Tax havens should be emulated, not persecuted

By: Daniel Mitchell – April 19, 2013

When the financial crisis hit, politicians from high-tax nations didn't let the crisis go to waste. Acting through the G-20, they launched an attack on so-called tax havens, asserting that "hot money" from the offshore world somehow had caused the banking system to become unstable.

This campaign against low-tax jurisdictions made no sense. Nobody in the Cayman Islands or Monaco was responsible for the Federal Reserve's easy money. Nobody in Panama or Singapore had anything to do with the corrupt system of Fannie Mae/Freddie Mac subsidies.

As Yogi Berra would say, it's now déjà vu all over again. Tax havens are being attacked again, though this time they're fighting a two-front battle.

The first attack was launched a few months ago by a left-wing international bureaucracy based in Paris. Funded with American tax dollars, the Organization for Economic Cooperation and Development (OECD) published a report on "Addressing Base Erosion and Profit Shifting," (BEPS) and will follow up in a few months with specific recommendations.

This new OECD scheme is targeting multinational companies for a big tax hike, probably by requiring global tax returns, but that means tax havens are in the cross hairs because their pro-growth tax policies make them attractive locations for cross-border economic activity. Indeed, the OECD specifically has complained that "small jurisdictions act as conduits, receiving disproportionately large amounts of Foreign Direct Investment compared to large industrialised countries and investing disproportionately large amounts in major developed and emerging economies."

In other words, the bureaucrats (who rather conveniently get tax-free salaries while trying to raise the burden on the rest of us) think well-run jurisdictions such as Bermuda and the Cayman Islands somehow are bad because big companies are attracted by their non-destructive tax policies.

The OECD deserves credit for consistency, as its new campaign isn't just targeting small tax havens, but will also undermine the relatively attractive fiscal systems in nations such as Ireland, Hong Kong, Switzerland, Slovakia, Singapore, Estonia, and the Netherlands. The burden of this will fall not on companies, but on workers, consumers, and shareholders.

The second attack was triggered by the recent theft of client data from service providers

in a couple of low-tax jurisdictions, including the British Virgin Islands. This led to news reports that some shady individuals utilized tax havens. The Washington Post tried to foment a scandal because 30 out of 4,000 Americans on the list had some interaction with the legal system.

That's actually a very low rate. You almost certainly would find far more evidence of misbehavior if you took a random sample of 4,000 Americans from just about any cross-section of the population. Particularly if you examined the financial affairs of 4,000 people from Wall Street. Or 4,000 Prius owners. Or 4,000 people who wear Birkenstocks.

It's wrong to stereotype and profile based on certain characteristics, yet anti-tax haven demagoguery is perfectly acceptable in political circles since it is seen as expanding the power of government over taxpayers.

The real issue we should be addressing is whether we need some sort of external constraint to protect us from fiscal crises that are triggered by the overspending and overtaxing of the political class.

For a couple of decades following the Reagan and Thatcher tax cuts, governments around the world have been forced by tax competition to lower tax rates, reduce double taxation of saving and investment and reform their tax system.

Defenders of the welfare state and proponents of class-warfare tax policy have resented this liberalizing process and grab any opportunity to demonize tax havens, particularly since these jurisdictions have strong human rights laws that protect the financial privacy of investors.

What makes this debate so surreal is that the United States actually is one of the world's biggest tax havens, both because of attractive incorporation laws in states such as Delaware and Nevada and because we don't tax – or require the reporting of – much of the interest and capital gains paid to non-resident foreigners. These policies have been very beneficial to the United States. According to the most recent Commerce Department data, we have more than $20 trillion of foreign funds invested in our financial system.

Instead of persecuting other jurisdictions for doing the same thing, we should be reforming our tax system with a simple and fair flat tax so that American citizens also can benefit from such policies.