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Inequality and Taxation in a Globalised World

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Inequality and Taxation in a Globalized World

Gabriel Zucman
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Income and wealth inequality have increased a lot in recent decades

- UK: top 1% income share from 6% in 1970s to 14% today
- Rising top income shares in all anglo-saxon countries
- Rising top wealth shares in the US and globally

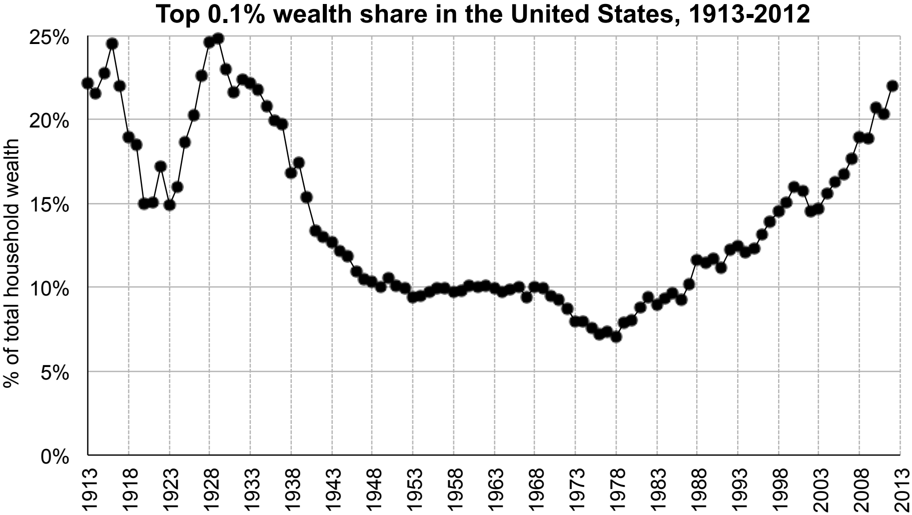
Rising inequality has triggered **calls for more redistributive tax policies**

- Higher top marginal tax rates
- A global wealth tax (Piketty, 2014)

$$\Downarrow$$

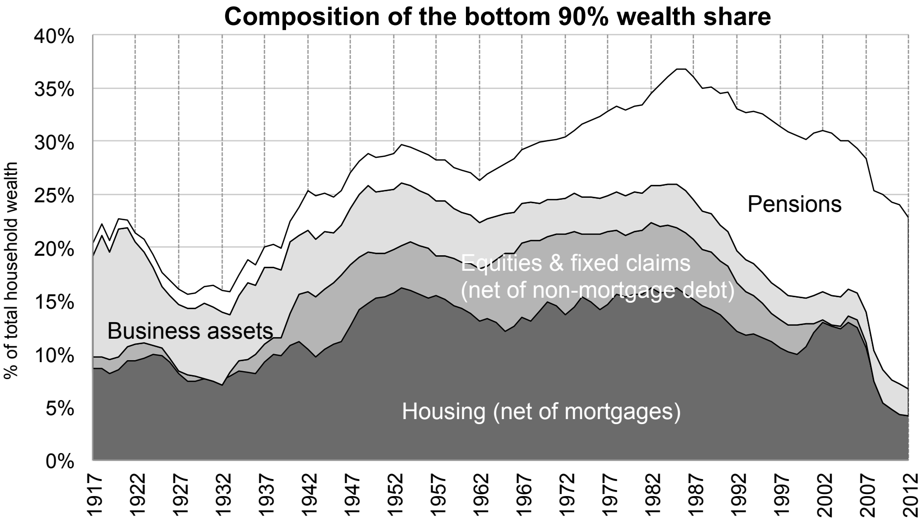
Is that feasible? Under which conditions?

At the very top, US back to early 20th century wealth concentration levels



This figure depicts the share of total household wealth held by the 0.1% richest families, as estimated by capitalizing income tax returns. In 2012, the top 0.1% includes about 160,000 families with net wealth above $20.6 million. Source: Appendix Table B1.

The rise and fall of middle-class wealth in the US



Globalization raises new challenges for tax policy

Tax competition between countries

- Low tax rates for footballers, researchers, multinational companies...

Tax avoidance by multinational companies

- Exploiting the loopholes of corporate taxes
- Usually within the letter (but not spirit) of the law
- Examples: Google, Apple, Amazon...

Tax evasion by wealthy individuals

- Undeclared offshore bank accounts
- Disconnecting wealth from beneficial owner

$$\Downarrow$$

How big are these challenges? And how can they be overcome?

I- Multinational corporations tax avoidance and tax competition

The taxation of multinationals is based on 3 principles adopted in the 1920s

Source-based taxation

Taxes are to be paid to countries where profits have been made

Not to countries where shareholders live (= residence taxation)

But how to determine where the profits have been made?

Arm's length pricing

Subsidiaries of a same group must compute their profits as if unrelated

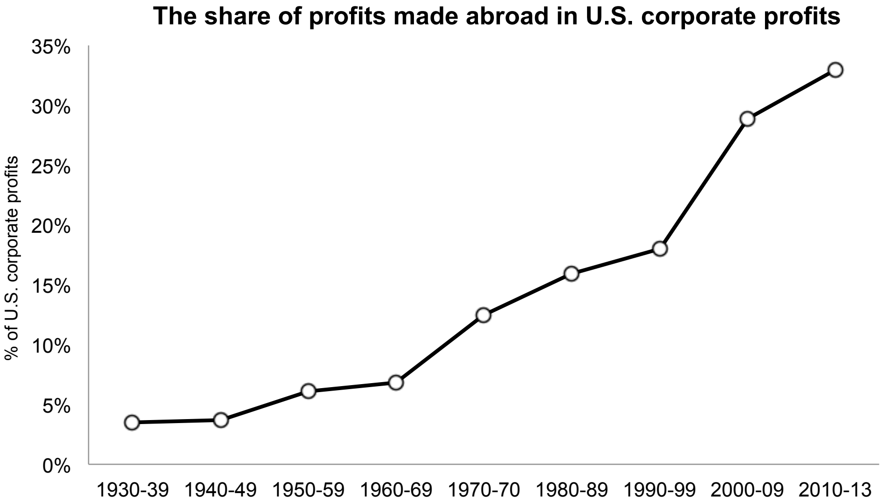
I.e., trade goods and services internally at market prices

Bilateral agreements

No multilateral agreement like GATT

Instead, thousands of bilateral tax treaties

The choices made in the 1920s are coming back to haunt the tax authorities



Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). Foreign profits include dividends on foreign portfolio equities and income on US direct investment abroad (distributed and retained). Profits are net of interest payments, gross of US but net of foreign corporate income taxes. Source: author's computations using NIPA data, see Online Appendix.

Each of the 3 core principles for international taxation raises its own issues

Bilateral agreements

Treaty shopping to generate stateless income

Example: Google google

Arm's length pricing

Easy to manipulate transfer prices

Reference prices often do not exist

Source-based taxation

Artificial profit shifting

Tax competition for real investments

$\Downarrow$

The way we tax corporations is not adapted anymore to today's globalized world

What is the cost of multinational corporate tax avoidance?

Hard to quantify: double-counting issues, tax laws vary substantially across countries, etc.

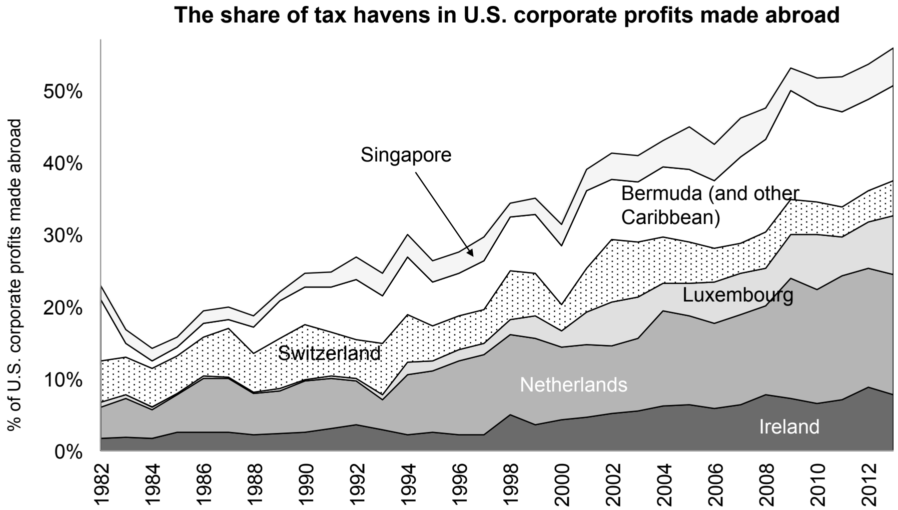
My approach: use national accounts and balance of payments data

Focus on the United States: what is happening to the profits of US-owned companies?

$$\Downarrow$$

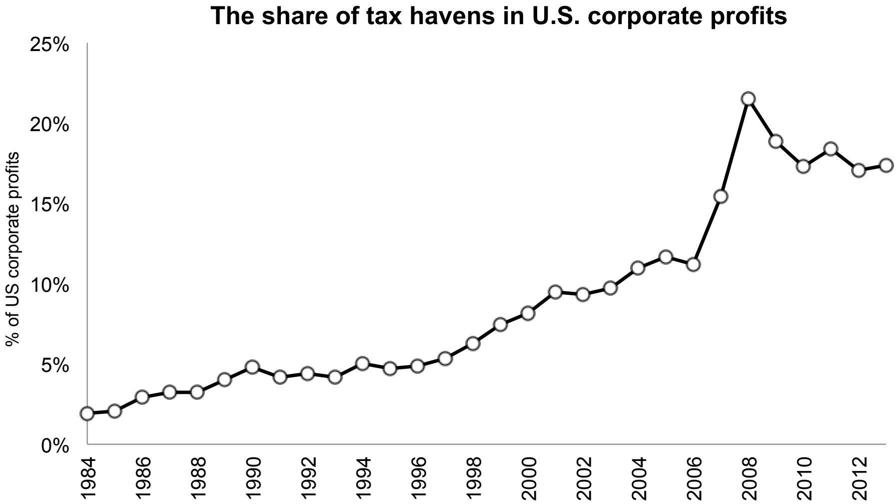
Latest data show offshore tax avoidance is sizable and growing fast

More than half of the foreign profits of US-owned firms are booked in tax havens



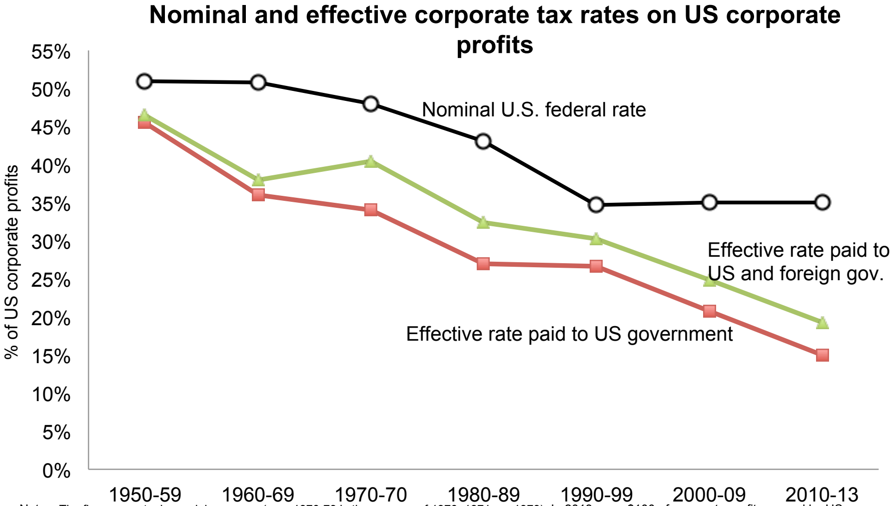
Notes: This figure charts the share of income on U.S. direct investment abroad made in the main tax havens. In 2013, total income on U.S.DI abroad was about \$500bn. 17% came from the Netherlands, 8% from Luxembourg, etc. Source: author's computations using balance of payments data, see Online Appendix.

20% of all US corporate profits are booked in tax havens



Notes: This figure charts the ratio of profits made in the main tax havens (Netherlands, Ireland, Switzerland, Singapore, Luxembourg, Bermuda and other Caribbean havens) to total US corporate profits (domestic plus foreign). Source: author's computations using NIPA and balance of payments data, see Online

The effective rate paid by US corporations has been reduced by 1/3 since late 1990s



Notes: The figure reports decennial averages (e.g., 1970-79 is the average of 1970, 1971, ..., 1979). In 2013, over $100 of corporate profits earned by US residents, on average $16 is paid in corporate taxes to the U.S. government (federal and States) and $4 to foreign governments. Source: author's computations using NIPA data, see Online Appendix.

There is no shortage of plans to fix the corporate tax

Repeal of the corporate tax

- Would undermine the individual income tax
- Could have large effects on inequalities

More harmonization of treaty rules

- Strengthening of arm's length rules
- OECD base erosion and profit shifting
- Effective?

The way forward: tax worldwide consolidated profits

A simple solution to artificial corporate profit shifting

Start from global consolidated profits of firms

Then allocate to each country using some formula

For instance, sales only (like for US States)

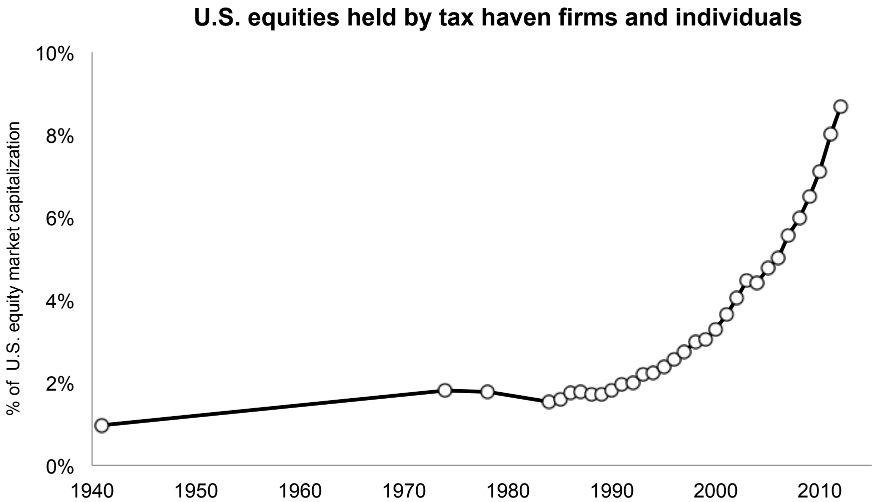
More complicate formulas: employment, capital, sales...

$$\Downarrow$$

Would remove any tax avoidance opportunity

II- Tax evasion by wealthy individuals

A growing fraction of wealth is being managed by offshore financial institutions



In 2012, 9% of the U.S. listed equity market capitalization was held by tax haven investors (hedge funds in the Cayman Islands, banks in Switzerland, mutual funds in Luxembourg, individuals in Monaco, etc.). Source: author's computations using US TIC data

What do offshore centers do?

A great deal of activities, many of which legal and legitimate:

- Investment funds (Luxembourg, Ireland...)
- Shadow banking (Caymans...)
- Treasury management (U.S.-Cayman...)
- Personal wealth management (Switzerland, Singapore...)

But some offshore centers, institutions and instruments also facilitate tax evasion by wealthy individuals

How offshore tax evasion works

Shell companies

Fake invoices

Offshore accounts

Disconnecting legal and beneficial ownership

What do we know about the magnitude of offshore tax evasion?

Monthly statistics by the Swiss National Bank

Systematic anomalies in the international investment positions of countries caused by offshore portfolio wealth

Example: UK-Switzerland-US

8% of the world's financial wealth offshore; if anything lower bound

Limited evidence on what fraction evades taxes (maybe 90-95% prior to 2008, down to 80% today?)

8% of the world's financial wealth is held offshore, costing at least $200bn

	Offshore wealth ($ bn)	Share of financial wealth held offshore	Tax revenue loss ($ bn)
Europe	2,600	10%	75
USA	1,200	4%	36
Asia	1,300	4%	35
Latin America	700	22%	21
Africa	500	30%	15
Canada	300	9%	6
Russia	200	50%	1
Gulf countries	800	57%	0
Total	**7,600**	**8.0%**	**190**

Despite recent policy initiatives, much remains to be done

Automatic exchange of bank information may become global standard by end of 2010s: a huge step forward

Still three obstacles:

- Securing compliance from offshore bankers
- Addressing the opacity of international financial record-keeping
- Making sure offshore banking does not move to uncovered jurisdictions

$$\Downarrow$$

A world financial registry would make it possible to measure wealth and fill in the giant gaps in international data

A world financial registry

What is it?

Same as land registries, but for financial assets

On a beneficial ownership basis

What's the goal?

Measure wealth better

Stakes go way beyond tax evasion

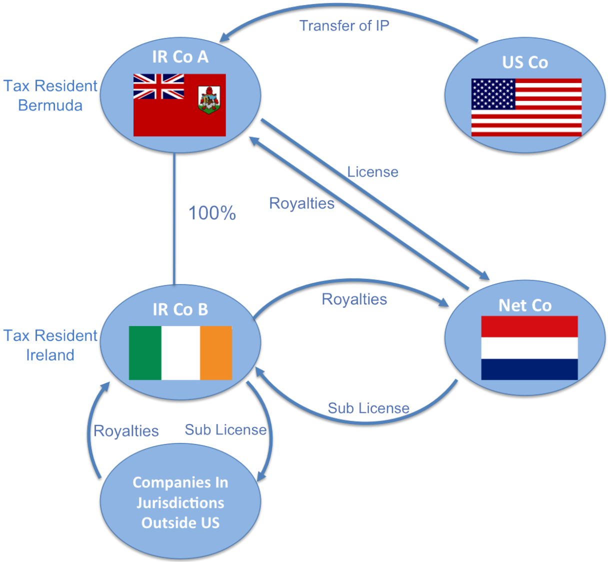
Is it possible?

Partial registries already exist today

Simply need to be merged and transferred to a public authority

Supplementary Slides

How Google avoids taxes: the double Irish Dutch sandwich



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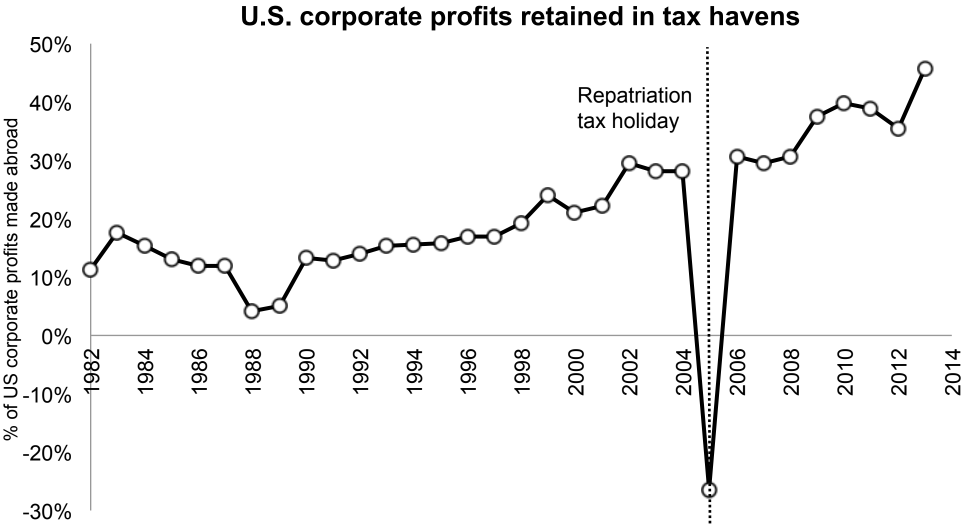

Notes: This figure charts the ratio of US direct investment income reinvested in the main tax havens (Netherlands, Ireland, Switzerland, Singapore, Luxembourg, Bermuda and other Caribbean havens) to total US direct investment income abroad.The negative amount of reinvested earnings in 2005 means that, out of 2005 production, U.S. firms repatriated more that 100% of the 2005 profits of their foreign affiliates (i.e., the 2005 data point excludes repatriations from profits made prior to 2005). Source: author's computations using balance of payments data, see Online Appendix.

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