Established 1973

4 rue de Chevreuse
75006 Paris, France
Tel: +33 (0)1 4720 2415
Website: www.aaro.org
Email: contact@aaro.org

Offshore Tax Evasion by Individuals: What Do We Know About Its Scale?

Note from the Association of Americans Resident Overseas (October 2019)

Introduction and summary

"Enhanced enforcement" targeting international tax evasion by US residents has been building since the late 1990s, causing much grief to American expatriates and dual nationals caught in the net. Much of the problem is the tax code's punitive pro-Wall Street bias and its refusal to respect host country law and practice where the United States has no jurisdiction – the recent GAO report identifying "challenges" faced by expatriates managing retirement plans diagnoses the situation well[1]. But until the recent enforcement initiatives, notably, financial threats to banks authorized by the Foreign Account Tax Compliance Act (FATCA) [2], these "challenges" flew under the radar and few problems arose in practice. But FATCA identifies "non-compliance" and forces adjustments. In doing so it has greatly restricted access to the global financial system for many "US persons".

The narrative justifying this enforcement regime largely stresses the need to preserve the integrity of a system threatened by tax haven "abuse". But in reality there is little in the regime specific to tax havens. More than 345,000 Foreign Financial Institutions (FFIs) worldwide have effectively been enlisted as IRS agents who press for US compliance everywhere. We have reports of infants receiving menacing "FATCA" letters. Opening a savings account for children, should the account reach a (low) reporting threshold, may expose them to felony prosecution for oversights or mistakes in filing information reports. These reports can only be filed online and

[1] Government Accountability Office, "Workplace Retirement Accounts" (GAO-18-19), January 2018, cover letter to Senator Wyden, pp.2-3. See pp.12-14 for a summary of the main concerns.

[2] Heavy fines as part of various "Offshore Voluntary Disclosure" programs have also been part of this effort. These have been extensively analysed by the Taxpayer Advocate.

often in a foreign language. Retirement plans and other savings vehicles endorsed by host authorities in their own jurisdictions can be targeted as “offshore trusts”, requiring punitive paperwork whose cost vastly exceeds any US taxes that might be due. The regime is so poorly targeted that compliance costs imposed on financial institutions and individuals appear to be 20 or more times any tax revenues generated by FATCA and, judging by a KPMG survey of the global banking industry, this figure could exceed 100[3]. This allows nothing for higher fees US fund managers can command from all Americans because of the captive market for their services created by biases in the tax system.

All this has been justified by the alleged huge scale of the problem -- officially endorsed estimates regularly put losses “in tax revenues due to offshore tax abuses” at around $100 billion annually or more.[4] For example, the Tax Division of the Department of Justice (DOJ) stated on its web site in 2014 (since taken down) that the figure is at least $100 billion. The OECD repeats this figure on its web site[5], as does the Congressional Research Office[6]. The Treasury Inspector General for Tax Affairs (TIGTA) report in 2009 cited a range of $40-123 billion[7]. In 2014 the Staff Report of a Senate Sub-committee raised its own estimate to $150 billion[8]. Private figures can go higher. A “FACT Sheet” prepared by Financial Accountability and Corporate Transparency (FACT), a Washington NGO, puts annual “offshore tax haven abuse” at $129 billion to $205 billion[9]. And a Stanford Business School paper cites a figure of $458 billion for unreported offshore income[10], although this appears to be a mistake. This huge evasion problem is routinely reported as established fact, usually without a basis for any estimates. Rather, citations simply reference other

---

3 This survey is reported by Alizca Brodzka, “The deadweight cost of implementation of FATCA”, *Nauki O Finansach, Financial Sciences,* 2014, pp.16-17; and Kristin Parillo in “The top challenges for asset managers” *Tax Notes International*, 4 March 2013, p.804.

4 The language in quotations comes from the Staff Report on *Tax Haven Banks and US Tax Compliance* for the US Senate Permanent Sub-committee on Investigations, July 17, 2008, p.1. This seems to be the original source of the $100 billion estimate.

5 www.oecd.org/ctp/fightingtaxevasion.htm.

6 See https://fas.org/sgp/crs/misc/R40623.pdf, J. Gravelle, “Tax Havens: International Tax Avoidance and Evasion”, 2015, p.1. She cites the Staff Report on “Dividend Tax Abuses” for the same committee cited earlier, September 11, 2008.

7 TIGTA, Reference 2009-IE-R001, cites the July 2008 Senate report cited earlier on p.1 and cites the “non-IRS”-estimated range on p.3.

8 Permanent Sub-committee on Investigations, hearing on “Offshore Tax Evasion: the Effort to Collect Unpaid Billions in Hidden Offshore Accounts”, February 26, 2014, p.9.

9 See www.thefactcoalition.org/policy-analysis/fact-sheets, “Offshore Tax Haven Abuse by the Numbers (November 2017)”.

10 Lisa De Simone, Rebecca Lester and Kevin Markle, “Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (FATCA)”, February 2019, p.8.

reports, leaving the reader to try to track down an original source. We are left to look for underlying data-based substance as if we were opening a set of Russian dolls.

This note documents what we know about the size of the problem ostensibly being targeted and how we arrived at the conventional wisdom cited above. In summary, while egregious anecdotes exist and some international tax evasion by individuals obviously occurs in a country of 330 million people, there is no basis beyond crude guesswork for any numerical estimates of its scale in the United States. Widely reported estimates in the hundreds of billions of dollars like those cited above have no foundation.

What does IRS say about the scale of international tax evasion?

While IRS has for many years made estimates of the "tax gap", i.e. the difference between its estimates of what is legally due and the amount voluntarily paid[11], it has always employed a framework that measures underpayment by type of tax and not geography. Even though it is convinced that international tax evasion is significant, it makes no estimates of the international component—evidently because it is difficult. In 2013 TIGTA noted that in January 1981 a report requested by IRS/DOJ (tax division)/US Treasury concluded that lack of information made an estimate of offshore tax evasion impossible and that "Thirty years later the information void still exists."[12] In 2009 TIGTA had observed that "The IRS has not developed an accurate and reliable estimate of the international tax gap and has no plans to comprehensively measure it…"[13] and in 2013 it recommended a feasibility study to see whether measuring it was even possible (see Recommendation 5 in the 2013 report).

If IRS is not a source, where do the various estimates come from? And what basis do they have? We recount.

History: the legendary John Mathewson

Not long after the January 1981 Treasury report cited by TIGTA in 2013 (above), a time when the Brezhnev era was dying in the Soviet Union, the world was still

[11] For 2001 the estimate was $345 billion. It rose to $450 billion for 2006. Following a $60 billion downward revision due to improved methodology, mainly related to estimates of under-reporting, it averaged $394 billion for 2008-10 and $441 billion during 2011-13. Implied voluntary compliance rates have been in the 83-84% range. Enforcement and late payments have consistently raised the "net" compliance rate to around 86%, reducing the "net" tax gap for 2011-13 to $381 billion.

[12] TIGTA, Reference 2013-IE-R008. See the paragraph containing note 32.

[13] TIGTA, Reference 2009-IE-R001. See the report's cover memo.

analogue, the internet did not yet exist and international capital movements were still being liberalized, John Mathewson moved from Chicago to the Cayman Islands. Time passed, communications technology advanced, financial markets continued to liberalize and, by 1986, Mathewson was controlling owner of the Guardian Bank and Trust. Under Mathewson Guardian's business was selling shell companies which could bank at Guardian to hide income from the US taxman. By 1994, now 25 years ago, IRS had caught onto Mathewson and in 1996 he was arrested. Guardian's assets were around $150 million. To avoid prison he provided his client list which consisted of around 2000 names, 95% of whom were American. IRS settled 1165 cases, collecting $3.2 billion in taxes, interest and penalties.

The Mathewson story was clearly egregious and has had a major political impact in Washington. The evasion itself, by both Mathewson and his clients, was brazen and if replicated on a large scale would threaten the integrity of the tax system as a whole. The recovery of billions seemed to promise untapped revenues on a large scale, notwithstanding the disproportion between penalties and whatever underlying tax liability $150 million in assets in a bank can generate. Mathewson was brought before the Senate Permanent Sub-committee on Investigations to recount his crimes and respond to questions about his operations in March 2001[14], after most of the cases had been closed. His story has been cited, referenced and retold as part of the offshore evasion narrative inside the Beltway ever since. Reminders recalling his legend have been regularly recycled in and around Congress, notably in 2002[15]; 2005[16]; 2006[17]; 2007[18]; 2008[19]; and 2017[20].

---

[14] Senate Sub-committee on Permanent Investigations, Hearing on *The Role of US Correspondence Banking in International Money Laundering*, March 1,2,6, 2001.

[15] Jack Blum, written submission to Senate Finance Committee Hearing on "Schemes, Scams and Cons: the IRS Strikes Back", April 11, 2002, p. 43.

[16] J. Guttentag and R. Avi-Yonah, "Closing the International Tax Gap", in Max B. Sawicky (ed.), *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration*, Economic Policy Institute, 2005, p.99.

[17] Written submission by R. Avi-Yonah to Senate Permanent Sub-committee on Investigations, "Tax Haven Abuses: the Enablers, the Tools and Secrecy", August 1, 2006, pp. 1-2. This substantially repeats the paper cited in the previous footnote. See also the Staff Report accompanying this hearing, p. 2, fn. 5.

[18] R, Avi-Yonah, written submission to the Senate Finance Committee, "Hearing on Offshore Tax Evasion: Stashing Cash Overseas", May 3, 2007, p.37. This overlaps with the material cited in the previous two footnotes.

[19] Senate Permanent Sub-committee on Investigations, "Tax Haven Banks and US Tax Compliance", July 17, 2008, Staff Report, p.3, see fn.9.

[20] Elise Bean, statement before House Sub-committee on Government Operations, "Reviewing the Unintended Consequences of FATCA", April 26, 2017.

IRS' response to Mathewson: investigating abusive offshore schemes (late 1990s to 2003)

The back of Jack Blum's envelope

An important feature of Mathewson's service was provision of credit/debit cards to allow clients easy access to their accounts. With the development of "smart" cards with embedded chips to enhance security, diffusion of such cards was increasing, at least outside the United States. As the internet expanded and IRS processed the tax evaders involved with Guardian it increasingly focused on the scope these cards provided for tax evasion when issued by banks in recognized tax havens. Since nearly all offshore schemes that it regarded as "abusive" involved credit card use, it decided to invest a great deal of resources in tracking the use of these cards.

As will be seen below, this was part of a wider effort to address a range of abusive schemes that IRS considered to "represent a rapidly growing risk to the tax base."[21] Results would be meagre but a casual calculation contributed by an attorney named Jack Blum in support of the search for credit card information has played an oversized role in developing the popular tax evasion narrative. Blum seems to be respected for his legal expertise and a passionate spokesman for anti-financial globalization causes but there is no apparent basis for treating him as an expert on quantitative analysis of tax evasion[22].

As part of this effort IRS petitioned a federal court which, in October 2000, authorized it to serve "John Doe" summonses on MasterCard and American Express. Their purpose was:

> "*to obtain limited information on U.S. taxpayers holding credit cards issued by banks in several tax haven countries.*"[23]

---

[21] IRS, "FY 2003-2004 SB/SE Strategic Assessment Report, March 2, 2002, as cited by David Brostek in GAO-02-618T, *Testimony Before the Committee on Finance, U.S. Senate,* "Internal Revenue Service, Enhanced Efforts to Combat Abusive Tax Schemes—Challenges Remain", April 11,2002, p.4.

[22] Blum is a Washington insider who made his name as a young lawyer fighting white-collar crime in the Lockheed scandal during the Nixon administration. He spent 14 years as staff attorney for various Senate committees before moving to private practice, specializing in financial crime and international tax evasion. He has frequently testified on these subjects before various Congressional committees and consulted for IRS and the Dept. of Justice. He is Chair of the Tax Justice Network USA, an anti-financial globalization NGO, and regularly speaks out in public (c.f. You-tube) on these issues. See Michael Wines, "Washington at Work: a Crusader Driven by Outrage", *New York Times*, August 22, 1991, for a sympathetic portrait of Blum.

[23] GAO-02-618T, p.6.

In support of that petition Blum filed a declaration in which he estimated that tax losses due to offshore accounts could run to $70 billion. This attracted some attention. Senator Susan Collins appeared to refer to it in her exchange with Mathewson during his March 1, 2001 testimony, elevating it to "one government estimate", and the House Majority Leader, Dick Armey, asked the Congressional Research Office (CRO) to find out about Blum's methodology and the basis for this estimate.

Blum never gave a satisfactory reply. On July 23, 2001 David Brumbaugh provided a CRO reply to Armey[24]:

> "*In response to your request we contacted Mr. Blum and discussed his estimate; he was not able to send us a written discussion of his estimating procedure…*"

The discussion reported by Brumbaugh makes it clear that Blum's estimate was based on a simple back-of-the-envelope calculation requiring data or assumptions about four numbers which need only to be multiplied: (1) the size of offshore asset-holdings; (2) the average taxable return on these assets; (3) the effective tax rate to which these are legitimately subject; and (4) the rate at which asset holders fail to report their earnings and so evade taxes. But Blum only offered thoughts on (1), putting the volume of deposits in tax havens at $3-4 trillion and providing an estimate of 60-70% for the US share. The CRO's response to the majority leader concluded:

> "*We did not discuss these particular aspects [i.e. (2), (3) and (4), above] of the estimating process in our initial conversation with Mr. Blum and our attempts to contact Mr. Blum on a follow-up basis have not been successful.*" [25]

When Blum testified at the April 11, 2002 Senate Finance Committee hearing on "Schemes, Scams and Cons", at this stage on contract to IRS, the Chairman returned to Armey's question. He recalled Blum's $70 billion estimate in his introductory remarks (Transcript, p.2) and later (Transcript, p.23) asked Blum directly how he had arrived at his estimate. Blum responded in generalities, admitting that the number was a "rank estimate" and said "You just have to take a guess at it." So no clear statement of the basis for Blum's number seems to exist.

---

[24] Thanks to William Byrnes for identifying this obscure correspondence. See his "Background and Current Status of FATCA and CRS, Sept. 2017 edition", *Texas A&M School of Law, Legal studies Research Paper* No. 17-75 for extensive and regularly updated discussion of FATCA and CRS.

[25] Congressional Research Service memo from Daniel L. Brumbaugh to the House Majority Leader, attention Elizabeth Tobias, *Reported Estimate of U.S. Tax Revenue Lost Through Use of Tax Havens*, July 23, 2001.

In 2002 IRS made its own guess of $20-40 billion lost to offshore abuse each year…

As the internet expanded, IRS worked to learn more about the types of schemes that were emerging, their scale and how to combat them. The 2002 Senate Finance Committee hearing on "Schemes, Scams and Cons" both highlighted abusive schemes by calling witnesses who confessed to their crimes and served as a progress report from IRS and key government agencies to Congress.

Among these agencies was the General Accounting Office[26] (GAO) which summarized IRS's work in its written submission[27] and followed up with another report in November 2003[28]. These reports, both by Michael Brostek, Director of Tax Issues, are not primary sources but they appear to provide the only account available of any efforts to establish a basis in evidence for estimates of the scale of offshore tax evasion.

IRS organized its efforts around four main areas: frivolous returns; frivolous refund claims; abusive domestic trusts; and offshore schemes such as Guardian's. Its estimates of the scale of evasion in these areas, as of February 2002 and reported to GAO[29], were:

- Frivolous returns: c. 62,000 taxpayers avoiding $1.8 billion in tax;
- Frivolous refunds: c. 105,000 taxpayers avoiding $3.1 billion in tax;
- Abusive domestic trusts: c. 65,000 taxpayers avoiding $2.9 billion in tax; and
- Offshore schemes: c. 505,000 taxpayers avoiding $20-40 billion in tax.

The estimates for returns ($1.8 billion) and refunds ($3.1 billion) were pretty solid as they were built on actual returns and action to recover funds from filers, giving IRS a sense of how many filers and what amounts were involved. But returns provided little basis for making judgements about trusts and offshore schemes, and Brostek characterized these estimates as "very uncertain at this time"[30].

---

[26] Now the Government Accountability Office.

[27] GAO-02-618T, *Testimony Before the Committee on Finance, U.S. Senate,* "Internal Revenue Service, Enhanced Efforts to Combat Abusive Tax Schemes—Challenges Remain", April 11, 2002.

[28] GAO-04-50, *Report to the Chairman and the Ranking Minority Member, Committee on Finance, US Senate*: "Internal Revenue Service, Challenges Remain in Combating Abusive Tax Schemes", November 2003.

[29] GAO-02-618T, p.5.

[30] GAO-02-618T, p.7.

As Brostek examined the basis for the domestic trust ($2.9 billion) and offshore ($20-40 billion) estimates his reports became murky. An (unidentified) IRS official reported that these estimates were derived from 2000 tax returns, the latest available in February 2002 when the estimates were made[31]. This allowed around ten months for analysis of the “limited number of cases that have been examined or investigated”[32]. Since this “limited number of cases” cannot be extrapolated sensibly to the entire economy to estimate the total number involved, there was no obvious basis for valuation of either domestic trusts or offshore schemes. Both IRS and Brostek should arguably have stopped there.

But IRS did not stop and Brostek described an apparent valuation methodology in each of his reports. These were not only flimsy but inconsistent. In April 2002 he wrote:

> *“…[valuation of the limited number of cases examined relies] on intelligence obtained in the course of normal tax administration and Criminal Investigation activities, and on IRS officials’ professional judgements.”*[33]

Then in November 2003 he reported, now with regard to offshore schemes alone:

> “*Saying there were no reliable data to predict tax implications, IRS derived an estimate based on average dollars in other parts of the abusive tax scheme program.”*[34]

…but quickly abandoned it

This is obviously unsatisfactory. The 2002 statement describes little more than guesswork while the “other” schemes referred to in 2003 were very heterogeneous, including such items as refund claims for slavery reparations and “soles”, i.e. tax exempt religious organizations consisting of only one person[35]. These would be a weak basis for valuing offshore schemes reliant on credit cards, even if there were a coherent estimate of the volume being valued, which there was not.

Given IRS’s conviction that offshore schemes were by far the largest problem and its observation that virtually all such schemes involved credit cards it redoubled its pursuit of credit card users. In March and August 2002 it issued another round of summonses that targeted VISA International, as well Amex and MasterCard, now

---

[31] GAO-02-618T p.5.

[32] GAO-02-618T p.6.

[33] GAO-02-618T p.6.

[34] GAO-04-50, p.1-2.

[35] C.f GAO-04-50, p.6.

seeking records on transactions using cards issued by banks in 31 offshore financial centers[36].

All these summonses were contentious, given that US courts have no jurisdiction over the banks issuing the cards and that there was no obvious way to confine the search to US persons. The companies resisted them but compromises were reached and in April 2002, MasterCard provided IRS with its first information. It remains less clear what information American Express and VISA International provided but by August 2003 IRS had received something from them as well[37].

Making use of this information was a challenge. Even the early information from MasterCard arrived too late to inform the analysis that had generated IRS's $20-40 billion offshore tax loss estimate. IRS was able to identify "about 235,000 accounts issued through 28 banks, located in 3 countries", some 25-55% of which it believed were associated with US customers. The methodology is not clear but on the basis that MasterCard held around 30% of the market, IRS extrapolated this to estimate "that there could be 1 to 2 million U.S. citizens with credit/debit cards issued by offshore banks."[38]

There is no suggestion that IRS had access to bank account information, as opposed to just credit card transactions, and this information could not easily be used to identify individuals' nationalities, income or tax status. So in August 2002, in addition to expanding its request for credit card records to 31 countries, IRS issued summonses for additional information to 123 merchants identified in the MasterCard records. Obtaining and analyzing records from merchants was slow but by August 2003 IRS was able to carry out audits on 2800 tax returns and assess more than $3 million in taxes[39].

Overall this is a poor return on IRS's investment. No evidence to support the $20 -40 billion estimate has been reported and the demands on staff time and resources for enforcement must have been large compared to their benefits, just over $1000 per audit. For whatever reason, IRS appears to have abandoned its $20-40 billion offshore estimate by the time Brostek reported in November 2003.

Brostek did not say that explicitly but as bureaucratic language goes his report amounted to a rap on the knuckles. In his covering letter to Senators Grassley and Baucus on November 19, 2003 he summarized the earlier Finance Committee discussion relating to the $20-40 billion estimate as part of the background. But in

---

[36] GAO-04-50, p.11.

[37] GAO-04-50, p.11.

[38] GAO-02-618T, p.6.

[39] GAO-04-50, p.11.

his “Results in Brief”, he dropped these figures and noted in reference to abusive schemes collectively that

> *“Officials have not estimated how many tax dollars might be involved overall.”*[40]

IRS had developed a working estimate of how many people might be involved in offshore and other abusive schemes. This had been reduced from 570,000 in February 2002 to “more than 400,000” in October 2003[41]. But it had no documentation supporting this until preparing something at GAO’s request. Brostek’s sole recommendation was that when IRS prepares estimates in the future the Commissioner should document the underlying support for those estimates. Commissioner Mark W. Everson agreed

> *“…that we need to document the basis for the underlying estimates of the Abusive Schemes problem and will establish a methodology to do so.”*[42]

How has the narrative evolved since Brostek’s November 2003 report?

Notwithstanding IRS’ efforts during the previous few years, the only estimate of the scale of offshore tax evasion available when Brostek reported to Senators Grassley and Baucus in November 2003 was Jack Blum’s $70 billion. This was based on no more than an unsourced guess that US offshore deposits in tax havens were 60-70% of $3-4 trillion, i.e. in the $1.8-2.8 trillion range. Blum is a lawyer with no known credentials as a financial analyst, his 60-70% share assumption was far above the 25-55% share of the John Doe accounts identified by IRS as US-related and he dodged all requests to flesh out the derivation of his $70 billion. IRS has reported no estimates of the international tax gap that we can identify since 2003. How has this figure been extrapolated to become conventional wisdom that revenue losses are in the hundreds of billions annually?

First, it is a simple matter to repeat Blum’s exercise by making assumptions about the four key variables and multiplying. Numerous analysts have done this, mostly generating estimates in the range of $20-100 billion that effectively endorse Blum. It is evident from the annex, which reviews these calculations, that these estimates rest on implausible assumptions. More realistic ones generate something closer to $5

---

[40] GAO-04-50, p.2.

[41] GAO-04-50, p.9, see Table 2. Brostek added that although IRS associated no dollar amount with this estimate “it believes the amount is substantial [and] is trying to be more data-driven in this area and is not tracking dollars associated with its projection.”

[42] GAO-04-50, p.26.

billion. But assumptions guaranteed to produce grossly inflated estimates have rarely been challenged so Blum's guesswork has acquired longevity and a credibility that it does not deserve.

Second, inflated as these back-of-the-envelope calculations may be they are still far below many of the numbers cited as if they had a basis. This has been due to a chain of citations and references which have persistently biased the estimates upwards while cautions and caveats about the uncertainties have been ignored. Repetition has added spurious authority to the recycled estimates. We retrace the evolution of the Washington narrative about international tax evasion since Blum's October 2000 brief:

- The Senate Finance Committee hearing in April 2002 where Brostek and Blum both testified, as recounted above, is the starting point. Another witness at this hearing was Charles O. Rossotti, then Chairman of IRS. Senator Baucus, the Committee Chairman, asked him about the scale of tax evasion due to the various schemes being discussed. His reply (Transcript, p.36): "*One of the key things that makes this difficult is that inherently you have people who are violating the law….while we certainly do not have any precise number at all, having looked at the data, it is my belief that we are into the several tens of billions of loss per year, whether that be $20, $30, or $40 billion per year, we really do not have a precise number.*" These tentative numbers were obviously the staff estimates reported by Brostek.

- While Brostek's testimony and follow-up report have received little attention, Chairman Rossotti's response was noted and highlighted by Martin A. Sullivan, a Washington tax policy expert. Writing in May 2004, i.e. six months <u>after</u> Brostek reported that no estimates of dollar amounts were available, Sullivan quoted Rossotti's earlier statement verbatim in *Tax Notes*[43], a respected specialist publication. While he also cited Brostek's report he did not call attention to IRS' failure to reaffirm Rossotti's numbers. Note that while this disseminated Rossotti's testimony more widely throughout the policy community, Sullivan did nothing to single out the $40 billion top of the range relative to Rossotti's smaller numbers.

[43] Martin A. Sullivan, "US citizens hide hundreds of billions in Cayman accounts", *Tax Notes*, May 24, 2004, p.958.

- Joseph Guttentag and Reuven Avi-Yonah, well-known tax specialists, did that. Their contribution to the 2005 Economic Policy Institute (EPI) volume[44] in which they recalled the Mathewson history (cited earlier), also contained their own back-of-the-envelope tax loss calculation (arriving at $50 billion). To justify the plausibility of their own figure they stated (p. 101, citing Sullivan) that "T*his figure is in the mid-range of estimates of the international tax gap in 2002 by former IRS commissioner Charles O. Rossotti ($40 billion) and IRS consultant Jack Blum ($70 billion)*." Note that at this stage the $20-40 billion range, already abandoned by IRS, disappears in favour of the high end of the range alone.

- The Staff Report on "Tax Haven Abuses: the Enablers, the Tools and Secrecy" for the Permanent Senate Sub-committee on Investigations the following year, in August 2006, assured the Sub-committee (p.1) that "*Experts estimate that Americans…illegally evade between $40 and $70 billion in US taxes each year through the use of offshore tax schemes*." Both Blum and the IRS origin of the long-abandoned $40 billion now disappeared from the narrative in favour of recognized "Experts", i.e. Guttentag and Avi-Yonah. A reference to corporate tax evasion appears for the first time in a footnote but this is clearly kept separate.

- Avi-Yonah testified before the Sub-committee at this hearing and provided a written submission which summarized much of his EPI paper with Guttentag, bringing this "Expert" analysis directly to Congress' attention. He made a similar presentation at the hearing of the Senate Finance Committee in May 2007.

- In July 2008 the Staff Report on "Tax Haven Banks and US Tax Compliance" for the Permanent Sub-committee on Investigations flatly put losses due to offshore tax abuses at $100 billion (p.1). This appears to be the first estimate to exaggerate individual tax evasion by conflating it with unrelated corporate issues, notably transfer pricing. It is sourced to "a variety of tax experts" of which only Guttentag and Avi-Yonah's contribution relates to individual US taxation, as opposed to corporate issues or worldwide totals.

---

[44] Max B. Sawicky, editor, "Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration", Economic Policy Institute, 2005.

- This 2008 Staff figure of $100 billion appears to be the basis for several widely diffused official estimates[45] of international tax evasion sourced to the Senate that are routinely accepted as if they were data. Where a sectoral breakdown is provided, estimates for individual evasion have converged around the $40-70 billion attributed to Guttentag and Avi-Yonah. Those for corporate evasion are more varied but $53 billion relating to transfer pricing, inviting a $123 billion total, is a recurring figure.

- In 2014 the Sub-committee Staff raised its estimate to $150 billion annually[46]. The entire increase appears to reflect revised estimates of corporate tax evasion: an explanatory footnote cites 12 articles and studies about corporate evasion, nine of which post-date the 2008 Staff Report. The $40-70 billion estimate, still wrongly attributed to Guttentag and Avi-Yonah, remained the only reference to taxation of US individuals.

Thus IRS' abandoned $20 - 40 billion and Blum's $70 billion never-explained guesswork were transformed in little more than a decade into virtually unquestioned common knowledge that offshore tax evasion exceeds $100 billion per annum.

The Anecdotes

The fact that there is no basis for widely-cited estimates of international tax evasion by individuals does not imply that such evasion is zero. It is inevitable that in a country of 330 million, relying on self-reporting, there will be cases of people trying to evade taxes. Individual cases are merely anecdotes, and cannot be related to the larger picture in terms of the scale of international tax evasion, but they are concrete and may suggest patterns that should be investigated. Some of these are egregious and some less so but they have played a significant role in the narrative that has surrounded policies toward tax evasion.

The testimony of John Mathewson about Guardian Bank's activities in the Cayman Islands opened the first of series of at least six hearings focused on tax evasion and abuses by banks in tax havens. These were held by the Senate Permanent Sub-committee on Investigations and the Senate Finance Committee during 2001-2014. Officials, lobbyists, tax authorities and convicted criminals (like Mathewson) were

---

45 Including the Department of Justice, the OECD, the Congressional Research Office and the Treasury Inspector General for Tax Administration (TIGTA), cited earlier.

46 Senate Permanent Sub-committee on Investigations, "Offshore Tax Evasion: the Effort to Collect Unpaid Billions in Hidden Offshore Accounts", Staff Report, February 26, 2014, pp. 9-10.

called as witnesses to highlight cases and issues. Nearly all related in some way to "offshore".[47]

There is no way to know how representative these cases are since they were selected by Congressional staffers from whatever larger pool of cases exists to support their point. Their selection included a dozen tiny banks, including Guardian, whose business models were probably not viable in the first place. They also covered two larger banks whose activities were exposed by whistle-blowers (UBS of Switzerland and LGT of Liechtenstein) as well as Credit Suisse (another Swiss mega-bank) following their investigation of UBS. Staffers also reviewed the offshore activities of 14 clients of tax haven banks.

The outstanding common theme of these anecdotes is that offshore abuses nearly always took place in Switzerland, whose known history of bank secrecy goes back at least to the Great Council of Geneva in 1713, or in recognized tax havens such as Liechtenstein, the Isle of Man and various Caribbean jurisdictions. A subsidiary feature is that most identified tax evaders were US residents. Evaders were rarely expatriates or non-resident dual nationals (who in any case would normally owe any tax mainly to their host government and take credits against any US liability).

The central place of Switzerland in this story stands out. The post-World War I origins of its modern wealth management services is well documented by Gabriel Zucman in his 2013 book "The Hidden Wealth of Nations: the Scourge of Tax Havens". In 1934 the Swiss banking secrecy framework was strengthened, criminalizing violations, in response to French and German pressure on banks.

The active marketing of tax evasion to US residents by some of the largest Swiss banks was clearly abusive[48]. This may have justified the harsh Swiss Bank Program of 2013 that went beyond the 14 large Swiss banks under US criminal investigation to target smaller banks <u>not</u> under criminal investigation but who feared that they might be. By the end of 2016 this program had extracted more than $1 billion from 80 banks in penalties "in lieu of restitution, forfeiture or criminal fine" without any possibility of judicial review.

But there is no basis in any of the literature surveyed here, or in the thousands of pages of testimony, written submissions and exhibits produced by the Senate Committee on Finance and Permanent Sub-committee on Investigations in their hearings, for extrapolating the abuses of UBS, Credit Suisse and John Mathewson to the entire world. Nor is there any basis for extrapolating abuses by the few US residents they served to American expatriates and dual nationals living outside the

[47] The discussion summarized earlier relating to frivolous and fraudulent refunds and domestic trusts in April 2002 was the main exception.

[48] Notably, the UBS episode of 2007-8 was the main political trigger for the various enforcement initiatives that followed.

US. This handful of anecdotes cannot justify targeting everywhere outside the US as a tax haven.

Annex: Estimating offshore tax evasion on the backs of envelopes

The calculation that David Brumbaugh inferred must underpin Jack Blum's $70 billion guess is simple and a number of analysts have carried out their own variant. Assumptions are needed for four variables: (1) the size of offshore asset-holdings; (2) the average taxable return on these assets; (3) the effective tax rate to which these are legitimately subject; and (4) the rate at which asset holders fail to report their earnings and so evade taxes. Data to underpin these assumptions are very scarce so producing meaningful estimates is an issue of analyst judgement. What can sensibly be said?

Offshore holdings: Data relating to cross-border asset holdings by non-bank entities are notoriously varied and unreliable. A very high estimate by the Tax Justice Network of $21-32 trillion for global holdings[49], revised up from its 2005 estimate of $11 trillion, exaggerates by including corporate accounts and failing to net out extensive double counting. Given Jack Blum's connection to the Network, his $1.8-2.8 trillion US figure from 2000 may reflect the same biases (in addition to his apparently exaggerated estimate for the US share of the world total, noted earlier). Boston Consulting Group reportedly estimated cash and security holdings by high net – worth individuals in North America to be $16.2 trillion in 2003, with less than 10% offshore. Guttentag and Avi-Yonah translated this into $1.5 trillion US offshore assets.

Gabriel Zucman's book, cited above, is probably the best available analysis of the issues at hand. Zucman is familiar with available data sources and the concepts, which led him to call attention to the overstatement by the Tax Justice Network. The book puts individuals' holdings globally at EUR 5.8 trillion ($7.5 trillion) and a follow-up paper revises this to $7.6 trillion. For the US alone, Zucman estimates $1.2 trillion for 2013[50], barely half the $2.3 trillion mid-point of Blum's range.

Taxable returns: Many offshore assets will be real estate, which is usually a tax shelter (c.f. Donald Trump's 1995 tax return). Equity returns consist of dividends,

---

[49] James S. Henry, "The Price of Offshore Revisited", Tax Justice Network, July 2012, p.5.

[50] G. Zucman, "Taxing Assets Across Borders: Tracking Personal Wealth and Corporate Profits", *Journal of Economic Perspectives*, Vo 28, No.4 Fall 2014, Table 1.

whose yield has rarely moved outside the 1.5 - 2.5% range since the 1990s,[51] and capital gains. These have averaged slightly over 3% since the millennium, as bull markets have been punctuated by two major market collapses. Only the realized portion of gains is normally taxable. Cash and short term instruments rarely generate returns above LIBOR, especially when commissions are taken into account. LIBOR was less than 2% on dollar deposits for most of the period between Blum's calculation (2000) and the housing bubble and since the financial crisis of 2008 it has mostly been below 0.5% (90-day LIBOR briefly rose to around 3% during 2018 but as of October 2019 has fallen back to around 2%). Low risk bond yields are now even below LIBOR, at just over 1.5%. And for many people risk is an issue, biasing them toward investments yielding lower returns.

While some fund managers may boast of long-term returns of the order of 10% p.a. and very long term returns on equity alone have approached that figure, the economic system as a whole in a low inflation environment does not generate anything like this. The taxable component can only be a fraction of the total. So, in aggregate, taxable returns must be in low single figures.

<u>Effective tax rates</u>: Taxable returns on equity, i.e. dividends and realized gains, are subject to favourable rates (now 20% maximum, in recognition that these are being double-taxed) so only cash and fixed income generate ordinary income to be taxed at standard rates. It is common for analysts to estimate revenues lost by assuming something close to maximum statutory tax rates apply even though there is no reason to believe that everyone is at or near the top bracket. Given the high weight of equity in portfolios the overall effective tax rate must be well below maximum statutory rates.

<u>Cheating</u>: Gabriel Zucman is one of the rare writers who acknowledge a likelihood that tax cheating on offshore accounts is less than 100%. Based entirely on data from the Swiss tax authority, the only available source for compliance data, he works on an 80%-cheating assumption globally. While we have no US data we know that at least some people both disclose their overseas financial accounts and report the associated income. Mitt Romney's 2011 return was a high-profile case in point. Senator Claire McCaskill's recent family financial disclosures are another. Milo and Lois Kentera[52] are low-profile cases.

Given this, what do realistic parameter values suggest for lost revenues? If we assume that:

---

51 The yield moved outside this range during the peak of the tech boom in 2000 and during the crisis bear market of October 2008 to May 2009.

52 See Kentera v. United States, Case No. 16-CV-1020-JPS (E. Dis. Wisconsin, January 30, 2017) for a summary of the facts.

- Offshore financial assets held by US taxpayers amount to $1.2 trillion, in line with Zucman, are 28% cash and deposits (this follows Tax Justice Network, which cites McKinsey), and that the rest is securities;
- Cash and deposits pay 2% p.a. (roughly 90-day LIBOR, allowing nothing for commissions) and securities generate taxable income of around 4% (probably high since benchmark 10 year Treasuries are now paying around 1.5% and dividend yields run around 2%);
- Effective tax rates on this mix are around 25% (seems generous); and
- Half of this income is reported properly while half accrues to tax cheaters.

We get just over $5 billion, an order of magnitude less than Blum's $70 billion.

It is evident that deriving Blum's $70 billion, or any other figure in the $20-100 billion range that the Tax Justice Network, Guttentag and Avi-Yonah, Zucman and Gravelle have generated, requires grossly inflated assumptions about one or more of the four variables that go into the calculation. Indeed, all these writers appear[53] to have assumed taxable returns in the 6-10% range and effective tax rates between 29 and 35%. The maximalist 100% cheating assumption appears to be quasi-standard (Zucman being the exception). The more realism that is embedded in the assumptions, the more the estimates converge on a figure in the single figure billions.

[53] We have to guess about the details of Blum's result. If we work from the mid-point of Blum's asset range, i.e. $2.3 trillion, and assume 100% cheating, a 10% taxable return on investment and a 30% effective tax rate, we obtain Blum's $70 billion almost precisely.