International tax police find new culprit: law firms

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Many nations in Western Europe can no longer afford their big welfare states. Countries such as Greece, Spain, and Italy already have needed bailouts, while it's just a matter of time before several other European nations face a fiscal day of reckoning. But the problem isn't confined to Europe. Countries such as the United States and Japan also have serious long-run problems because of changing demographics and poorly designed entitlement programs.

Unfortunately, rather than fix their own fiscal problems, many of these nations are working through international bureaucracies such as the G-20 and the Organization for Economic Cooperation and Development to rewrite the rules and traditions of global commerce in an attempt to extract more tax revenue.

This is why there's been a major attack against so-called tax havens as part of a coordinated campaign to undermine fiscal sovereignty and restrict the human right of financial privacy. Apparently small jurisdictions are not allowed to follow the same strategy of low taxes and small government that enabled nations such as the United States to become rich.

One of the more bizarre chapters in this story is the way the pro-welfare state crowd is now trying to demonize financial service providers such as law firms that are hired to fill out paperwork by investors and entrepreneurs who are setting up trusts, companies, and other entities.

Consider, for instance, the plight of Mossack Fonseca, a professional services firm based in Panama. The BBC and other agenda-driven journalistic outlets have sought to impugn the reputation of this firm, which has been in business for nearly 40 years and has never once in its history been charged or even formally investigated in connection with a single case of criminal wrongdoing. But this collection of legal practitioners and egghead trust advisors is suddenly being portrayed as an international crime syndicate that's corrupting Western civilization one business incorporation at a time.

The controversy, in large part, derives from a basic and arguably willful misunderstanding of what firms like Mossack Fonseca do – and don't do – for their clients. In basic terms, these firms help people create new businesses and trusts. These legal entities are created in jurisdictions all around the world, and companies like Mossack Fonseca are legally obligated to conduct extensive due-diligence to ensure that the "beneficial owner" of these entities – the end-clients – is operating in a legal way, and that any funds deposited in these new companies have been legally earned. Banks conduct a similar due-diligence process on their own clients, and law firms typically work closely with them on their shared accounts to ensure full compliance with applicable laws.

But unlike banks, these law firms don't take possession of their clients' money. So the notion that they are involved in "money laundering" is laughable. Once incorporation papers are filed, the law firms don't direct in any way the operation of the businesses. When problems do arise and various categories of "red flags" are triggered, these firms must immediately contact local oversight and enforcement agencies under the law, and convey to them every bit of data and information they've gathered, even information that's otherwise protected. In other words: to blame these law firms for the misdeeds of the infinitesimally small number of people who game the system would be like blaming a car company for an owner driving his sedan off a cliff.

Firms like Mossack Fonseca are merely just the latest stand-ins and proxies for a much wider campaign being waged by left-wing governments and their various allies and interest groups. This campaign is built around aggressive attacks on anyone who, for any reason, seeks to legally protect their hard-earned assets from confiscatory tax policies.

What makes this issue so frustrating is there's actually a pro-growth way to end this controversy. High-tax governments should reform their own tax regimes with an eye on competing for capital and luring new businesses to their shores in an increasingly globalized and interconnected world. That's basically what happened in the 1980s, starting with the Reagan and Thatcher tax rate reductions, and it triggered a lengthy period of global prosperity.

Unfortunately, a cabal of governments in recent times has decided not to compete on that terrain at all – instead simply seeking to malign and destroy any entity, individual or jurisdiction that exists that deprives them of tax revenue to which politicians greedily believe they are entitled.

As usual, the media outlets running these perennial "exposés," usually at the bidding of OECD bureaucrats (who ironically get tax-free salaries) and government officials from high-tax nations, are barking up the wrong copse of trees.

It may be the case that foreign-based law firms like Mossack Fonseca are easy and salacious targets, notwithstanding the mundanity of the work they do and the critical role they play in helping the global economy operate efficiently. But the narrative being advanced by international media outlets suggesting that these firms are breaking the law, or helping others do the same, is

belied by the fact that none of them have actually been charged with any crime. Unfortunately, stories about law firms that follow the law don't typically sell many newspapers.

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