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REFORM

Malawer: When global taxation and U.S. politics collide

By Stuart S. Malawer, ***J.D., Ph.D.***

Activists in Paris this month chant slogans as part of a protest triggered by the so-called "Panama papers," leaked documents that revealed secret international accounts at a bank in Panama.

Anger over tax havens for individuals and multinational corporations has moved from the margins to the mainstream. This is a red-hot issue in the U.S. presidential campaign.

This anger shows signs of growing almost daily with the newest disclosures and corporate schemes for reorganization. Popular resentment of secret deals and ineffective global tax rules is putting immense pressure on governments to formulate and execute new policies to tax real economic activities worldwide.

In particular, the problem for the United States and the European Union in taxing the offshore income of multinational corporations is simple: We are trying to tax global transactions, yet we are still living in a multi-jurisdictional world.

In other words, the U.S. and the E.U. are trying to tax transactions outside of their territorial jurisdictions, which is very tough.

The only global tax system today is a collection of national ones with few tax treaties. This allows for lawful tax avoidance. Lawful tax avoidance allows firms to take full advantage of the skewed system while evading their national and corporate responsibilities to governments and communities in their home jurisdictions, which provide them with their legal standing, protection, and support. This doesn't sound right.

By and large, the disconnect between limited national jurisdiction and global transactions is the underlying problem. This actually makes tax avoidance both lawful and insidious. Both the U.S. and the E.U. are beginning to grapple with the issue; sometimes they are at odds and sometimes not.

Both have taken important steps in mandating bank disclose foreign depositors. For example, under the Foreign Tax Compliance Act of 2010 (FACTA), there is a U.S. tax on foreign banks for noncompliance when the U.S. requests names of U.S. depositors. The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCen) is considering establishing an analogous disclosure of beneficial owners of offshore

shell companies to help fight money laundering. Those companies provide secrecy for foreign buyers of ultra-expensive condos in New York and Miami.

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The pending actions by the E.U. against Apple and the recently announced anti-inversion rules by the U.S. Treasury are just the latest round of attacks on tax avoidance.

The recent release of the "Panama papers" further highlights the already intolerable situation concerning individuals stashing money abroad.

This raises issues about the facilitation of tax evasion and the failure to exercise due diligence by financial institutions.

The claim that "double-taxation treaties" should not mean "no taxation treaties" is ringing true more and more every day. The amount of money kept by U.S. firms abroad by utilizing corporate inversions, tax deferrals, transfer pricing, and earnings stripping (i.e. the use of tax-deductible intracompany loans) is staggering: about $1 trillion. To me, "deferral taxation" really means either no taxation or very little taxation after repatriation, which is rare

Understanding global business and trade must include understanding the taxation of these cross-border corporate and investment transactions. The use of offshore shell companies is legitimate in some trade and investment transactions. But the story is much broader than that.

Apple, Microsoft, and Google alone have piled about $500 billion into offshore accounts. Apple's tax rate for overseas transactions is about 2.5 percent, while for domestic operations it is about 17 percent. The same can be said for other IT, Internet, and pharmaceutical firms that rely on intensive intellectual property rights and intangibles assets while the firms are incorporated and doing business in the U.S.

What should be done?

My sense is that both the U.S. and the E.U. really need to get serious about global tax avoidance by multinationals. The Organization for Economic Cooperation and Development (OECD) and the G-20 can help, but the answer at this point is better legislation and aggressive prosecutions by national authorities.

The debate about overall corporate tax rates is somewhat real, but I believe that even if these were lowered, tax evaders would still find it attractive not to pay the amounts due. We'll see.

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But to begin, we in the United States need an honest discussion of the responsibilities that individuals and multinational corporations have to pay their taxes whenever real economic and business transactions take place.

The U.S. can start this process by having an honest discussion during this campaign season. Hopefully, this will lead to better national legislation and international cooperation and regulation.

One idea to consider is to include tax transparency as well as corporate and banking transparency when negotiating new trade agreements. This would subject countries to trade sanctions for failing to comply with tax transparency and other treaty obligations to disclose banking information. This would exert a significantly greater amount of pressure on non-complying countries than is being done today.

But more importantly, addressing global tax avoidance and bank secrecy would start to rebuild popular trust in trade. The failure to do so would only encourage more anti-trade resentment.

Global tax avoidance is a blight on our tax system. If stashed funds abroad are repatriated, they could be used for corporate reinvestment in the U.S. Taxes paid on those funds could go to rebuild our infrastructure.

Multinational corporations have an obligation to the communities where they do business and to the country that sustains them. U.S. multinationals benefit from U.S. laws and diplomacy. They need to act responsibly.

Stuart S. Malawer, J.D., Ph.D., is distinguished service professor of law and international trade at George Mason University *(Graduate School of Policy, Government and International Affairs*). His website is GlobalTradeRelations.net Contact him at StuartMalawer@msn.com.