

## **Tax Havens: A Guided Tour**

Interview with Gabriel Zucman

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**What sums of money are hidden in tax havens? By whom? And how? Using original methodology and data that has not yet been fully utilized, Gabriel Zucman sheds new light on these questions, in the hope that it might boost the fight against tax havens.**

Gabriel Zucman is currently completing his PhD at Paris School of Economics. He studies worldwide wealth inequality. With twenty other junior researchers, he takes part in the economy journal <a href="#">Regards croisés</a> .
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**La Vie des Idées:** Mr Zucman, you have done some major research into what you call the “missing wealth of nations”, that is, the household wealth that does not appear in national and global statistics because it is hidden in tax havens. Could you first of all give us a few rough estimates? What is the total sum of that wealth? How is it structured? Who are its main holders? Where are the main tax havens?

**Gabriel Zucman:** The study I carried out suggests that, globally, around 8% of household wealth is held in tax havens. At the end of 2008, the financial wealth of households – that is, bank deposits, portfolios, investment fund placements and life insurance contracts held by households all over the world – was as high as 75,000 billion U.S. dollars. Households therefore held around 6,000 billion dollars in tax havens.

We often presume that having a Swiss bank account means having dormant money in a safe or current account. In fact, wealthy households do not go to Switzerland to place millions in an account that yields 1% interest a year. From their Swiss accounts they make quite sophisticated investments. The vast majority of offshore assets are invested in securities: shares, units of investment funds, bonds. Of those securities, investment funds play a predominant role. This comes as no surprise: investing in a fund, which is itself then invested

in American bonds, Brazilian shares, etc., yields a far higher return than building up a cash reserve in a current account.

It is much more difficult to find out who owns the assets in tax havens than to discover the total amount of offshore assets and their composition. In fact, the only reliable data we have is for Switzerland. Swiss banks manage around one third of offshore assets, which means around 2,000 billion dollars at the end of 2008. This makes Switzerland the biggest tax haven when it comes to cross-border wealth management.

Of those 2,000 billion dollars, more than 60% belongs to Europeans, particularly Italians, French, Germans, Spanish, Portuguese and Greeks. In second place come the Gulf countries – since the 1970s, rich families from the Gulf have been important customers for Swiss and London banks, which is hardly surprising considering the underdeveloped financial systems in the Gulf states.

Contrary to popular belief, the wealth of African dictators and Russian oligarchs only makes up a tiny fraction of the assets managed by Swiss banks. Most of the money in Switzerland still belongs to Europeans and, more generally, to residents of rich nations, with the exception of Japan. It seems, however, that the portion attributed to emerging countries is growing, while that of Europeans and Americans is declining.

The situation in other tax havens is not known. Some reports compiled on the basis of interviews with assets managers suggest that most of the assets managed in European tax havens (Switzerland, Luxembourg, Jersey, Guernsey, Liechtenstein, etc.), belong to Europeans; most of those managed in the Caribbean (Cayman Islands, Bahamas, Bermuda, etc.) to Americans, both North and South; and most of those managed in Asian tax havens (Singapore and Hong Kong) belong to Asians. However, the only reliable data available applies to Switzerland.

Clearly, a large share of offshore wealth must belong to Europeans, since they own the majority of the assets managed by the biggest tax haven: Switzerland.

**La Vie des Idées:** Why does Japan stand apart from other rich countries? In other words, why do Japanese householders not invest their assets in tax havens as Europeans and Americans do?

**Gabriel Zucman:** We need to be careful, because we only have information on Switzerland. However, it is true that the Japanese do not seem to be big customers of Swiss banks. Studies trying to show what motivates people to invest their money in tax havens have not reached a unanimous conclusion. Even so, it seems likely that domestic tax rates play an important role: in Japan, dividends received by households are taxed at just 10%, in comparison with 21% in the United States, 24% in Germany, and more than 30% in France.<sup>1</sup>

### **How Assets and Income Are Hidden**

**La Vie des Idées:** Could you also give us an idea of the normal set-up or arrangement, for example of a European household, when it conceals its assets and income from the tax department? How does this work?

**Gabriel Zucman:** There are two distinct stages: sending the money to Switzerland (for example), and managing the money that has been sent there. We can start with stage two. If you have one million euros in a Swiss bank account, the French tax department has no way of knowing about it, because Swiss banks exchange almost no information with the French tax office (which is the principle behind banking secrecy). That million generates revenue (interest, dividends) that the French authorities know nothing about, so having an account in Switzerland allows you to avoid income tax, solidarity tax on wealth, and inheritance tax.

Generally speaking, people who invest money in Switzerland take extra precautionary measures. For example, very few accounts are held directly by households; most offshore assets are held by shell corporations, trusts or foundations, so as to make the link between an account and its real beneficiary more opaque.

In a typical scenario, a French household owns a Swiss bank account via a shell corporation registered in Panama (all of this is a formality; nothing actually happens in Panama, because the shell corporation is established directly in Switzerland). The money is invested, to a fairly large extent, in investment funds operating in Luxembourg (which, in

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<sup>1</sup> Cf. OCDE taxation statistics, available online at: [http://www.oecd.org/document/60/0,3746,en\\_2649\\_34533\\_1942460\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/60/0,3746,en_2649_34533_1942460_1_1_1_1,00.html)

many cases, are actually subsidiaries of Swiss banks). Luxembourg does not tax cross-border deposits: our household therefore receives 100% of the dividends paid out by the fund. The French tax office has no means of knowing about offshore income earned by households, and so, if the household fails to declare its income in its tax return, then it pays no tax in France. Finally, if the tax department grows suspicious, it will quickly discover that the account apparently belongs to a Panamanian company, not a French household with a Paris address. When one knows how to interpret it, in other words, when one understands how it is constructed, the official data provided by the Central Swiss Bank, which is publicly available, clearly reveals this typical France-(Panama)-Switzerland-Luxembourg pattern. It is not just a bad detective novel.

We now come to the first stage: how does the money get to Switzerland? In the collective imagination, the money is transported in a suitcase, but it is difficult (and very risky) to transport such sums of money. In reality, most transfers are quite ordinary electronic payments. For example, a company managed by a French household makes a deposit in a Swiss account in order to purchase a fictitious service. Another method used by many employees in the London financial sector is to have their salaries paid directly into an account in Jersey. It is also common for employees of multinational corporations to receive their salary in an account in Cyprus, for example. Once the money is in one tax haven, it can easily be moved to another.

Why do some companies pay their employees' salaries into offshore accounts? Because they make most of their profits in tax havens. The profits made by an American company in a tax haven are not taxed in the United States if they are not brought back into the country. Rather than bringing their profits back into the U.S., multinational companies have every interest in paying their employees directly out of revenue made in tax havens.

### **How Can Money in Tax Havens Be Counted?**

**La Vie des Idées:** Given the complexity and anonymity of these measures, which are chosen specifically to avoid state supervision, how do you measure and study it, and to what extent do you trust your results?

**Gabriel Zucman:** When a French household has units of investment funds from Luxembourg in a Swiss account, France records no assets (French accountants have no means of measuring

those assets). Switzerland recognizes no assets or liabilities (given that, in terms of international accounting, this does not concern Switzerland: it is an investment made by a French national in Luxembourg). Luxembourg, however, does recognize a liability: more specifically, accountants in Luxembourg recognize that foreign nationals have units of investment from Luxembourg, which constitutes a liability for Luxembourg in relation to the rest of the world. Inevitably, more liabilities than assets are recorded worldwide; liabilities recorded by Luxembourg in particular are far higher than the total assets recorded by all the world's countries for Luxembourg (incidentally, the difference was 1000 billion dollars in 2008).

In order to demonstrate these anomalies, I use a harmonized survey carried out under the direction of the IMF from 2001, the Coordinated Portfolio Investment Survey (CPIS). This survey is of exceptional quality, and was started in an attempt to resolve the anomalies that IMF statisticians have been observing for decades in the global balance of payments – especially the abnormal imbalance between assets and liabilities. The survey enabled data to be harmonized between countries, best practices to be shared around the world, etc. It allowed almost all the problems in international accounting to be solved... except for one. French accountants, despite their best efforts, were unable to record, as they should, the assets held by French citizens in Switzerland. The anomalies that remain in the CPIS, therefore, after the considerable efforts at harmonization made by the IMF and world experts, largely reflect household use of tax havens.

Of course, the method I use is indirect. It is impossible to pinpoint to the nearest billion the amount of money held in tax havens. It is impossible to know exactly who holds offshore accounts. My study only gives rough estimates. I think the estimate of 8% for global financial assets is reasonable. All the existing studies, whether carried out by consultants through interviews, or by NGO specialists in tax havens, give higher figures, sometimes much higher. My intention is not to exaggerate the problem. What is more, I am only interested in one aspect of tax haven activity – the management of cross-border wealth for individuals. A lot of other things go on in tax havens, about which we still have a great deal to learn.

The study I carried out is based on data that has not existed for long, but which is entirely open to the public and easily accessible. All those who wish to can therefore redo my calculations, using the appendix of my work in particular, which provides a step-by-step

description of the way in which I proceeded, the sources I used, etc. I hope this will enable my estimations to be improved upon. Certainly, when new data surfaces it will allow the figure to be enhanced.

**La Vie des Idées:** The estimates you have given for this hidden wealth seem quite high. In what way can they change our normal understanding of the major global economic and financial balance?

**Gabriel Zucman:** Taking into account the offshore wealth of households has a notable impact on what we know about international financial imbalances. In the official figures, the euro area holds a negative position in relation to the rest of the world: it would seem that the rest of the world has more assets in the euro area than the euro area has in the rest of the world. That is quite surprising in terms of economic theory, because Europe, like Japan, is generally a region of low growth, which is ageing and has a high savings rate; economic theory suggests that it should therefore be a net creditor in relation to the rest of the world.

Taking account of the unrecorded wealth of European countries enables us to resolve that paradox: it is likely that, if the offshore assets of Europeans were included, the external position of the euro zone would be positive.

In the same way, official statistics maintain that the rich world overall is in debt with the developing world. Economic theory suggests that the rich world should, instead, be in credit, or at the very least in balance. Once we take into account the unrecorded assets in tax havens, we can partly reconcile the theory with the facts.

### **Combating Tax Havens**

**La Vie des Idées:** Do these results also mean that rich households are still much richer than it would appear from national statistics, and therefore that inequality, at least in terms of wealth, is even higher? Does this also mean that those households are effectively succeeding in hiding their wealth, and that any attempt to tax assets is at best futile, and at worst counter-productive?

**Gabriel Zucman:** Offshore assets on the whole escape all available sources of data, whether they be national accounting, fiscal information or surveys. As the assets in tax havens no doubt belong to very rich people, it is likely that wealth inequalities are even more

pronounced than our usual methods of analysis show. However, tax havens do not fundamentally challenge our knowledge of wealth distribution within countries. The sources available show that wealth is extremely concentrated: as far as we know, the richest 10% in France own more than 60% of national assets. Perhaps they actually own 65-70% of national wealth – in any event, the wealth is highly concentrated.

As far as the impact of tax havens on wealth taxation is concerned, we need to be very clear. It is perfectly legal (at least in France) to have a bank account in Switzerland or the Bahamas. However, it is entirely illegal not to declare the income one receives into an offshore account. Tax havens enable those who wish to break the law to do so. The United States and Europe should get to grips with this problem in a coordinated fashion. If they so wish, the major countries can easily put an end to tax fraud by individuals in tax havens. They merely need to force tax havens to automatically release the information they hold. Each time a French household receives a dividend in a Swiss account it holds via a Panamanian shell corporation, Switzerland should send that information to France. The European Union, if it spoke out in unison, would easily have the capacity to force all tax havens to comply with that automatic exchange of information. In any case, that is the ultimate goal of the Savings Taxation Directive established by the EU in 2005. It is therefore quite possible that tax fraud in tax havens will be eradicated in a few years' time. It all depends on how united the EU countries are, and on the will of the United States.

**La Vie des Idées:** If it is not so difficult, why have EU Member States and the United States taken so long to combat tax havens? And how are the latter able to resist the demands of the international community?

**Gabriel Zucman:** Despite laudable efforts from several NGOs and a number of researchers who caught on to this issue very early, there is a significant lack of information on tax havens. That lack of information leaves the door wide open for lobby groups who do not want any specific changes to be made. And it is difficult to implement good policies when we do not fully understand what is happening, or the scale of the problem. For this is a very technical issue, to which details are of great importance. For example, as it currently stands, the EU Savings Taxation Directive does not apply to offshore accounts belonging to Europeans via non-European shell corporations. Until recently, nobody in Brussels knew that most offshore accounts were held through these structures, and as a result the Savings Directive is

ineffective. Economists have a share of the responsibility: they take very little interest in tax havens. Things are starting to change, however, and that should help decision-makers to establish measures that are better adapted.

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