SENATE TAX 5

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U.S. firms funnel more than half their foreign profits through tax havens

By Henry Farrell November 12, 2014

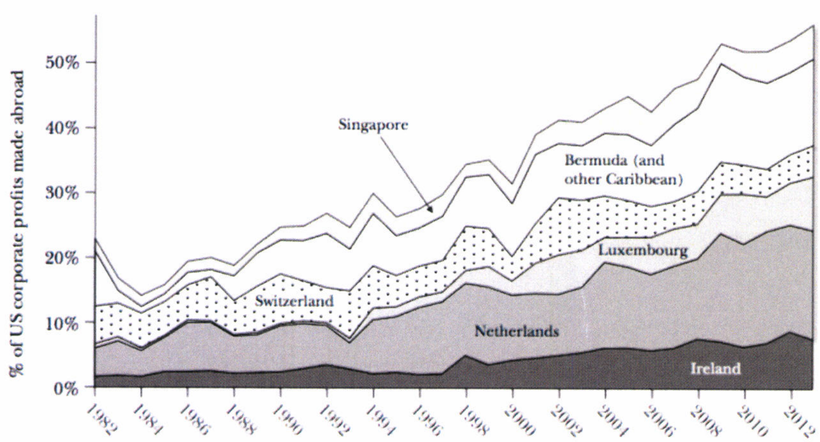
Over the last couple of decades, large firms have become increasingly adept at using complex international arrangements to reduce their taxes. This has become a big political issue in the United States (where there is increasing pressure to get U.S. firms to start paying their taxes) and in Europe (where the incoming president of the European Commission is in political trouble over his possible previous role in facilitating dubious tax arrangements for foreign firms). However, it is difficult to measure the extent of the problem, exactly because these tax-dodging arrangements are so complicated. If, for example, profits pass through a chain of artificial subsidiaries located in a number of different countries (as in the notorious "double Irish plus a Dutch sandwich") to take advantage of loopholes, then it's difficult to measure and count them.

Gabriel Zucman, in a new article in the Journal of Economic Perspectives has figured out a possible way to measure the extent to which U.S. firms use tax havens to lower taxes on foreign profits. By looking at national accounts and balance of payment statistics, it's possible to get aggregate figures on how much money is being funnelled through foreign tax havens. And the answer is — quite a lot. Zucman:

The balance of payments provides a country-by-country decomposition of this total, indicating that 55 percent are made in six tax havens: the Netherlands, Bermuda, Luxembourg, Ireland, Singapore, and Switzerland. The use of tax havens has steadily increased since the 1980s and continues to rise. Moreover, the trend toward more widespread use of tax havens by US-owned corporations shows no particular sign of slowing down. As tax havens rose as a share of foreign profits (to 55 percent today) and foreign profits rose as a share of total US corporate profits (to about one-third), the share of tax havens in total US corporate profits reached 18 percent (that is, 55 percent of one-third) in 2013. That is a tenfold increase since the 1980s …

The figure below shows the increase in profits flowing through tax havens over the last 30 years.

Figure 2
The Share of Tax Havens in US Corporate Profits Made Abroad



Source: Author's computations using balance of payments data. See online Appendix.
Notes: This figure charts the share of income on US direct investment abroad made in the main tax havens. In 2013, total income on US direct investment abroad was about $500 billion. Seventeen percent came from the Netherlands, 8 percent from Luxembourg, etc.

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Zucman estimates that these artificial tax avoidance schemes have provided U.S. firms with the equivalent of somewhere between a 6 percent and 8 percent tax cut over the last decade and a half. That's quite a lot of money.

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http://www.washingtonpost.com/blogs/monkey-cage/wp/2014/11/12/u-s-firms-funnel-more-than-half-their-foreign-profits-through-tax-havens/