

Obama and the Tax Havens

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While our new president struggles to find cabinet appointees who are not also tax challenged, he has sent unmistakable signals as to his intent that the rest of us pay our fair share. As you may have surmised from previous articles, I have placed many millions of dollars of client money in offshore trusts over the years. The reasons are usually asset protection and tax efficiency. In all cases, they fully comply with U.S. tax and regulatory law. Nothing goes unreported, no tax is evaded.

Nonetheless, there is considerable evidence that not all who employ world markets take the same approach. Some 20,000 U.S. persons have apparently rat-holed money in accounts with Union Bank of Switzerland (UBS), and were revealed only when a departing employee spilled the beans. IRS is now in process of recovering that list, and plans to run the miscreants to the ground.

The political rhetoric is unsurprising: cracking down on “abusive tax havens,” more than 30 countries that “peddle secrecy” and “cloak tax evasion and other misconduct.” Then-Senator Obama co-sponsored the *Stop Tax Haven Abuse Act* in 2007. It never passed, but his staff indicates that more of the same will be considered early in his administration as president.

The Brits are piling on, as well. England’s Chancellor Alastair Darling announced in his pre-budget report that the United Kingdom will commission an independent review of British offshore financial centers. The review will focus on their role in both the global economy and long-term business strategies. These are code for tax practices. Every multi-national in existence has a tax department the primary purpose of which is to so order the company’s affairs as to lawfully minimize the tax burden wherever it operates. Nothing unlawful here, since no one has an obligation to pay more than is owed. Nonetheless, the difference between the rates paid and those that would be paid absent the offshore financial centers is coveted by the taxing agencies of the industrialized world.

The legislation co-sponsored by President Obama as Senator contains some tips as to what we can expect. They include (a) a rebuttable presumption that transactions through offshore financial centers are taxable, (b) increasing the reporting/withholding requirements on institutions dealing with offshore financial centers, and (c) increasing penalties for tax evasion through those jurisdictions. Note that tax *avoidance* is lawful, while tax *evasion* is not.

The administration believes tax revenue may be increased by some \$50 billion in this manner, and that increase is seen as a way to fund tax breaks and spending programs now under way. The rebuttable presumption stands on its head our constitutional presumption of innocence, imposing on the taxpayer the task of proving that the transaction is taxed – or not

– in a more favorable way than is asserted by IRS.

The list of “tax havens” includes all those that have provided safe and responsible environments for business operations since the early part of the last century. Sure, they compete for business with high-tax industrialized nations, just like one dry cleaner competes with another two blocks down the street. They offer lower ship registration fees, for instance. Lower taxes mean more competitive insurance products, lower trust administration fees, and lower transaction costs. That’s the capitalist system in action.

Much is made of “lax regulatory oversight” in the offshore financial centers. False. Offshore financial center regulation is more often tighter and more effective than that of the complaining nations. Look for instance at our Securities and Exchange Commission; it looked the other way while senior management of public companies ripped off shareholders with back-dated stock options, insider trading, and outrageous bonuses (the last, often while losing billions), not to speak of pooling bad mortgages for resale as securities. Congress, looked the other way while a minority advocacy group pressured government-sponsored agencies to make home loans to people who could not afford to repay, then protected the bureaucrats who did the politically correct thing by enabling lenders to make those loans. This continued despite warnings from wiser members, until the securitization of mortgage debt became so tainted with bad loans that the worldwide market collapsed, taking the U.S. economy down with it. And we are throwing rocks at how *other* nations regulate their business affairs?

Reporting requirements are to be increased. Right now, if you have a foreign grantor trust country, you file a *Form 3520* when establishing the trust and each time you add to it, a *Form 3520-A* showing trust income, expenses, and assets on hand each year, a *Form TD F 90-22.1* each year for each bank account of the trust, a *Form 5471* each year for any foreign corporation owned directly or indirectly. In addition, each bank and asset manager dealing the trust or corporation must obtain your *Form W-9* explaining to IRS your relationship to the account or entity. In addition, every major offshore financial center has an exchange of information agreement with IRS. This appears to give the Service all the tools necessary to be and remain informed about taxable interests.

If the foreign trust is of the *non-grantor* variety, those used with foreign private annuities, for example, the *Form 3520* – once – is the only filing required.

Yet, the administration remains dissatisfied. It is possible to create a foreign non-grantor trust, one not taxable by the U.S. except for certain U.S.-source income. The administration proposes to attribute to the U.S. person who created the trust the rights and powers of a trust protector. A trust protector – usually a non-resident, non-U.S. person – is one to whom is delegated the power to fire the trustee, make changes to the trust, change beneficiaries, and move the trust to another jurisdiction under certain circumstances. The person who creates the trust may keep the power to fire the trustee and replace it with another independent

trustee, all without becoming the deemed “owner” of the trust for income tax purposes. The *other* powers deemed reserved to the creator, however, lead to tax attribution. Hence, if the law is changed in this manner, flexibility in dealing with life changes will be lost.

As to penalties for failure to comply with today’s rules, Sen. Carl Levin characterized them as “Like a jaywalking ticket for robbing a bank.” As the principal sponsor of the 2007 legislation, he advocates doubling the time in which to complete tax audits, authorizing “John Doe” subpoenas for use in audits, and cutting off the right of noncompliant offshore financial center banks to deal with U.S. banks. In addition, a 40% penalty would be imposed on under-payments of tax resulting from transactions lacking in “economic substance” as defined by IRS.

The administration has shown little inclination to back away from the tactics described above, the current economy notwithstanding. These schemes are instead seen as revenue-raisers needed to pay for the stimulus package. Time will tell.