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Tax Evasion Through Offshore Accounts: a Review of the Empirical Evidence and Questions for Future Research

In this piece, I briefly review the evidence on offshore tax evasion. While empirical investigation of the offshore world is rendered difficult by institutionalized secrecy, researchers have produced a significant amount of "evidence of the invisible" (Slemrod and Weber, 2011) in recent years, often through the creative use of non-standard data sources.

I first discuss the likely magnitudes involved: how much financial wealth is held by private individuals through tax havens? I then turn to distributional aspects: how is the wealth in tax havens distributed across countries and across segments of the population within countries? Finally, I summarize the existing evidence on the effectiveness of the policy instruments employed to enforce taxes on offshore assets: legal action against offshore banks, information exchange with tax havens, protection of whistleblowers and tax amnesties.

How Much Wealth Do Households Own in Tax Havens?

Before embarking on further analysis of offshore tax evasion, it is natural to gauge the magnitude of the problem: how much financial wealth do private individuals own in tax havens?

The question is difficult given the often highly incomplete statistics of offshore financial centers, but a recently developed method provides a compelling answer (Zucman, 2013). The method exploits that assets held through secret foreign accounts leave traces in international investment statistics in the form of a global gap between assets and liabilities: when a French tax evader owns a U.S. security through a secret Swiss account, the U.S. records a foreign liability but no country records a foreign asset. The study concludes that personal wealth on tax haven accounts amounts to around \$6,000 billion, or roughly 8% of all household financial wealth.

Who Owns the Wealth in Tax Havens?

Macro-data on foreign investment say nothing about which segments of the population own the wealth in tax havens – that question can only be addressed with micro-data. Alstadsæter et al. (2017) compile such micro-data for Denmark, Norway and Sweden from various sources: leaked customer information from the Swiss bank HSBC Switzerland ("Swiss Leaks") and the Panamanian corporate service provider Mossack Fonseca ("Panama Papers") as well as information from voluntary disclosure programs. Linking these micro-data to population-wide tax records on wealth, the study estimates how offshore assets are distributed across wealth groups.

The figure illustrates the extreme concentration of offshore wealth in the Scandinavian micro-data. Both among customers in HSBC Switzerland and among voluntary disclosers of offshore assets, around 50% belongs to the top 0.01% of the wealth distribution and around 80% belongs to the top 0.1%. For comparison, the dotted line shows the distribution of (mostly domestic) wealth recorded on tax returns: around 5% belongs to the top 0.01% and around 10% belongs to the top 0.1%. A recent paper from Colombia shows a similarly stark concentration of offshore wealth using data from voluntary disclosures (Avila and Londoño-Vélez, 2018).

The concentration of offshore assets among the wealthiest have implications for inequality: under plausible assumptions the wealth share of the top 0.01% increases by around a quarter when accounting for undisclosed offshore accounts. It also has implications for the distribution of tax evasion: while randomized tax audits display no strong wealth gradient in evasion, the amount and distribution of offshore assets suggests that evasion rates are around 10 times larger for the very wealthiest than for the national average.

Drawing on various macro-economic statistics, Alstadsæter et al. (2018) document significant cross-country variation in offshore wealth. The patterns suggest that a significant fraction of global offshore wealth is entirely unrelated to tax evasion, particularly in the context of developing countries. For instance, tax haven banks may serve to circumvent capital controls during a currency crisis, as suggested by the exceptionally high levels of offshore wealth in Argentina, and to launder the proceeds from corruption in extractive industries, as suggested by the high levels of offshore wealth in Russia and Venezuela. The latter is consistent with the empirical finding that commodity price booms cause significant increases in the offshore wealth of resource-rich countries when democratic governance is weak (Andersen et al, 2017)

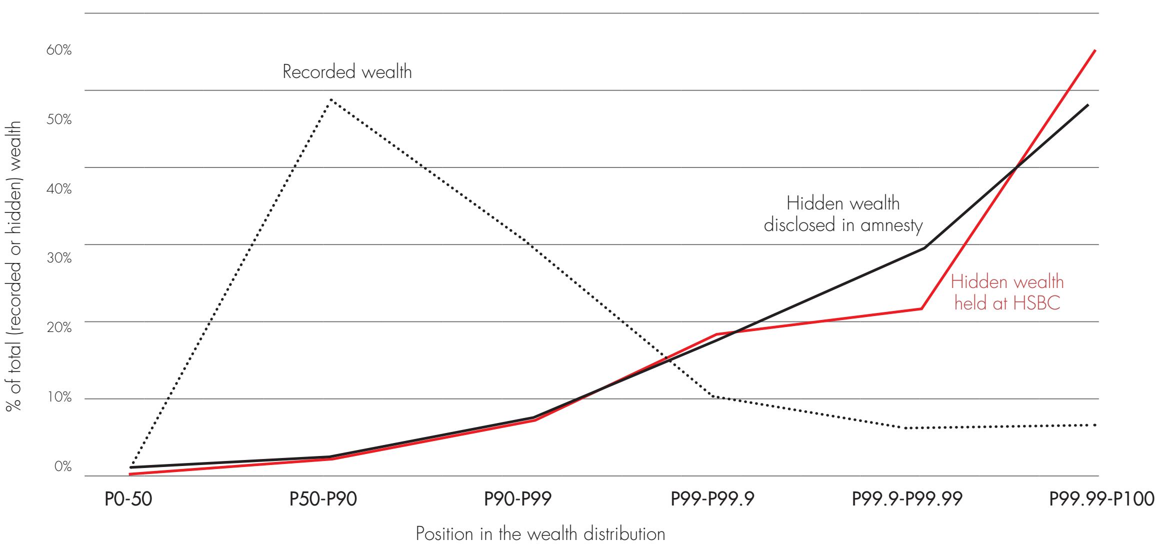
Do Our Enforcement Policies Work?

Over the last decade the policy activity in the field of offshore tax evasion has been prolific as discussed by Hebous in this Report. While the first waves of enforcement efforts seem to have brought only small increases in tax compliance, assessing the effects of the more recent initiatives based on automatic information exchange remains one of the most important questions for future research.

Johannesen et al. (2018) provide the first direct evidence on the compliance effects of the enforcement policies introduced in 2008-2009: court cases against Swiss banks, information exchange treaties with tax havens and a tax amnesty with reduced penalties for voluntary disclosers of offshore assets. Using U.S. administrative data, they show that the bundle of enforcement initiatives induced almost 100,000 U.S. taxpayers to disclose offshore accounts with a total value of $100 billion, around 10% of the estimated total U.S. wealth on offshore accounts.

Consistent with these modest compliance effects, a number of papers document that many offshore tax evaders, rather than becoming compliant, took actions to circumvent the early enforcement efforts. The withholding taxes on interest income in Switzerland, Luxembourg and other cooperating tax havens imposed by the Eu-

Figure 1: Distribution of Wealth: Recorded vs. Hidden



Notes: The figure shows the distribution of wealth in Scandinavia excluding offshore wealth (dashed line); the distribution of wealth held at HSBC Switzerland and revealed in the Swiss Leaks (red line); and the distribution of offshore wealth disclosed by amnesty participants (black line). Source: Alstadsæter et al. (2017).

ropean Union, induced tax evaders to set up anonymous holding companies (Johannesen, 2014; Omartian, 2016) and the treaties allowing for information exchange with cooperating tax havens induced tax evaders to move assets to non-cooperating tax havens (Johannesen and Zucman, 2014, Hanlon et al, 2015). One paper presents evidence suggesting that whistleblowing and customer leaks in tax havens were associated with a considerable increase in tax compliance (Johannesen and Stolper, 2017).

Most developed countries now engage in automatic information exchange with tax havens: the U.S. since 2015 under the Foreign Account Tax Compliance Act (FATCA) and most other countries since 2017 through adaptation of the Common Reporting Standard (CRS). While automatic information exchange is a potentially powerful tool to fight offshore tax evasion, it is also contested because of the costs it creates for banks and compliant individuals. A number of recent papers present indirect evidence consistent with considerable compliance effects of automatic information exchange using data on foreign portfolio investments (De Simone et al., 2018) and cross-border deposits (Casi et al., 2018; Menkhoff and Miethe, 2017); however, more research is warranted to critically assess the strengths and weaknesses of this new global policy standard.

Conclusion

Despite empirical challenges, researchers have produced significant knowledge about tax evasion through offshore accounts. It is clear that offshore evasion remains an important challenge for tax enforcement: it creates significant revenue losses and erodes the progressivity of the tax schedule by reducing the effective taxation of the wealthiest. More research is warranted to assess the effectiveness of automatic information exchange in combatting offshore tax evasion.

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