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TAX EVASION

Get the havens to help

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Imagine two towns, one so large that it is practically a city and the other a picturesque community with a tourism-based economy. The city has a large, relatively wealthy population and the small town does pretty well for itself. The city, however, has a problem. It imposes a tax on the income of its residents, but many city residents have decided they would rather bury their income in secret spots in the small town than pay their taxes. The city seethes, certain that the small town's government could help collect the city's taxes by finding the secret hiding spots but simply won't. Some residents of the small town make matters worse by getting rich selling high-end shovels and compasses to tax cheats from the city.

The United States and its industrialized peers, all of which rely to some degree on income taxes, can empathize with our imaginary city. The United States alone loses $50 billion a year in tax revenues because its citizens and residents hide their money in offshore tax havens. Over the years, the United States has done all sorts of things to try to collect those taxes. In 1973, the Internal Revenue Service famously used a private detective to "entertain" a banker while the contents of his briefcase were photographed to uncover the identities of tax cheats.

More recently, the United States and other members of the Organization for Economic Cooperation and Development (OECD) have taken another approach. They have created a list of a few dozen nations that fit their definition of a "tax haven." Most of the countries named (e.g., the Bahamas) were no surprise, but other inclusions (war-torn Liberia) and omissions (OECD member Switzerland) stood out. The OECD then urged those tax havens to "exchange information" to help them collect their unpaid income taxes. The OECD and others explain that those unpaid taxes threaten essential social welfare programs so that, by failing to help, tax havens are essentially stealing food from the mouths of the elderly and the poor. The governments of tax havens, by and large, have responded with empty promises to cooperate.

The residents of tax havens are more likely to identify with the small town than with the big city. They ask themselves why they should devote resources to solving their neighbors' problem when they have pressing problems of their own. One possibility is that they have a moral obligation to do so because some of the U.S. citizens and residents hiding their money are not just tax cheats, but are also drug traffickers and mobsters. Another is that the participation of a limited number of bankers, lawyers and accountants (the tax haven equivalent of shovel and compass salesmen) makes the problem as much theirs as their neighbors'.

An incentive system

The United States and the big city have the same problem. They both need help enforcing their income taxes. One approach that either one could take would be to offer to pay for that help. The United States could do that by sharing a fixed percentage of any part of the lost $50 billion that tax havens help them to recover. Perhaps the time has come to do just that. The IRS has already entered into precisely that sort of arrangement with private collection firms, trading collection assistance for up to 24% of the amount collected.

Given that the amounts at stake are quite large relative to the size of most tax havens (the Cayman Islands, for example, has a gross domestic product of just under $1.4 billion), such an approach could simultaneously solve both the incentive and the resource problems that keep tax havens from fully cooperating with anti-tax evasion efforts.

Like our imaginary city, the United States could provide its smaller neighbors with the money to develop the complex systems of information-gathering and reporting that would be required to do more than catch a handful of high-profile scoundrels. By striking a bargain that would leave tax havens with additional resources that could be devoted to their own health, infrastructure and environmental problems, the United States could also give tax havens a real stake in the success of their efforts. Because any payments would be contingent on genuine, verifiable cooperation, such a deal would strengthen, rather than weaken, the United States' fiscal health. The only losers would be tax cheats.

It isn't clear why this approach hasn't been tried. The instinctive suspicion that all countries have for "outsiders" is certainly one reason. The fact that wealthy and influential people on both sides benefit from tax evasion is another. It would be a shame if suspicion and selfishness allowed tax cheats to continue to win at everyone else's expense. There are certainly no guarantees that such a bargain would do the trick, but isn't it at least worth a try?

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