



The Coming Illegality of Acting Legally

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If you haven't heard yet, the release of the so-called Panama Papers has revealed that top global leaders such as Russian President Vladimir Putin and Iceland's prime minister may be using companies and other business entities created by a Panama-based firm as a way to avoid taxes or conceal wealth. It's creating quite an uproar. Unsurprisingly, with very little evidence of actual illegality on the part of the law firm from which the documents were stolen — or most of its clients — the usual suspects are already calling for sanctions or dramatic and punitive changes to international tax laws.

The French finance minister, for instance, already put Panama back on the list of countries that aren't sufficiently willing to help enforce onerous French tax law. That's despite France's removal of Panama from its list of uncooperative states and territories in 2012 after reaching a bilateral agreement on precisely that issue.

President Barack Obama, on the other hand, recognizes that most of the activities reported in the stolen pages are legal. As such, he wants to do something that might be even more radical than what France has done. He proposes making it illegal to legally reduce one's tax burden. Falling back on some generic and zero-sum concept of tax fairness, he told reporters that we "shouldn't make it legal to engage in transactions just to avoid taxes" and that he wants to enforce "the basic principle of making sure everyone pays their fair share."

No matter what paper you read or what program you listen to, this story is couched only in terms of a groundbreaking discovery that exposes how everyone and every company linked to an offshore account has run afoul of the legal system. Not true.

It is just a guess right now, but I predict that we will find out that most people who use tax havens are honest and law-abiding citizens — perhaps more so than politicians. As the Cato Institute's Dan Mitchell pointed out as soon as the papers came out, most parts of this story and other tax haven stories are non-stories.

International businesses, investors and entrepreneurs require international and neutral tax structures, such as the ones offered by Panama and Switzerland. The notion that having a company or a trust in Panama is automatically bad — or that because a few people use Panama accounts to do illegal things, all such arrangements are automatically bad — is ridiculous. Mitchell compares it to saying that "we shouldn't allow cars to be sold because someone may use one as a getaway car in a bank robbery."

Now, if someone is illegally hiding taxes from his government, he should be punished — in the same way the guy driving the getaway car should be — but we shouldn't punish the tax structures or the car company. If you want more global trade and more global investments, international bureaucracies such as the Organisation for Co-operation and Economic Development and governments around the world shouldn't make it harder to operate international businesses and engage in cross-border investment and business.

Unfortunately, that's the direction in which this whole drama is going. For years, France has punished its entrepreneurs and businesses with high taxes and terrible laws. As a result, last year alone, some 10,000 French millionaires called it quits and moved abroad. However, rather than reform its tax laws and streamline its government, it wants to put its grabby hands on some cash stored legally in Panamanian trusts. Why not, as long as the OCED is willing to help?

But it won't work in the long run. France and other high-tax nations can try very hard to destroy tax competition, financial privacy and the sovereignty of countries with better tax structures, but they still won't be able to afford their big and broken welfare states. Some European welfare states — e.g., Italy, Spain and Greece — have already hit the wall, and it's only a matter of time until France joins their ranks.

Instead of going after countries such as Panama and the important and legal structures they offer to international businesses and investors, high-tax nations and the media should wait to see whether any laws were actually broken. And while they're waiting, they should reform their own governments' self-destructive fiscal systems. That's the real financial scandal.