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Swiss Bank Drops Out of IRS Tax Compliance Program

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Reversing earlier moves taken this summer and fall, a major international bank is ending its cooperation with the Internal Revenue Service's efforts to prevent investors from investing money in foreign countries with more amenable tax structures and policies, such as Ireland or Switzerland.

During a Zurich speech, Barclays bank executive Francesco Grosoli announced that the firm's Swiss operations had "recently exited the program," after evaluating its legal options. Grosoli declined to reveal additional details, but said that the bank had decided to end compliance with the U.S. extra-territorial enforcement actions at some point within the last "three or four months."

Deputy Tax Collectors
The program, organized under the Foreign Account Tax Compliance Act (FATCA), requires foreign banks to provide confidential information to the IRS. Non-compliance carries heavy penalties levied upon foreign firms, with fines as high as half of the value of the American assets in question.

Announcing the law's passage in 2010, President Barack Obama warned the world's banking industry that if they did not "cooperate with us, we will assume that they are sheltering money in tax havens and act accordingly."

Since the law's passage, 25 bank employees have been accused of helping clients evade taxes. Two of Switzerland's top banks, UBS and Credit Suisse, have paid fines of over $3 billion combined, while dozens of other bank are still under investigation.

Another international bank, HBSC, settled with the United States Securities and Exchange Commission (SEC). The bank's clients were not properly registered, the SEC alleged, and HBSC employees made at least 40 visits to the U.S. to meet with clients.

The U.S. Department of Justice is still investigating whether HBSC was helping Americans engage in tax evasion.

Dropping Out

Although Barclays is currently the only Swiss bank to have announced its non-compliance with the program, Cato Institute Senior Fellow Dan Mitchell explained that foreign banks' refusal to hand over their customers' data to the Internal Revenue Service (IRS) is understandable.

"Banks are subjected to very costly regulations and are put in an unpalatable position of acting as deputy enforcers for the IRS, even though that may violate the human rights laws on privacy in other countries," said Dan Mitchell, Senior Fellow at the Cato Institute.

Lack of cooperation between high- and low-tax jurisdictions is not a new economic development, explained Mitchell, as countries such as Switzerland have traditionally respected investors' privacy.

"Low-tax, privacy-respecting jurisdictions have always existed. They first became 'havens' for human rights or political freedom," Mitchell explained. "Successful people in some European nations put their money in places like Geneva to avoid confiscation, expropriation, or discrimination in their home countries."

As opposed to generating tax revenue by increasing the difficulty of placing money in other countries, Mitchell added that the U.S. should instead seek to make its own tax structure more attractive to investors.

"The entire issue is solved with the right kind of tax reform," he continued. "If we no longer double-taxed saving and investment, and no longer had extra-territorial taxation, then it wouldn't matter if people had their money in a bank in in Georgetown, Cayman Islands, or Georgetown, Kentucky."

Good Ideas, Bad Ideas

In addition to providing additional investment options for individuals, empirical evidence says that investor-friendly tax rules have significant positive economic benefits.

In 2004, University of Michigan Richard A. Musgrave Collegiate Professor of Economics James R. Hines Jr. reviewed empirical data on economic indicators of high-tax and low-tax countries. Most notably, Hines noted that "tax haven countries as a group exhibited 3.3 percent annual per capita GDP growth from 1982-1999, whereas the world averaged just 1.4 percent annual GDP growth over the same period."

"Even very low rates of direct taxation of business investment may yield significant tax revenues if economic activity expands in response, producing wealth and expenditure that augment tax bases," Hines explains in the study.

Hines' study concludes that "countries are not randomly selected to be tax havens; tax policies are choices that governments make on the basis of economic and other considerations"—an observation with which Mitchell agreed.

"In other words, so-called tax havens exist because of bad policy choices—with tax just being part of the mix—in other nations," Mitchell said.

In addition to benefitting investors and haven countries' economies, academic studies have found evidence that the benefits of friendly tax policy spill across borders, boosting the economic health of countries neighboring haven countries.

In 2004, Havard University Business School Mizuho Financial Group Professor of Finance Mihir A. Desai, examined data from American multinational firms' tax haven usage.

In the study, Desai wrote "the evidence also indicates that use of tax havens indirectly stimulates the growth of operations in non-haven countries in the same region," as "Careful use of tax haven affiliates permits foreign investors to avoid some of the tax burdens imposed by countries with high tax rates, thereby maintaining foreign investment at levels exceeding those that would persist if tax havens were unavailable."