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# Evasive Maneuvers

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## Evasive Maneuvers

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Tax Havens, Tax Evasion, Tax Avoidance, and the Future of Tax Law in America

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### Abstract

*“Evasive Maneuvers”* surveys the issue of tax havens by examining evasion terminology, evasion law, and selected relevant stories. The author uses articles and reports from the Organization for Economic Co-Operation and Development, the United States Senate, and the Internal Revenue Service, as well as from several law review articles. This paper seeks to illuminate some of the major players in the tax evasion battle and identify some of the significant types of tax evasion and avoidance techniques being used. Furthermore, the paper develops and presents the defenses and arguments of tax haven nations. Lastly, the author delves into the global impact of tax havens and discusses the future methods being implemented to combat their deleterious effects on tax revenue.

## Evasive Maneuvers

--Halliburton in Iran? -- Mitt Romney in the Cayman Islands? --A powerful contractor to the United States in Bermuda? What do these things have common?

To most citizens tax time is a troubling annoyance that comes around once a year to ruin a perfectly good weekend, week, or for some unfortunate souls an entire month. Rarely does the average citizen fully understand his or her own tax responsibilities, let alone the tax games being played by some of the more sophisticated players. The reason for this is that tax issues are often tricky and complex topics which cannot be easily understood without some special training or understanding. The purpose of this paper is to discuss briefly, for students without graduate training, what tax havens are, techniques of tax avoidance and evasion, as well as pertinent legislation in this field. To illustrate these concepts, one can look to current and relevant stories. The issue of potential solutions and remedies to this problem will be considered.

### The Facts and the Stories

Both individuals and corporations take advantage of tax loopholes. One study, covering 1.3 million corporations,<sup>1</sup> showed that “two out of every three United States corporations paid no federal income taxes from 1998 through 2005” and that 68% of foreign corporations doing business within the U.S. had “not paid taxes during the time period covered.” This same study, entitled “Study Tallies Corporations Not Paying Income Tax,” went on to state that “at a basic corporate tax rate of 35 percent, all the corporations covered in the study in theory owed \$875 billion in federal income tax.”<sup>2</sup> In fact as countries grow and develop there is a rise in tax evasion practices. A report by the International Monetary Fund “shows that for every one percent point increase in industrialized countries’ top corporate tax rates capital flows to offshore centers rose by 5% in general and by

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<sup>1</sup> These corporations had a net worth of \$2.5 trillion and included foreign corporations doing business within the U.S.

<sup>2</sup> Browning, Lynnley. “Study Tallies Corporations Not Paying Income Tax.” NewsBank NewsFile Collection with Periodicals. 5 Mar. 2008. NewsBank InfoWeb. 2 Nov. 2008

19% for Caribbean centers.”<sup>3</sup> The point is that wealthy individuals and corporations, with the proper assets and knowledge, go to great lengths to secure favorable taxation policies. The following stories illustrate this issue by using examples of both individuals and corporations that went to great lengths to limit or, in some cases, eliminate entirely their tax burdens.

*The Story of Mr. Weil and the Union Bank of Switzerland*

On November 18<sup>th</sup> of 2008 *The Wall Street Journal* released as a cover story “Top Banker Cited In Tax-Dodge Case.”<sup>4</sup> The article centers on a man by the name of Raul Weil, a high ranking executive for the Union Bank of Switzerland’s Action Group (hereafter UBS AG).<sup>5</sup> Mr. Weil is accused of developing a system which hid “\$20 billion in assets belonging to about 20,000 clients.” The charges<sup>6</sup> brought against Mr. Weil are felonies and if convicted he faces a maximum of five years in jail. “At one point, U.S. officials weighed a possible indictment against the bank, though that idea was put aside because of the possibility of [exacerbating] the global banking crises, according to people familiar with the case.” The present case got its legs after a 2008 breach of UBS’s veil of secrecy when “a former UBS banker, Bradley Birkenfeld, pleaded guilty...to helping American clients evade taxes. [Birkenfeld] told prosecutors that the Swiss bank generates some \$200 million a year in revenue from U.S. clients.” Prosecutors claim that “UBS held training sessions for bankers...to teach them ‘how to avoid detection by authorities when traveling in the United States.’ The bankers used encrypted laptop computers and erased references to the U.S. banking clients in communications. Discussing the issues that may have forced UBS into its current predicament the author went on to state that “since the outbreak of the credit crisis, which forced UBS to write down

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<sup>3</sup> Duggart, Caroline. Tax Havens and Their Uses. New York: BPR, 2002. Pg 2.

<sup>4</sup> Perez, E., & Mollenkamp, C. (2008, November 13). Top Banker Cited In Tax-Dodge Case. *The Wall Street Journal*.

<sup>5</sup> UBS is present in all major financial centers worldwide. It has offices in over 50 countries, with about 38% of its employees working in the Americas, 34% in Switzerland, 15% in the rest of Europe and 13% in Asia Pacific. UBS employs more than 75,000 people around the world. <http://www.ubs.com/1/e/about/ourprofile.html>

<sup>6</sup> Charges were brought in the U.S. District Court of Fort Lauderdale Florida

some \$46 billion in assets, Mr. Weil has overseen efforts by UBS to stanch outflows of client money. Earlier [in that month,] UBS said in a third-quarter report that clients took out 83.7 billion Swiss francs (\$70.9 billion), a result UBS called ‘disappointing.’”<sup>7</sup>

The current worldwide economic recession has hurt international banking communities. This has given some institutions more incentive to implement marketing practices that are all the more aggressive leading major banks to apply pressure to their parent countries’ legislative bodies. For example, UBS has pressed its parent country, Switzerland, to pass legislation protecting it from foreign prosecution. The *Wall Street Journal* article “Top Banker Cited In Tax-Dodge Case” explains that “in October, [of 2008] the bank got a boost when Switzerland, seeking to protect the county’s reputation as [a] haven for private banking, agreed to back a recapitalization of UBS and take as much as \$60 billion of souring assets off UBS’s books.”<sup>8</sup> Countries that implement these types of regulations create environments that become too inviting for major banks like UBS to pass up, and banks are not alone when it comes to institutions seeking to avoid, manipulate, or bend tax regulations and policies.

### *Halliburton and Iran*

Jefferson Morley in a 2005 paper identifies a Halliburton<sup>9</sup> subsidiary based out of the Cayman Islands as doing business with the nation of Iran, a member of President Bush’s “axis of evil.” The shell company, Halliburton Services and Products, was formed to allow Halliburton to circumvent laws making it illegal to do business with so-called enemies of America. Former Vice President Dick Cheney is a former employee of Halliburton that entered into the agreement with Iran “to develop

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<sup>7</sup> Perez, E., & Mollenkamp, C. (2008, November 13). Top Banker Cited In Tax-Dodge Case. *The Wall Street Journal*.

<sup>8</sup> Ibid.

<sup>9</sup> Halliburton, founded in 1919, is one of the world’s largest providers of products and services to the energy industry. With over 55,000 employees in approximately 70 countries, the company serves the upstream oil and gas industry throughout the life cycle of the reservoir - from locating hydrocarbons and managing geological data, to drilling and formation evaluation, well construction and completion, and optimizing production through the life of the field.

<http://www.halliburton.com/AboutUs/default.aspx?navid=966&pageid=2458>

two sections of Iran's South Pars gas field."<sup>10</sup> This deal "will reportedly produce 50 million cubic meters per day of treated natural gas for domestic use and 80,000 barrels of gas liquids per day for export" and Halliburton took "\$30 to \$40 million from Iranian operations in 2003."<sup>11</sup> Morley quotes an Iranian government spokesperson as saying that the project "served the interests" of Iran. Here we can see an example of an American company, formerly an employer of the former Vice President of the United States, indirectly doing business with a nation that has been deemed a threat to regional and global stability. Cronyism and the ability to look the other way when dealing with the United States international trade and tax policies and law can lead to our funding of enemies of the state.

### *A U.S. Contractor's Mystery Subsidiary*

In a May 2008 article titled: "Shell Firms Shielded U.S. Contractor from Taxes: Defense Outfit May Have Saved Millions,"<sup>12</sup> Farah Stockham details another American corporation using offshore shell companies to avoid taxes. March of 2005 found MPRI,<sup>13</sup> a company that specializes in the training of soldiers, entering into a \$400 million contract with the United States Government to train Iraqi police officers. Within two months of the formation of the contract, MPRI had set up a corporation on the island nation of Bermuda to which it subcontracted much of the work. According to Farah Stockham "MPRI's subsidiary...company appears to have no phone number, website, or staff of its own"<sup>14</sup> and does no

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<sup>10</sup> Morley, Jefferson. "Halliburton Doing Business With the 'Axis of Evil'" World Opinion Round Up. 3 Feb. 2005. Washingtonpost.com. 2 Nov. 2008 <washingtonpost.com (subscription required)>.

<sup>11</sup> Ibid.

<sup>12</sup> Stockham, Farah. "Shell Firms Shielded U.S. Contractor from Taxes: Defense Outfit May Have Saved Millions." NewsBank InfoWeb. 04 May 2008. Boston Globe, The. 2 Nov. 2008

<sup>13</sup> "Since 1987, MPRI, an L-3 Communications company, has provided national security, defense, and law enforcement customers within the US and abroad with professional services, specialized products, and integrated solutions for education, training, and operations. MPRI's products include maritime, driving, and marksmanship simulations and a multi-hazard emergency and routine operations management system. Our programs are staffed with highly skilled men and women whose professionalism, ethics, integrity, and commitment to quality ensure mission accomplishment. Competent, dedicated, experienced, and versatile, MPRI is respected around the globe for delivering quality results under often dangerous and arduous conditions." This is taken from the MPRI's home website at: <http://www.mpri.com/index.html>

<sup>14</sup> Stockham, Farah. "Shell Firms Shielded U.S. Contractor from Taxes: Defense Outfit May Have Saved Millions." NewsBank InfoWeb. 04 May 2008. Boston Globe, The. 2 Nov. 2008

actual work in regards to the training of Iraqi police.” The plan is simple actually, establish a shell subsidiary company in a tax friendly country, rout all income from foreign work (foreign work paid for with American tax dollars) into the shell subsidiary, and avoid the tax. Practices like these are unethical and levy an even larger undue burden upon the taxpaying citizens of the United States.

### *A Presidential Candidate*

During Mitt Romney’s formative years in the private sector he “utilized shell companies in two offshore tax havens to help eligible investors avoid paying U.S. taxes,”<sup>15</sup> according to Bob Drogin of the New York Times. In Drogan’s article “Tax Havens Factor Into Romney’s Business Plan,” he explains that “Romney was listed as a general partner and personally invested in BCIP Associates III Cayman, a private equity fund that is registered at a post office box on Grand Cayman Island and that indirectly buys equity in U.S. companies. The arrangement shields foreign investors from U.S. taxes they would pay for investing directly in U.S. companies.” As of 2007 Romney had still retained “an investment in the Cayman fund through a trust. Campaign disclosure forms show the investment paid him more than \$1 million [in 2006] in dividends, interest and capital gains.” The former presidential hopeful had made a name for himself as an influential and successful businessman, a man who understood the needs of the American business culture. With an estimated personal wealth of \$250 million it is hard for this author to understand or appreciate apparent conflict of rhetoric for American prosperity and a history of tax avoidance. Unfortunately these issues are not simply isolated to corporations or individuals of the United States.

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<sup>15</sup> Drogin, Bob. "Tax Havens Factor Into Romney's Business Success." [NewsBank NewsFile Collection with Periodicals](#). 18 Dec. 2007. NewsBank Info Web. 2 Nov. 2008



## We're Not the Only Ones

The United States is not the only economy confronted with massive tax evasion and avoidance schemes. The European Union<sup>16</sup> also has its fair share of internal and external tax issues. "European Union countries say they lose billions in revenue as a result of tax evasion, with Germany asserting it is deprived of as much as 30 billion Euros (\$45.6 billion) a year."<sup>17</sup> Britain also exemplifies the tax problem. As of February 2008, Britain's "residents who weren't born there can take advantage of the nondomicile – or nondom – rule,<sup>18</sup> which means they're only taxed on income made in or brought into the country. While most of their cash [is] safely tucked away in offshore trusts, foreigners can live in Britain virtually tax free."<sup>19</sup>

### *The German Example*

"The former chief executive of Germany's Deutsche Post admitted...in court that he evaded taxes by squirreling money away in Liechtenstein."<sup>20</sup> This statement headlined many of Germany's and other European Union nations' major papers after Klaus Zumwinkel, 65, was charged with illegally moving nearly 1 million Euro (\$1.8 million U.S.) out of Germany and into the tax haven nation of Liechtenstein.<sup>21</sup> Accusations against Zumwinkel surfaced in February of 2008; German officials have spent more than a year collecting enough material to make an official complaint. It has also been reported that the German government went so far as to pay an informant as much as 5 million

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<sup>16</sup> Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom are all members of the European Union.

<sup>17</sup> Castle, Stephen. "European Commission Moves to Broaden the Attack on Tax Havens." NewsBank NewsFile Collection with Periodicals. 5 Mar. 2008. NewsBank InfoWeb. 3 Nov. 2008

<sup>18</sup> This rule, while rather complex, is something of a double edged sword. While a country like Britain would certainly want to encourage wealthy individuals from foreign nations to spend money within Britain the rule works against Britain when a wealthy British national takes money earned in Britain out of the country.

<sup>19</sup> Farouky, Jumana. "Take the Money and Run." NewsBank NewsFile Collections and Periodicals. 18 Feb. 2008. NewsBank InfoWeb. 3 Nov. 2008

<sup>20</sup> "Former Deutsche Post CEO Admits Tax Evasion." Statesman.com 22 Jan. 2009. Austin American Statesman. 25 Jan. 2009.

<sup>21</sup> Liechtenstein is considered one of the top tax haven nations in the world; the country has been reported to have billions in foreign capital invested in their banks. Liechtenstein also has some of the most lax banking regulation in the world.

euro. Zumwinkel's fate has been decided by an agreement between the prosecutor and Zumwinkel's defense. Zumwinkel "received a two-year suspended sentence and must pay a [one] million-euro penalty"<sup>22</sup> as part of the agreed terms. A conviction of tax evasion can carry up to a ten year sentence in Germany, but typical punishments are substantially less. The Zumwinkel case provides us with just one of many examples of a nation other than from the United States suffering from tax evasion practices.

### *Tax Policy Variations*

A quick look at two major tax policy lines would help to contextualize this topic and is appropriate at this time. Many countries, such as the United States, calculate their citizens' tax responsibilities based upon nationality. Anyone who is a national of the United States as his or her nation of origin is required to pay tax to the United States, regardless of current residency. This means that a United States national, living in Greece, for example, is still required to pay taxes to the United States. The United States, however, will only seek the difference between what would be the obligation to the U.S. treasury and what has already been paid to the tax payers' current resident nation. If, for example, Greece's marginal rate is at fifteen percent and the United States national is paying at atwenty percent marginal rate, he or she is only be required to pay the five percent difference to the United States.<sup>23</sup>

While the first tax structure is based upon nationality the second major tax structure, used by the United Kingdom and others, is a tax structure based upon residency. Countries under this tax structure are only concerned with taxable entities or persons who are currently residing within

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<sup>22</sup> "Former Deutsche Post CEO Admits Tax Evasion." [Statesman.com](http://Statesman.com) 22 Jan. 2009. Austin American Statesman. 25 Jan. 2009.

<sup>23</sup> Professor Levitt. Personal interview. 06 Jan. 2009.

their borders. Countries using this structure are always searching for ways to control mass exoduses of wealth.<sup>24</sup>

### Reaction: The United States Government Fights Back

In July of 2008 Michigan Senator Carl Levin chaired a hearing entitled, *Tax Haven Banks and U.S. Tax Compliance*, (hereafter THB) which was followed by a second hearing, *Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends*, (hereinafter DTA) in September of 2008. The THB hearing was held to examine “how tax haven banks facilitate tax evasion by U.S. clients, hide client and bank misconduct behind the cloak of bank secrecy laws, and add to the offshore abuses that cost U.S. taxpayers an estimated \$100 billion dollars each year.”<sup>25</sup> The following DTA hearing was held to examine “how some financial institutions have designed, marketed and implemented transactions to enable foreign taxpayers, including offshore hedge funds, to dodge millions of dollars of taxes on U.S. stock dividends each year.”<sup>26</sup> The fact is that “U.S. taxpayers are required to report all of their foreign financial accounts if the total exceeds \$10,000 at any point during the tax year. Failure to report the accounts can result in penalties of up to 50 percent of the amount in the account”<sup>27</sup> Certainly many multi-million dollar corporations such as UBS AG, Halliburton, and MPRI far exceed this threshold. The following is a brief outline of pertinent legislation and the developing international cooperation to combat tax haven abuses.

### Tax Havens

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<sup>24</sup> Ibid.

<sup>25</sup> "RECENT AND ONGOING INVESTIGATIONS." Carl Levin United States Senator. 18 Oct. 2008 <<http://levin.senate.gov/senate/investigations/index.html>>.

<sup>26</sup> Ibid.

<sup>27</sup> "Senate: Offshore tax abuses may total \$100B a year." NewsBank NewsFile Collection with Periodicals. 17 July 2008. Associated Press News Service, The. 2 Nov. 2008

To continue a discussion about tax havens we should look at the findings of the Organization for Economic Co-Operation and Development (hereafter OECD), which is “a forum where advanced industrialized democracies seek to promote cooperative solutions to the world's economic and social problems.”<sup>28</sup> Created in 1961 the OECD had twenty original members but that has since grown to include thirty countries<sup>29</sup> and is currently in talks with ten other countries<sup>30</sup> who are seeking possible membership. The OECD’s function to its member nations is that it “(a) collects, analyzes, and disseminates data; (b) provides a setting where officials from national governments can meet to exchange ideas and experiences; (c) promulgates codes and standards of best practice across a whole spectrum of policy areas including...taxation; (d) undertakes ongoing surveillance and periodic peer review to ensure members are adhering to the OECD's structures; and (e) facilitates the work of other international organizations.”<sup>31</sup>

The report “Harmful Tax Competition: An Emerging Global Issue” (hereafter HTC) was issued in 1998 by the OECD. This report outlined the guidelines and criteria for the requirements of what tax haven nations are. The report sets forth three main purposes of tax havens they “provide a location for holding passive investments (‘money boxes’); they provide a location where ‘paper’ profits can be booked; and they enable the affairs of taxpayers, particularly their bank accounts, to be effectively shielded from scrutiny by tax authorities of other countries.”<sup>32</sup> Chapter 2, section 40 of the HTC report states that there are “broad categories of situations in which the tax levied in one

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<sup>28</sup> "Organisation [sic] for Economic Co-Operation and Development." Encyclopedia of Governance. Vol. 2. Thousand Oaks, CA: Sage Reference, 2007. 638-640. Gale Virtual Reference Library. Gale. ICUF. 22 Oct. 2008

<sup>29</sup> Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States are the current full member nations to OCEd.

<sup>30</sup> In May 2007, OECD countries agreed to invite Chile, Estonia, Israel, Russia and Slovenia to open discussions for membership of the Organisation [sic] and offered enhanced engagement, with a view to possible membership, to Brazil, China, India, Indonesia and South Africa. See [http://www.oecd.org/pages/0,3417,en\\_36734052\\_36734103\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html)

<sup>31</sup> "Organisation [sic] for Economic Co-Operation and Development." Encyclopedia of Governance. Vol. 2. Thousand Oaks, CA: Sage Reference, 2007. 638-640. Gale Virtual Reference Library. Gale. ICUF. 22 Oct. 2008  
[http://0-go.galegroup.com.novacat.nova.edu/ps/start.do?p=GVRL&u=novaseu\\_main](http://0-go.galegroup.com.novacat.nova.edu/ps/start.do?p=GVRL&u=novaseu_main) .

<sup>32</sup> Organization for Economic Co-Operation and Development. (1998). *Harmful Tax Competition: An Emerging Global Issue*. chapter 2, section 49, Printed in France: OECD Publications.

country on income from geographically mobile activities, such as financial and other service activities, is lower than the tax that would be levied on the same income in another country.”<sup>33</sup> The HTC went on to identify four clear and specific criteria for a tax haven nation:

“The necessary starting point to identify a tax haven is to ask (a) whether a jurisdiction imposes no or nominal taxes (generally or in special circumstances) and offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence. Other key factors which can confirm the existence of a tax haven...are: (b) laws or administrative practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdiction; (c) lack of transparency and (d) the absence of a requirement that the activity be substantial, since it would suggest that a jurisdiction may be attempting to attract investment or transaction that are purely tax driven.”<sup>34</sup>

According to the OECD report, a major component of what makes a tax haven nation is that the “country has no interest in trying to curb the ‘race to the bottom’ with respect to income tax and is actively contributing to the erosion of income tax revenues in other countries. For that reason, these countries are unlikely to co-operate in curbing harmful tax competition.”<sup>35</sup>

### Tax Evasion Law

Now that we understand that tax havens are really a form of tax avoidance, we must look to U.S. law to understand the definition of tax evasion. Tax avoidance is legal, though maybe not fair; however, tax evasion is a federal crime. The Internal Revenue Service has set the following guidelines for what is considered tax evasion. The following rules reprinted in the box below originate from Title

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<sup>33</sup> Ibid. chapter 2, section 40

<sup>34</sup> Ibid. chapter 2, section 52

<sup>35</sup> Ibid. chapter 2, section 43

26 of the Internal Revenue Code Chapter 68. For purposes of this section, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard.

Title 26, Chapter 68, Additions to the Tax, Additional Amounts, and Assessable Penalties

Subchapter A. Additions to the Tax and Additional Amounts Part II. Accuracy-Related and Fraud Penalties.

(d) Substantial understatement of income tax.

(1) Substantial understatement.--

(A) In general. For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of--

- (i) 10 percent of the tax required to be shown on the return for the taxable year, or
- (ii) \$ 5,000.

(B) Special rule for corporations. In the case of a corporation other than an S corporation<sup>36</sup> or a personal holding company (as defined in section 542 [26 USCS § 542]), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of--

- (i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$ 10,000), or
- (ii) \$ 10,000,000.

(2) Understatement.

(A) In general. For purposes of paragraph (1), the term 'understatement' means the excess of--

<sup>36</sup> An S Corporation (as defined by Schneeman, Angela. [The Law of Corporations and Other Business Organizations](#). Belmont: Cengage Delmar Learning, 2001. 178.) is "unlike other business corporations, the income of S corporations is not taxed at the corporate level, but is passed through to the corporation's shareholders, much like income is passed through to the partners of a partnership or members of a limited liability company. S corporation status is often elected by smaller, closely held corporations that are formed with the expectation of incurring a net loss for the first few years. The loss of the corporation is passed on to the shareholders of the corporation, who may use it to offset their income."

(i) the amount of the tax required to be shown on the return for the taxable year, over

(ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2) [26 USCS § 6211(b)(2)]).

In a case of tax evasion a government body must decide whether to seek criminal or civil prosecution. To prosecute criminally the government body has to be able to prosecute an individual such as the tax advisor, attorney, CEO, CFO, or any other specific individual. On the other hand civil prosecution allows for a prosecuting body to go after either a corporation as a whole or an individual actor. This in turn limits the penalties typically to monetary sums, as opposed to jail time. For the government to attempt a criminal prosecution the prosecutors must establish the following requirements and criminal prosecutions are held to higher burden of proof than are civil prosecutions.<sup>37</sup> To prove tax evasion charges under 26 U.S.C. § 7201, the government must establish (1) that the tax shelters were illegal, thus causing tax deficiency, and (2) that each defendant committed an overt act with the intent to commit tax evasion. For tax evasion under § 7206(1) and (2), the government needs to establish (1) that defendant filed or caused to be filed tax returns that were false as to material matters, and (2) that defendants did not believe that the tax returns were true as to every material fact.<sup>38</sup> These requirements and standards make successful prosecution very difficult.

Criminal prosecution is made even more difficult under the jurisprudence of intent established in *Cheek v. United States*.<sup>39</sup> This U.S. Supreme Court opinion holds that to be convicted criminally of tax evasion, a jury must find that the defendant has intentionally and willfully violated a known legal

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<sup>37</sup> Civil prosecution onus is on the preponderance of the evidence or a fifty-one percent or better belief of wrong doing. The criminal onus is substantially higher at beyond a reasonable doubt.

<sup>38</sup> Hsue, P. B. (2008). Comment: Lessons from *United States v. Stein*: Is the Line Between Criminal and Civil Sanctions for Illegal Tax Shelters a Dot? [Review of *Northwestern University Law Review*]. *LexisNexis Academic*. Retrieved December 15, 2008.

<sup>39</sup> *Cheek v. United States* 546 U.S. 1010 (November 7, 2005) (LexisNexis Academic, Nova Southeastern University, Dist. file).

duty in addition to willfully committing the act itself. Then in *United States v. Murdock*,<sup>40</sup> the court stated that “congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for the tax, as to his duty to make a return, or as the adequacy of the records he maintained, should become a criminal by his mere failure to measure up to the prescribed standard of conduct.”<sup>41</sup> On the whole the courts and Congress both have made it very difficult for the Internal Revenue Service to successfully pursue criminal prosecutions of individuals engaging in tax evasion practices, no matter how outrageous. There is a flip side to these tax issues. Some powerful people and entities see these restrictions and penalties as unfair and unjust.

### Open Market...Just Not an Open Tax Market

Many investors, corporations, and countries engaged in offshore banking tout the idea of a free tax market economy. Proponents of a free tax market economy believe that like any other goods and services, countries and banks ought to be allowed to competitively compete for foreign investments and capital. For many countries, banking services attracting foreign capital are central to their entire economy. Two-years after the OECD released the HTC they released another report under the protracted title: “Towards Global Tax Co-Operation: Report to the 2000 Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices” (hereafter TGTC). This report listed ten countries meeting OECD’s tax criteria who were full-fledged CARICOM<sup>42</sup> members; three were associate members; and four have

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<sup>40</sup> *United States v. Murdock* 290 U.S. 389 (December 11, 1933) (LexisNexis Academic, Nova Southeastern University, Dist. file).

<sup>41</sup> *Ibid.*

<sup>42</sup> CARICOM was established, in 1973, to help synchronize responses to the region’s growing economic, social, and political concerns. CARICOM was mandated “to facilitate enhanced coordination of member states’ policies in relation to issues of regional importance. The CARICOM Treaty has as its main goals the improvement of living standards, economic development, full employment, enhancement of international competitiveness, and effective foreign relations.” CARICOM has grown to include fifteen full-fledged members, five associate members, and seven countries have an observer status.

- CARICOM nations include 15 full members: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. There are five associate CARICOM member countries: Anguilla, Bermuda, British Virgin Islands, Cayman Islands, and Turks and Caicos Islands. There are seven CARICOM observer status nations: Aruba, Columbia, Dominican Republic, Mexico, Netherlands Antilles, Puerto Rico, and Venezuela.



observer status within CARICOM.<sup>43</sup> Many of these island nations have small and unstable economies,<sup>44</sup> economies that rely heavily on foreign investment. Often times banks in these tax haven nations will actively pursue and market their services to very wealthy people and corporations who seek to avoid their resident countries' income tax. Most banks falling under the definition of a tax haven would argue first and foremost that even if there should be a minimum tax requirement, what would that requirement be. The OECD's HTC report states that a nation would begin to be categorized as a tax haven if it offered no or nominal taxation. These tax haven banks would point out that no other service industry has an international standard of regulation. They would argue that standardizing a minimum tax would remove any advantage they may have in competing with larger and more influential nations.

Many Caribbean island nations have been labeled as tax havens and have suffered from this labeling. The small Caribbean nation of St. Vincent and the Grenadines suffered an "economic decline in the face of OECD...blacklisting."<sup>45</sup> An article in the *University of Miami Inter-American Law Review*, written by Vaughn E. James, examines the impact of the OECD's blacklisting<sup>46</sup> of St. Vincent and the Grenadines. "In the mid-1990's [St. Vincent and the Grenadines] 'launched an economic diversification program and strengthened measures to deal with the decline in the banana industry.' In 1996 the government reversed the laws governing the offshore financial sector. As a result, the sector experienced rapid growth. At one point, the sector boasted 11,400 registered entities, of which 28 were banks, 608 trusts, and the rest international business companies. The

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<sup>43</sup> OECD, Towards Global Tax: Report to the 200 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices, Pg. 17 - Organization for Economic Co-Operation and Development. France: OECD Publications, 2000.

<sup>44</sup> Small and unstable for this section refers to the CARICOM nations that rely heavily on and are dependent upon the flow of foreign capital into their banking sector.

<sup>45</sup> James, Vaughn E. "Twenty-First Century Pirates of the Caribbean: How the OECD Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty." LexisNexis Academic. Winter 2008. The University of Miami Inter-American Law Review. 3 Nov. 2008.

<sup>46</sup> The author recognizes that this may not be a social or politically sensitive or correct way of describing these nations, however, the term blacklisting is almost universally used in all OECD reports, IRS reports, and law reviews on this topic.

IMF<sup>47</sup> estimated that the offshore financial sector contributed EC\$ 30 million (3.5 percent of GDP) in 1999 in fees, employment, rentals, and use of utilities. Unfortunately for St. Vincent and the Grenadines, 1999 was the last year of prosperity for the offshore financial sector. In 2000...the OECD...included the multi-island nation on [its] blacklist. Concerned, the government enacted measures intended to strengthen the supervisory and regulatory framework for offshore activities - including the increase in staff and amendments to existing law. The measures also included the closure of several banks and insurance companies operating on the island. With an unemployment rate of 25-40%, St. Vincent and the Grenadines [was] devastated by the economic losses brought on by the closures and revocations.”<sup>48</sup> The ability of developed and influential nations to negatively affect nations labeled as tax havens is an issue that requires great scrutiny and is an issue that needs to be understood and dealt with in a sensitive manner.<sup>49</sup>

Many see the OECD as nothing more than wealthy nations organizing a unified front to squeeze smaller and developing nations out of a relatively small portion of the global economic pie. The OECD nations are vast and influential; they have the ability to enact sanctions on uncooperative nations that have the potential to cripple economies.

### A Look to the Future

#### *Come Clean With the Internal Revenue Service?*

A recent article appearing on November 24<sup>th</sup> 2008 in the *Wall Street Journal*, “Tax Evaders Come Clean With IRS,” discusses a current program within the Internal Revenue Service regarding tax evasion. “In 1990, the Service adopted Internal Revenue Manual section 342.142, providing that ‘a voluntary

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<sup>47</sup> International Monetary Fund, website: <http://www.imf.org/external/>

<sup>48</sup> James, Vaughn E. “Twenty-First Century Pirates of the Caribbean: How the OECD Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty.” *LexisNexis Academic*. Winter 2008. The University of Miami Inter-American Law Review. 3 Nov. 2008.

<sup>49</sup> Professor Levitt asks here whether the reason for the decline in this banana industry was related to international trade agreements. Further, he wants to know whether these agreements fostered an economic environment that may have forced these nations to take on the qualities of tax havens.

disclosure may result in no prosecution recommendation.’ This version of the policy provided that a voluntary disclosure is a communication that is ‘(a) Truthful; (b) Timely; (c) Complete; and, (d) . . . shows a willingness to cooperate . . . with the IRS in determining his/her correct tax liability. A taxpayer could no longer satisfy the timeliness element upon [Internal Revenue] Service initiation of an inquiry ‘that [was] likely to lead to the taxpayer, and the taxpayer [was] reasonably thought to be aware of that investigative activity.’<sup>50</sup> This means that someone who has come under investigation for tax evasion already cannot then say that he or she is participating in this program by showing cooperation. It is possible that more legislation of this nature can ensure that more firms and individuals actively pursue tax policies that benefit the United States.

### *The President’s Take*

Tax haven nations may also face a bleaker outlook thanks to the executive branch of the United States. When President Barack Obama was candidate Barack Obama his campaign website spoke about the issue of tax havens and tax evasion.

**“Cracking down on international tax havens:** According to a recent Congressional investigation, offshore tax abuse costs this country up to \$100 billion each year.<sup>51</sup> Barack Obama has been a leader in the Senate on designing efforts to crack down on tax havens by requiring greater disclosure of financial transactions in tax secrecy jurisdictions. As President, Obama would work with Congress to enact meaningful legislation to ensure that the Treasury and IRS have the tools they need to close down the use of international tax

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<sup>50</sup> Madison, A. D. (2001, Summer). AN ANALYSIS OF THE IRS'S VOLUNTARY DISCLOSURE POLICY [Review of *The Tax Lawyer*]. *LexisNexis® Academic*.

<sup>51</sup> Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Government Affairs, August 2006, available at <http://levin.senate.gov/senate/investigations/index.html>

havens for improper tax avoidance or tax evasion. This will save the United States tens of billions of dollars each year.”<sup>52</sup>

In 2007 then Illinois Senator Barack Obama, current Michigan Senator Carl Levin, and former<sup>53</sup> Minnesota Senator Norm Coleman introduced the bipartisan “Stop Tax Haven Abuse Act.” This act, among other measures would:

- Establish presumption to combat offshore secrecy by allowing U.S. tax and securities law enforcement to presume that non-publicly traded, offshore corporations and trusts are controlled by the U.S. tax payers who formed them or sent them assets, unless the taxpayer provides [proof] otherwise.
- Impose tougher requirements on U.S. taxpayers using offshore secrecy jurisdictions by listing 34 jurisdictions<sup>54</sup> which have already been named by the IRS court filings as probable locations for U.S. tax evasion.
- Strengthen penalties on tax shelter promoters by increasing the maximum fine to 150% of their ill-gotten gains, and on corporate insiders who hide offshore stock holdings by increasing the maximum fine...to 1\$ million per violation of U.S. securities law.<sup>55</sup>

The bill lists several other objectives all aimed at limiting and or restricting losses to the U.S. treasury by the unlawful use of tax havens. Bills like this may show some insight into the mind of President Obama and future mechanisms to combat tax evasion.

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<sup>52</sup> Printed In House. "BARACK OBAMA'S COMPREHENSIVE TAX PLAN." [BarackObama.com](http://www.barackobama.com/pdf/taxes/factsheet_tax_plan_final.pdf). Obama for America. 3 Nov. 2008 <[http://www.barackobama.com/pdf/taxes/factsheet\\_tax\\_plan\\_final.pdf](http://www.barackobama.com/pdf/taxes/factsheet_tax_plan_final.pdf)>.

<sup>53</sup> This may still be in dispute.

<sup>54</sup> Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Dominica, Gibraltar, Grenada, Guernsey/Sark/Alderney, Hong Kong, Isle of Man, Jersey, Latvia, Lichtenstein, Luxembourg, Malta, Nauru, Netherlands Antilles, Panama, Samoa, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Singapore, Switzerland, Turks and Caicos, and Vanuata.

<sup>55</sup> U.S. Senate. Permanent Subcommittee on Investigations. "Levin, Coleman, Obama Introduce Stop Tax Haven Abuse Act." Press release. [levin.senate.gov/newsroom/release](http://levin.senate.gov/newsroom/release). 17 Feb. 2007. 25 Jan. 2009.

The topic of tax havens has not strayed far from the mouth or mind of Barack Obama since his inauguration. On the 3<sup>rd</sup> of March of this year, Obama sat down in a press conference with the United Kingdom Prime Minister, Gordon Brown. The topic of global financial stability and recovery was addressed and the issues of shadow banking systems and tax havens were discussed. The two men were in agreement that there needs to be a collective and universal approach to these issues and that they must be resolved through reform and in the banking regulatory systems on an international level.<sup>56</sup>

### Conclusion

This paper has discussed the definition of tax havens, tax evasion and avoidance techniques, pertinent tax law, current and relevant stories related to the topic, and the future of tax evasion in the United States. Tax issues can be tricky, complex, and difficult to understand. The concepts and practices are not easily understood and this paper gives only a brief outline of these issues. The author of this paper hopes that a reader will become more aware of these tax issues and their deleterious effect on tax revenues. Some wealthy and disingenuous people are not paying their fair share of the tax burden choosing instead to practice these evasive maneuvers.

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<sup>56</sup> "British P.M. Brown Visit to DC." Washington DC. 04 Mar. 2009. 03 Mar. 2009. C-SPAN. <<http://www.cspan.org/Watch/watch.aspx?MediaId=HP-A-15976>>.

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