and to have their wealth grow here tax-free. We are, in this respect, the world's ultimate tax haven: Foreign nationals seeking to escape tax in their home countries typically hold bank accounts or trusts in other offshore financial centers that we label as tax havens, but those other jurisdictions are often just a pit stop on the route to U.S. capital markets.

Consider Panama—the source of the most leaked records in the Pandora Papers. Offshore wealth booked in Panama rarely stays in Panama: most of it is ultimately invested somewhere else, and that "somewhere else" is usually the United States. The United States accounts for more than half—51 percent—of outbound portfolio investment from Panama, and the United States is also the number-one destination for portfolio investment from other offshore financial centers, including the Bahamas, Cayman Islands, Ireland, Jersey and Guernsey, Luxembourg, and Switzerland.[1]

The United States 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 should carefully consider the high costs to ourselves and to our allies of the United States' ultimate tax-haven status—costs that, in my view, outweigh any plausible benefits.

Before proceeding further, it will be helpful to define key terms. "Offshore wealth" refers to assets owned by a citizen or resident of one country and held directly or by a financial institution in another country. Not all offshore wealth represents tax evasion: an individual might open a foreign bank account for entirely legitimate reasons—for example, because she spends a portion of the year in a foreign country for business or pleasure. And of course, not all tax evasion happens offshore: by all accounts, most tax evasion by U.S. individuals occurs entirely inside our borders. But one important reason why individuals hold wealth offshore is to evade taxation at home. For many countries—especially low- and middle-income countries—offshore tax evasion is a real drain on government revenue and a serious threat to state capacity.

Countries involved in offshore tax evasion can be grouped into three categories. First are the origin countries, where owners of offshore wealth reside. Second are the intermediary countries, where owners hold offshore wealth in bank accounts, investment funds, and trusts. Third are the destination countries, where offshore wealth is ultimately invested in stocks, bonds, real estate, and other assets. The United States is occasionally an origin country, sometimes an intermediary country, and very often the destination country.

Start with the United States' status as an origin country. U.S. households own 30 percent of the world's wealth,[2] but a much smaller share of offshore wealth. Americans account for only 7 percent of shell-company shareholders identified in the Panama Papers and only 3 percent of offshore wealth in secretive Swiss banks.[3] Certainly some U.S. individuals still evade the IRS using offshore accounts, even after aggressive enforcement efforts by the Justice Department over the last 15 years and the implementation of the Foreign Account Tax Compliance Act. But relative to the rest of the world, we are doing well in combating offshore tax evasion by our own citizens and residents.

As for the United States' status as an intermediary country: The Pandora Papers highlighted the role of trusts in some U.S. states—especially South Dakota—in holding and hiding offshore wealth for foreign nationals. But financial institutions in many other countries hide wealth too. According to one recent estimate in the *Journal of Public Economics*, only around 7 percent of the world's offshore wealth is booked in the United States. In this regard, we still rank behind Switzerland, Hong Kong, Singapore, the United Kingdom, Luxembourg, and the Cayman Islands.[4]

What makes us unique is our status as the go-to investment destination for offshore wealth. Foreign nationals seeking to evade home-country taxes still want to earn an investment return. And they want to their return to be tax-free, or close to tax-free, as there is little point in risking penalties for tax evasion in one's home country while paying taxes at a similar or higher rate in another country.

This is where the United States comes in. Since 1984, the United States has not imposed tax on portfolio interest paid to foreigners—for example, interest on corporate bonds and mortgage-backed securities. And while we still nominally impose a withholding tax of up to 30 percent on dividends paid to foreign shareholders, that tax does not apply to stock buybacks.[5] Instead, any gain from stock buybacks is taxable in a shareholder's home country. Of course, if the shareholder successfully hides her assets from home-country authorities, she will never pay tax here or at home.

Until the 1980s, the exclusion of buyback gains from U.S. withholding tax was largely an academic issue because buybacks were relatively rare. In recent years, though, 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 capitalization, five pay no dividends at all, and four pay nominal dividends amounting to less than 1 percent of stock price.[6] When these companies return cash to shareholders, they do so primarily through buybacks.

Foreigners can invest offshore wealth in these companies while paying no or negligible tax here or anywhere.

To understand the relevance of the dividend-buyback distinction to offshore wealth, consider two companies—AT&T and Facebook (now Meta). A foreign national who holds AT&T stock through an offshore account in the Cayman Islands would pay an annual U.S. tax equal to 2.6 percent times the value of her investment—a significant amount if it recurs year after year.[7] By contrast, a foreign national who holds Facebook stock through the same offshore account would pay an annual U.S. withholding tax of zero. The reason for this disparity is that AT&T returns cash to shareholders primarily through dividends while Facebook returns cash to shareholders exclusively via buybacks.

To be clear, I am not suggesting that Facebook and other mega-cap corporations that have shifted from dividends to buybacks are intentionally facilitating international tax evasion. The market-wide dividend-to-buyback shift has a number of causes—some innocuous. But a not-at-all innocuous consequence is to make the United States an even more attractive destination for foreigners to park their offshore wealth—including offshore wealth that is hidden from home-country tax authorities.

Our status as the world's ultimate tax haven brings real benefits. The offshore assets invested in the United States fund corporate investment, home mortgage loans, and government debt. But these benefits pale in comparison 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 government—in the hundreds of billions of dollars each decade.[8] Some of the benefits from those exemptions flow back to U.S. borrowers and stock issuers, but this is a very leaky subsidy for domestic capital investment.

Second, insofar as we facilitate tax evasion by citizens and residents of other countries, we potentially compromise our own national security and foreign policy interests. The global rule of law depends upon a network of stable and capable national governments. We subvert other members of that network when we aid and abet tax evasion by their citizens and residents. Beyond that, we undermine our credibility abroad when we spotlight—and sometimes scapegoat[9]—countries that serve as offshore intermediaries even as we allow hidden wealth to slosh around in our own markets.

What can the United States do to remedy the problem? First, we either need to apply our withholding tax to stock buybacks or induce U.S. corporations to shift back to dividends. Again, it is the trend from dividends to buybacks—combined with the exemption of buyback gains from withholding tax—that allows foreign nationals to invest tax-free in U.S. equities. The 1 percent excise tax on stock buybacks in the Build Back Better Act is a first step in the right direction, though a higher rate on buybacks would be even more effective at propelling a move back to dividends.

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. A withholding tax on portfolio interest will require careful design to prevent avoidance, but this should be a top priority for the Ways and Means Committee going forward.

Third, we need to work multilaterally with other countries that are home to large and liquid capital markets so that our anti-evasion efforts align with theirs. The recent and successful effort to reach an agreement at the OECD regarding corporate tax avoidance provides a model for the fight against individual tax evasion. In some respects, the problem of individual tax evasion should be easier to tackle, because there are only a handful of other countries that could plausibly replace the United States as the world's go-to investment destination for offshore wealth: the United Kingdom, France, Germany, Japan, and maybe China if it can maintain confidence in its capital markets. By contrast, attacking the problem by going after offshore intermediaries will be a game of whack-a-mole, because dozens of countries can potentially 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.

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[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.

[3] 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.

[4] Id. (online appendix at tbl.A2c).

[5] Daniel J. Hemel & Gregg D. Polsky, Taxing Buybacks, 38 Yale J. on Reg. 246 (2021).

[6] 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.

[7] As of this week, the dividend yield on AT&T stock was 8.77 percent. 8.77 percent x 30 percent ≈ 2.6 percent.

[8] 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.

[9] For a thoughtful critique of U.S. and OECD rhetoric regarding offshore intermediaries, see Steven A. Dean & Attiya Waris, Ten Truths About Tax Havens: Inclusion and the "Liberia" Problem, 70 Emory L.J. 1657 (2021).