

Outing Offshore Tax Dodgers

July 24 2008

Washington, D.C. -

While Uncle Sam is looking for tax cheats in Switzerland and Liechtenstein, U.S. lawmakers are frustrated that the use of offshore tax havens is flourishing in places like the Caribbean.

One example: The Uglund House in the Cayman Islands, where at least 18,857 international businesses--half of them with a U.S. affiliation--have been registered with the help of the building's sole tenant, the Maples and Calder law firm. And that's not the half of it. According to Jack Blum, an attorney with Baker & Hostetler in Washington, D.C., the British Virgin Islands is home to more than 500,000 shell companies. The tiny island of Nevis is the place of registry for tens of thousands of corporations, he says.

"Offshore tax evasion is a serious and growing problem," says Blum. But it's not because there's a proliferation of jet-setting billionaire tax dodgers these days. In a globalized economy with instant Internet money transfers, it's easier than ever to set up offshore tax structures "with the click of a mouse," he says. (See "End Of An Era?")

During a nearly two-hour hearing Tuesday, Blum's knowledge of offshore tax evasion captivated members of the Senate Finance Committee, and they in turn grew increasingly annoyed with the Internal Revenue Service's ability to enforce tax compliance in offshore havens.

"I'm all done defending you," Sen. Kent Conrad, D-N.D., told IRS official Frank Ng, who couldn't provide lawmakers with an estimate of how much revenue the government loses to offshore tax havens each year. A different Senate panel puts the figure at as much as \$100 billion per year, an estimate Blum thinks is low.

The IRS has long been concerned about curbing offshore tax evasion, but in recent months the issue has taken a new turn. Several countries, including the U.S., are investigating the extent to which their citizens are dodging taxes through a Liechtenstein bank, after the German government obtained a list of 1,400 of the bank's clients. Earlier this month, the U.S. government told Swiss bank UBS (nyse: UBS - news - people) to reveal the names of its U.S. clients with "undeclared" Swiss accounts.

On Friday, the Senate Permanent Subcommittee on Investigations holds its second recent hearing on offshore tax evasion, hauling in shopping mall magnate Peter Lowy for questioning.

In many cases, holding money in an offshore tax haven is perfectly legal. Although many businesses are clearly registered in the Cayman Islands for tax advantages, the islands have a

reputation for "stability and compliance with international [regulatory] standards," says a report unveiled at the hearing by the U.S. Government Accountability Organization. Indeed, while the number of businesses registered at the Uglund House raises eyebrows, the GAO does not accuse them of involvement in criminal activity.

But it's a slippery slope. "Persons intent on illegally evading U.S. taxes may be more likely to carry out financial activity in jurisdictions with no direct taxes, such as the Cayman Islands," the report says. According to Blum, the real problem is not in the Caymans but rather in places like the British Virgin Islands, where it's easy to set up "sham" trusts that can confound tax investigators.

Ng says the IRS is on the case. The Feds have 1,500 people (only about 2.5% of the IRS's workforce) devoted to international tax compliance. The IRS will soon begin audits of overseas U.S. taxpayers, and it's got several tools to help track tax dodgers who are stuffing their money in exotic locales. Among them: U.S. tax returns and forms that must be filed with the U.S. Treasury annually for any offshore account worth more than \$10,000.

"The obvious downside" to this type of reporting, says Ng, "is that they are dependent on the willingness of the taxpayer to comply." Unfortunately, tax cheats aren't always honest on their tax returns.

Blum suggests overhauling some tax compliance measures. He thinks corporations should have to prove they are engaged in real business activity abroad in order to claim that their "beneficial owner" is located offshore. He believes the government should end its Qualified Intermediary program, designed to help Uncle Sam reap tax benefits from foreigners investing in the U.S. The way it's structured actually helps foreigners and U.S. citizens evade taxes, Blum says.

He also wants to see withholding on capital gains in U.S.-connected offshore accounts. Currently, only dividends and interest are subject to withholding.

Problem is, these suggestions could take years to implement. Meantime, expect Congress and the IRS to keep looking for tax cheats in offshore havens.

But expect lawmakers to complain that not enough is being done.

Source: Brian Wingfield



HEALY CONSULTANTS