

**Public Economics for Public Policy**  
***Part IV: Capital Taxation & Tax Havens***

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*Sciences Po*

*MPA 2022-2023*

Capital Inequality and Capital Taxation

Global Profit Shifting, Tax Avoidance, and Tax Evasion

Offshore Real-Estate in Dubai

# Capital Inequality and Capital Taxation

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**Definition:** Capital Income = Income generated by wealth

Wealth arises from expected future income and value of assets

Private wealth includes real estate, corporate and business equity, fixed claimed assets (bonds+deposits), net of debts (mortgage, student loans, consumer credit)

Total wealth reflects both capital stock accumulated through savings and pure price effects

*Example 1:* house can increase in value because it is improved (capital) or because local prices go up (pure price effect)

*Example 2:* greater monopoly power makes a business more valuable to owners (but at the expense of consumers)

Recent increase in US private wealth mostly due to price effects

Wealth inequality more difficult to measure than income inequality

Ideal data source would be annual wealth tax declarations for the entire population

But exist in very few countries only (e.g., Norway)

**Levels:** Private wealth always more concentrated than income

Top 10% owns more than 50% of wealth in China, Europe, US

Bottom 50% owns less than 10%; middle 40% owns 40% or less

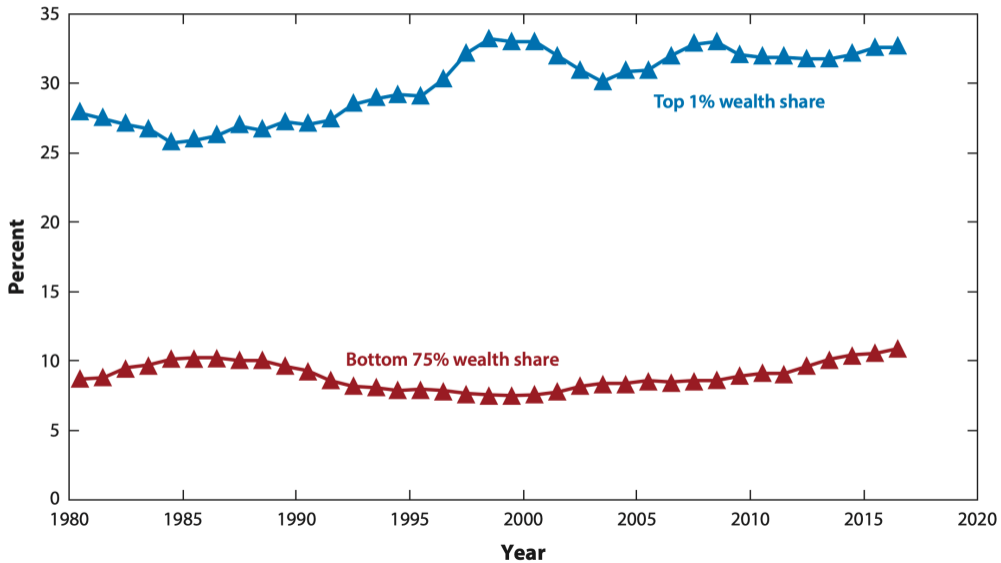
**Trends:** Evidence points toward rise in global wealth inequality over past decades

Given data limitation, in what follows: world = Europe + China + US

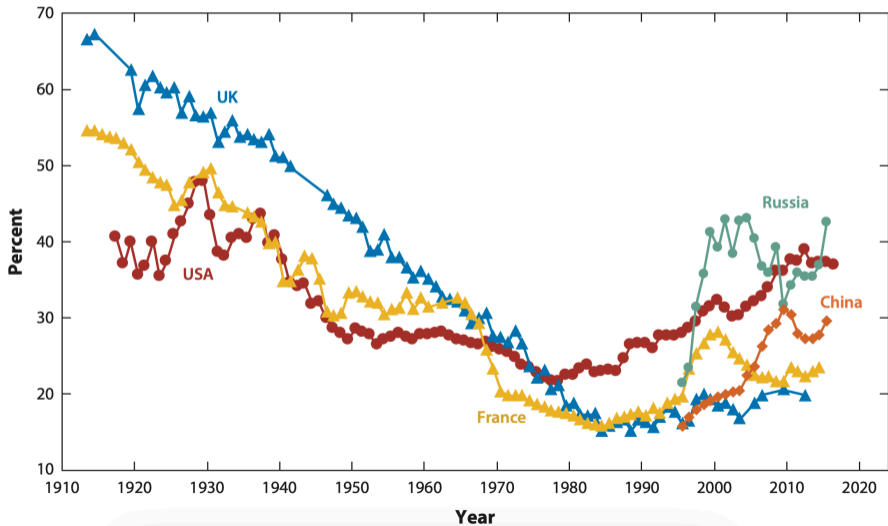
Global top 1% increased from 28% in 1980 to 33% today

Bottom 75% share hovered around 10%

# Top 1% and Bottom 75% shares of global wealth (1980-2017): China, Europe and the US



# Top 1% wealth shares across the world (1913-2015): The Fall and Rise of Personal Wealth Inequality



# The Great Reversal in the US

The US used to be much more equal than Europe, and now is much more unequal

Before World War I, wealth was less concentrated in the US than in Europe

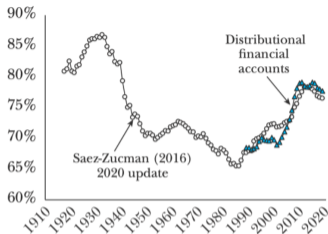
Substantial fall in wealth inequality in the 1930s and 1940s

Then gradual and dramatic increase since the late 1970s

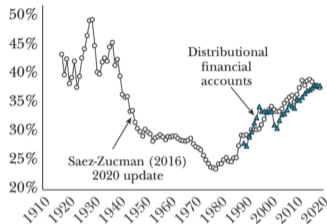


# Top wealth Shares in the US: Comparing Estimates

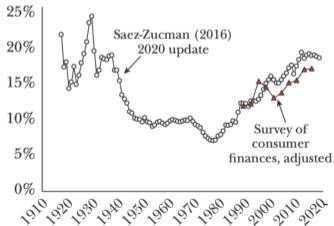
### Top 10% wealth share



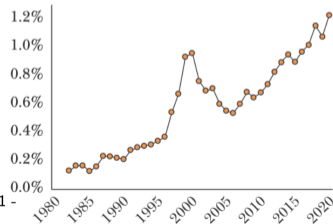
### Top 1% wealth share



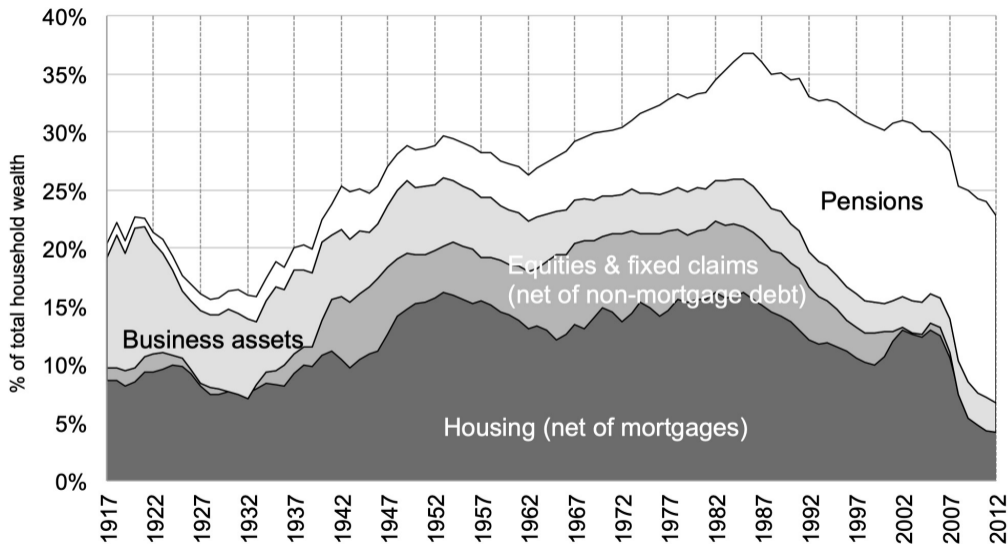
### Top 0.1% wealth share



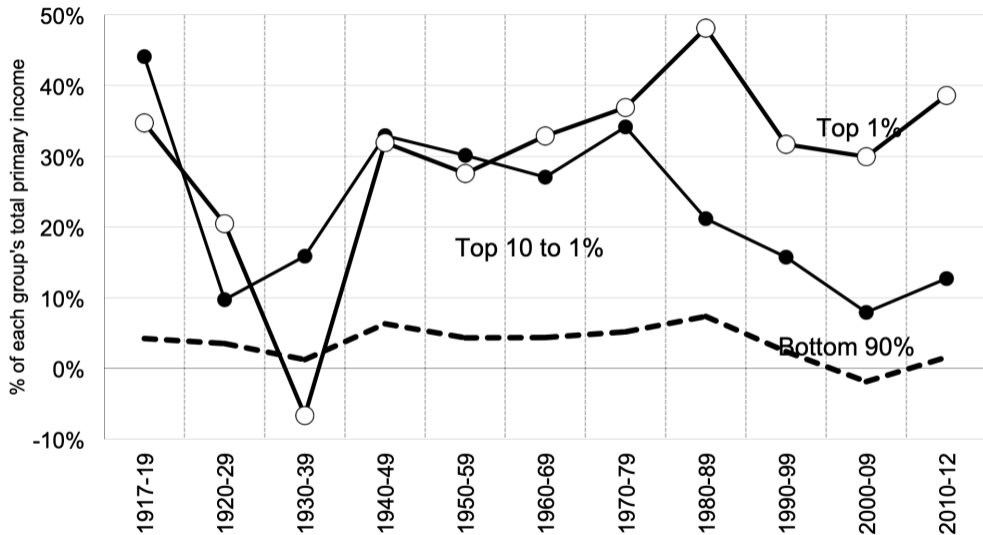
### Top 0.00001% wealth share



# Composition of the bottom 90% wealth share



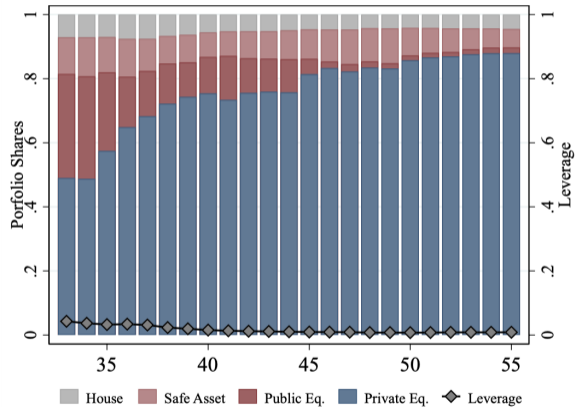
# Saving rates by wealth class (decennial averages)



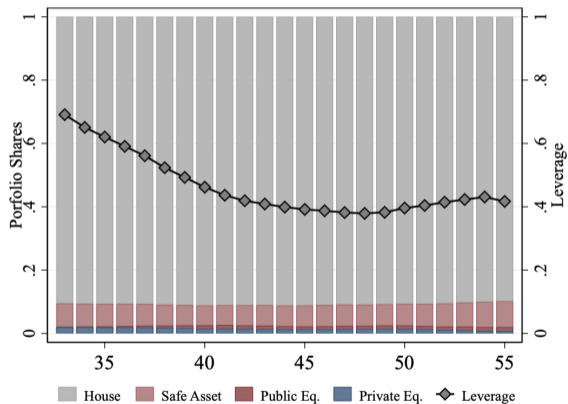
The rich save more as a fraction of their income, except in the 1930s when there was large dis-saving through corporations. NB: The average private saving rate has been 9.8% over 1913-2013.

# Portfolio composition in Norway (Ozkan et al., 2023)

## Panel A: Top 0.1% households

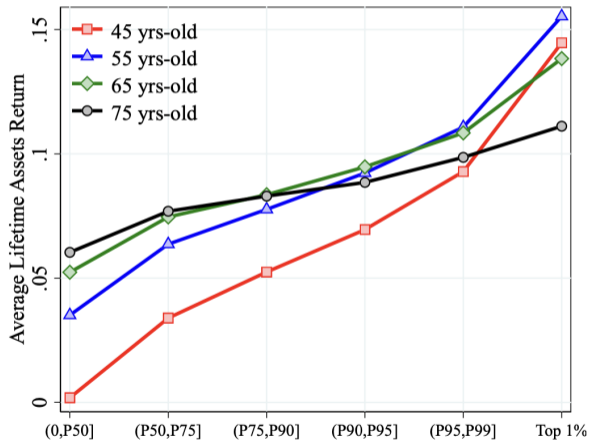


## Panel B: Bottom 50% households

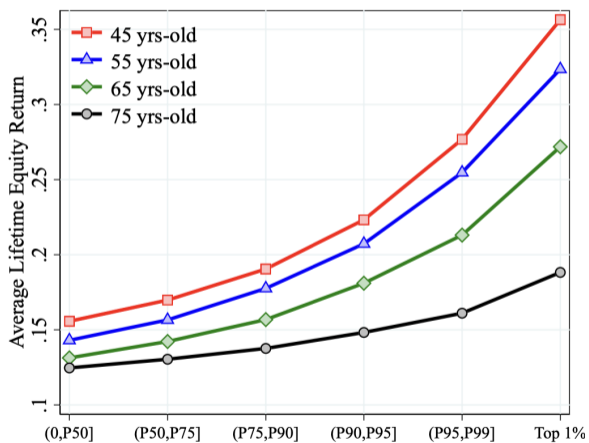


# Lifetime returns on assets: Large and Persistent Heterogeneity

## Panel A: Return on Total Assets

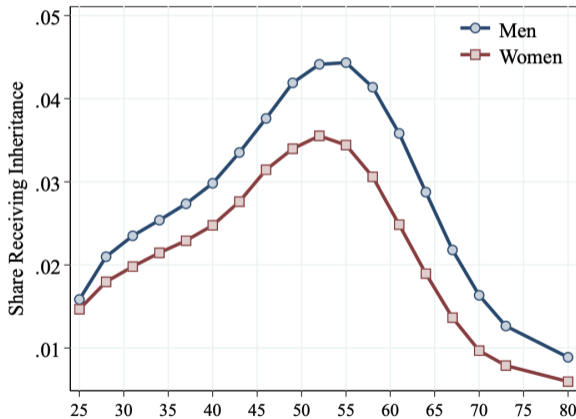


## Panel B: Return on Equity

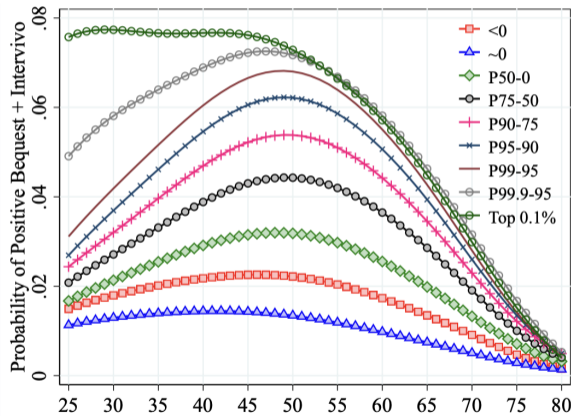


# Probability of receiving inheritance: High Heterogeneity

## Panel A: Mean probability



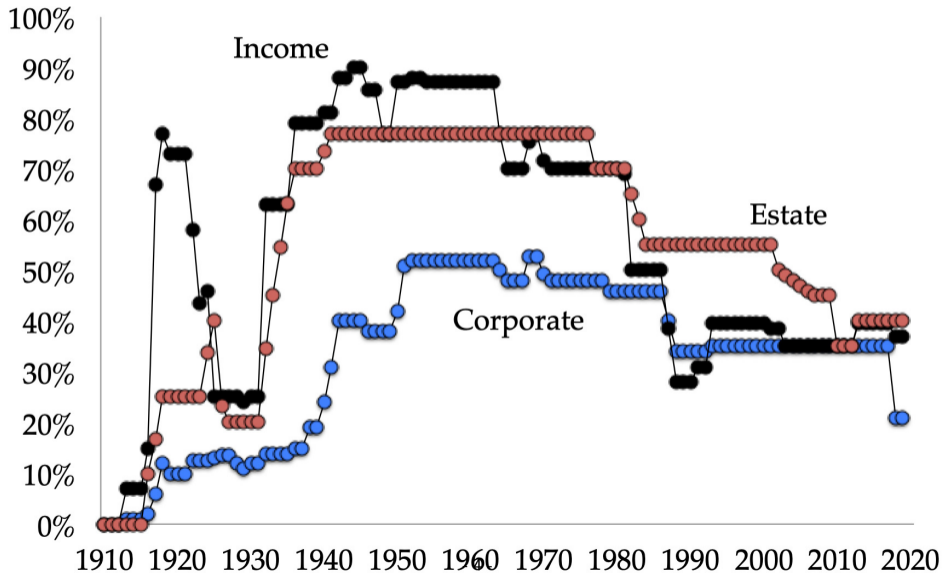
## Panel B: Conditional on wealth



# US Capital Income Taxation

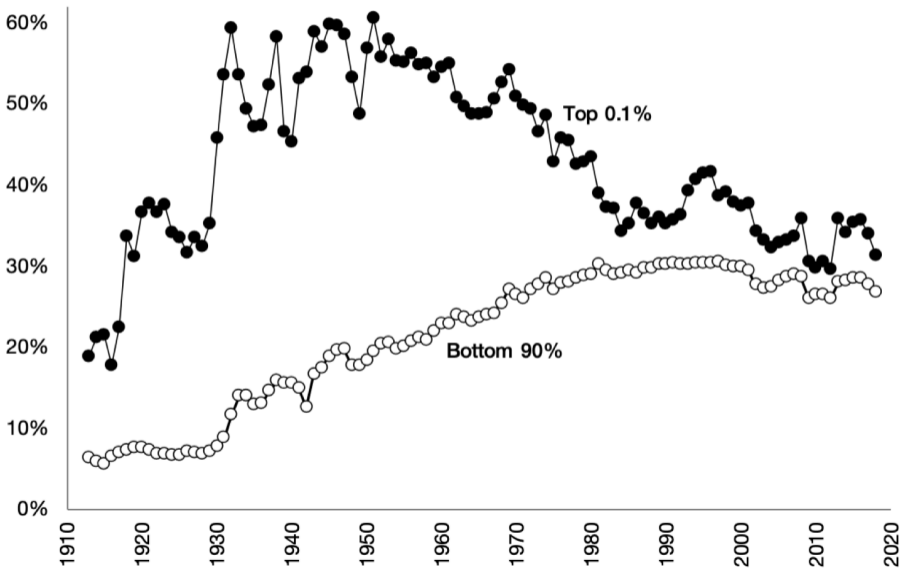
1. **Corporate Income Tax** (fed+state) on profits of corporations [complex rules with many industry specific provisions]: effective tax rate only 16% of corporate profits in 2018
2. **Individual Income Tax** (fed+state): taxes many forms of capital income
  - Realized capital gains and dividends receive preferential treatment (to lower double taxation of corporate profits)
  - Imputed rent of home owners and returns on pension funds are exempt
3. **Estate Tax**: tax on very large estates (40% tax above \$13m) bequeathed to heirs (small and poorly enforced)
4. **Property Taxes** (local) on real estate (old tax):
  - Tax varies across jurisdictions. About 0.5% of market value on average
5. **Wealth tax** on total net worth of rich families (does not currently exist, proposed by Warren and Sanders, and in CA)

# Evolution of the Top marginal tax rates in the US

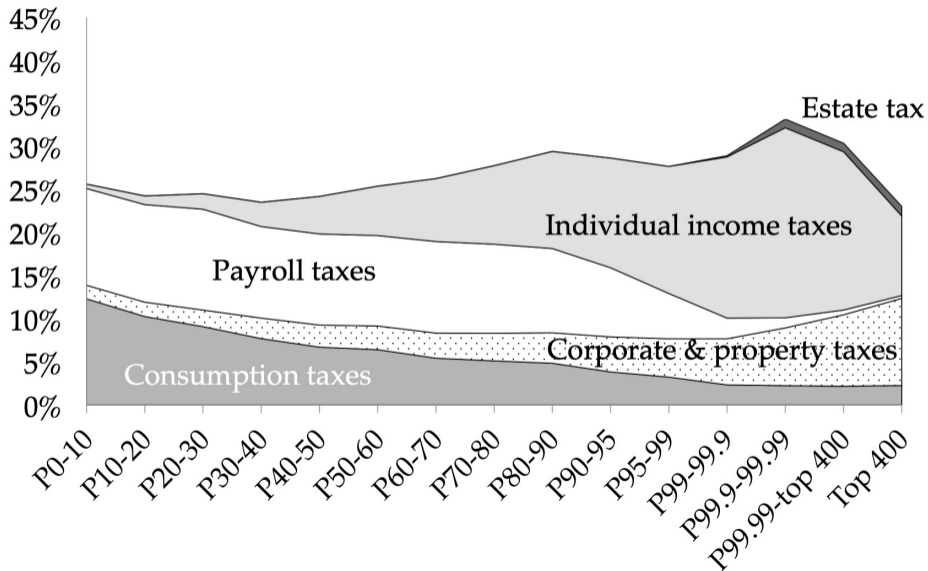




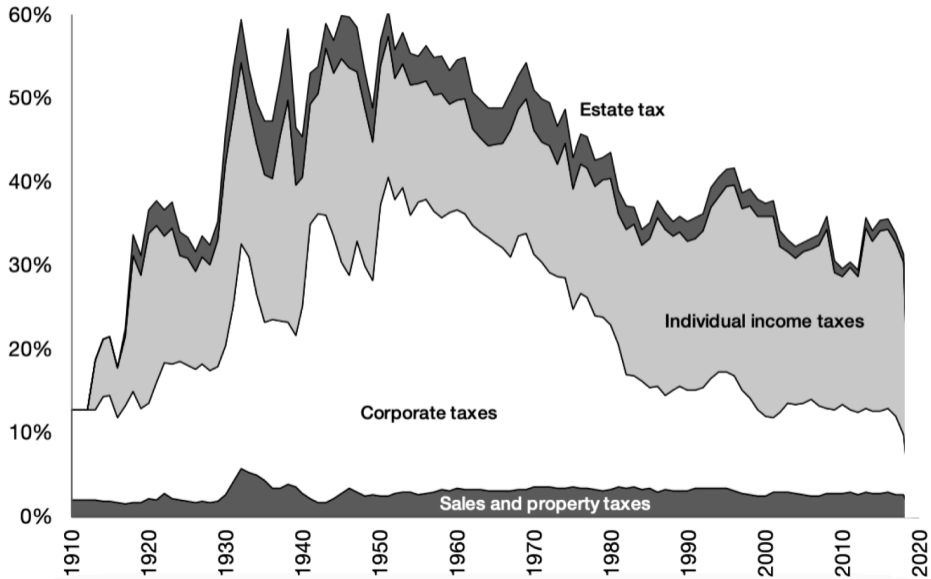
# Average Tax Rates: Top 0.1% vs. Bottom 90% income earners in the US



# Average tax rates by income group in 2018 in the US (% of pre-tax income)



# Average Tax Rate of the Top 0.1% income earners in the US



# French Tax System is Regressive at the Very Top



Source: Bach et al., 2023

# **Global Profit Shifting, Tax Avoidance, and Tax Evasion**

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To think about capital taxation in an open economy, key distinction is residence vs. source base capital taxation

**Residence:** capital tax based on residence of owner of capital (or location of headquarter for firms)

Most individual income tax systems are residence based (with credits for taxes paid abroad)

Can only escape tax through evasion or changing residence

**Source taxation:** capital income tax based on location of capital

Most corporate income tax systems are source based

3 main consequences of source-based taxation:

1. Profit shifting to low-tax countries
2. Relocation of capital to low-tax countries
3. Tax competition leading to equilibrium where tax rates are too low

- **Tax competition:** “Noncooperative tax setting by independent governments, under which each government’s policy choices influence the allocation of a mobile tax base among ‘regions’ represented by these governments” (Wilson Wildasin 2004)
- Tax planning
- Tax avoidance
- Tax fraud
- Tax evasion

- Tax competition
- **Tax planning:** Tax planning is the analysis of a financial situation or plan to ensure that all elements work together to allow you to pay the lowest taxes possible.
- Tax avoidance
- Tax fraud
- Tax evasion



- Tax competition
- Tax planning
- **Tax avoidance:** Tax avoidance involves bending the rules of the tax system to try to gain a tax advantage that Parliament never intended.
- Tax fraud
- Tax evasion

- Tax competition
- Tax planning
- Tax avoidance
- **Tax fraud:** Tax fraud occurs when an individual or business entity willfully and intentionally falsifies information on a tax return to limit the amount of tax liability.
- Tax evasion

- Tax competition
- Tax planning
- Tax avoidance
- Tax fraud
- **Tax evasion:** Tax evasion is a more serious form of tax fraud. As such, the burden of proof for tax evasion is higher, and so are the penalties.

- Tax competition
- Tax planning
- Tax avoidance
- Tax fraud
- Tax evasion

**Tax planning (legal) < tax avoidance (legal or illegal) < tax fraud (illegal) < tax evasion (illegal)**

Decreasing costs of mobility and capital flight

Bigger firms that are more likely to have interests in implementing tax avoidance or tax evasion (as well as more money to do it)

International firms with subsidiaries that could easily do optimization

## **Treaty shopping:**

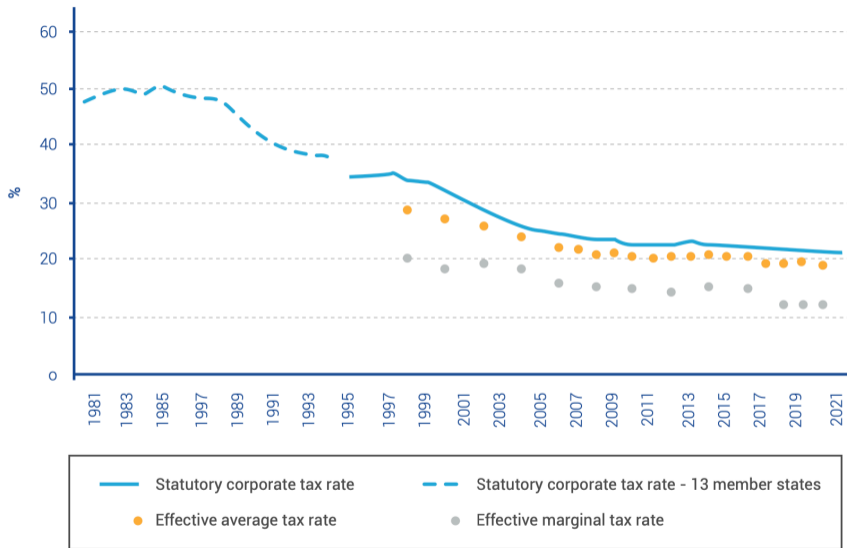
Anti-avoidance rules are supposed to limit ability of multinationals to shift profits

Can be avoided by exploiting inconsistency in tax laws across countries (treaty shopping)

For instance, inconsistent definition of what a corporation is or where it is located

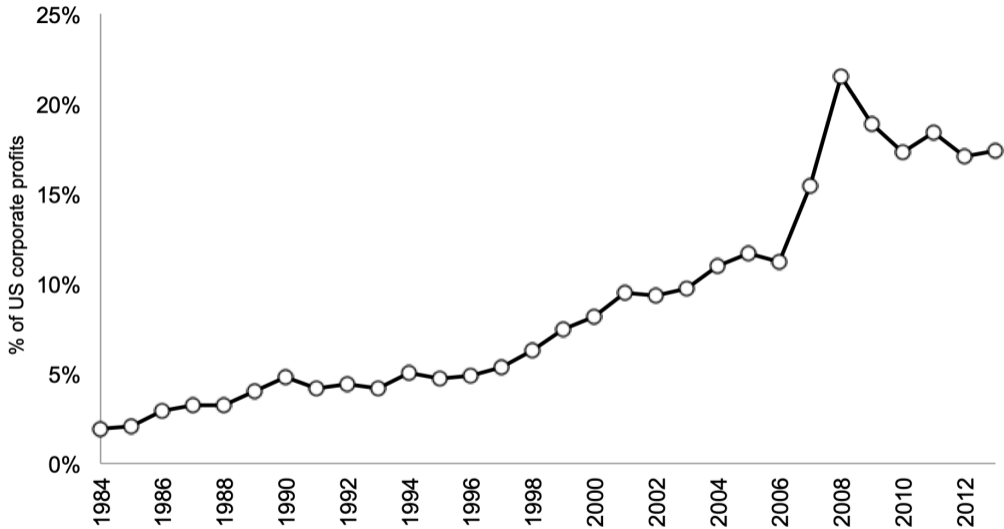
“Global” culture, international elites

# Development of corporate tax rates in Europe (1981–2021): A Race to the Bottom



Source: Flamant, Godard, and Richard, 2021

# Share of tax havens in U.S. corporate profits



Tax havens: Netherlands, Ireland, Switzerland, Singapore, Luxembourg, Bermuda and other Caribbean havens

Corporate taxes are to be paid where profits have been made

Problem: easy to manipulate location of profits

1. Manipulating intra-group import / export prices (transfer prices)

Subsidiaries of a same group are supposed to compute their profits as if unrelated (arm's length pricing)

In practice, relatively easy to manipulate transfer prices, and reference prices sometimes do not exist

Sizable evidence that intra-group prices differs from arm's length prices (Clausing NTJ 2003)

2. Intra-group borrowing

3. Locating intangibles in tax havens

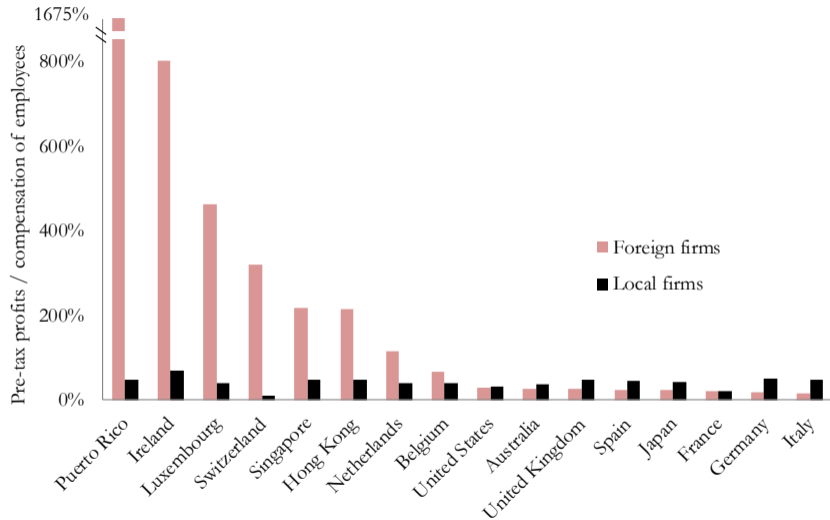
Booking assets in low-tax countries enables firms to deduct income in high-tax countries and earn interest & royalties in tax havens

Transfer of intellectual property can be done through outright sale (Google 2003)

Or cost sharing: offshore subsidiary contributes part of the cost of developing IP (→ exports of rights to use IP from US to, eg, Ireland in US trade data)

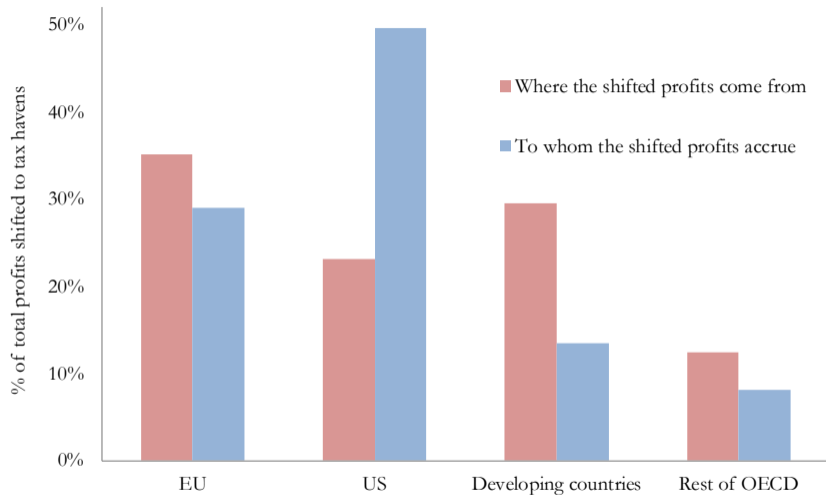


# Foreign firms are 8x more profitable than local firms in tax havens



⇒ More than \$600 billions shifted ( $\approx 36\%$  of international profits)

## Allocating shifted profits: heterogeneity by parent country



⇒ 77% of profits shifted out of the EU are shifted to EU havens

## What do offshore centers do?

Investment funds (Luxembourg, Ireland...)

Shadow banking (Caymans...)

Treasury management (U.S.-Cayman...)

Personal wealth management (Switzerland, Singapore...)

Offshore real estate (London, Dubai...)

## How offshore tax evasion works?

Shell companies

Fake invoices

Offshore accounts

Disconnecting legal and beneficial ownership

About **8% of the world's financial wealth** offshore

Limited data on what fraction evades taxes (major policy changes, lack of evaluation so far)

High concentration towards the top of the wealth distribution

Estimates usually relies on:

- Monthly statistics by the Swiss National Bank

- Systematic anomalies in the international investment positions of countries caused by offshore portfolio wealth

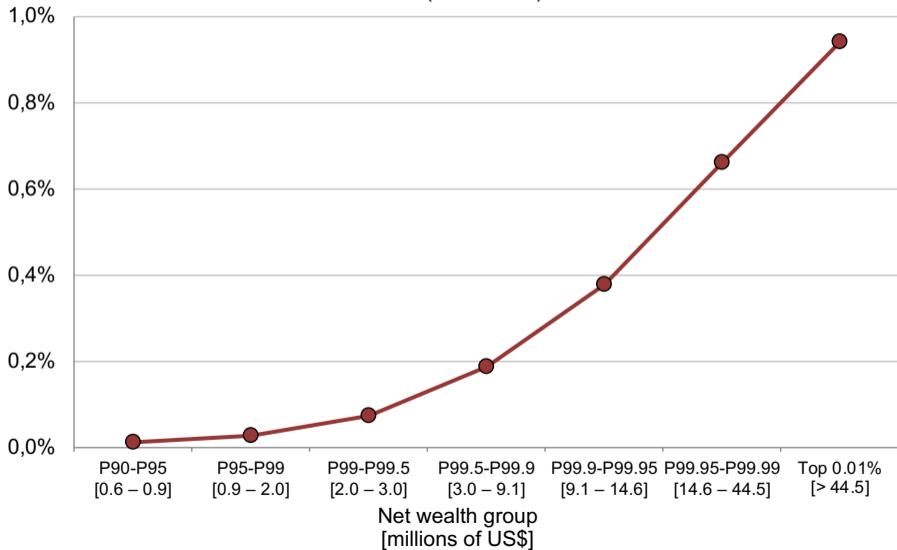
- Leaked data: Panama Papers, paradise papers, etc.: <https://offshoreleaks.icij.org>

## Estimates of tax evasion (Zucman, 2015)

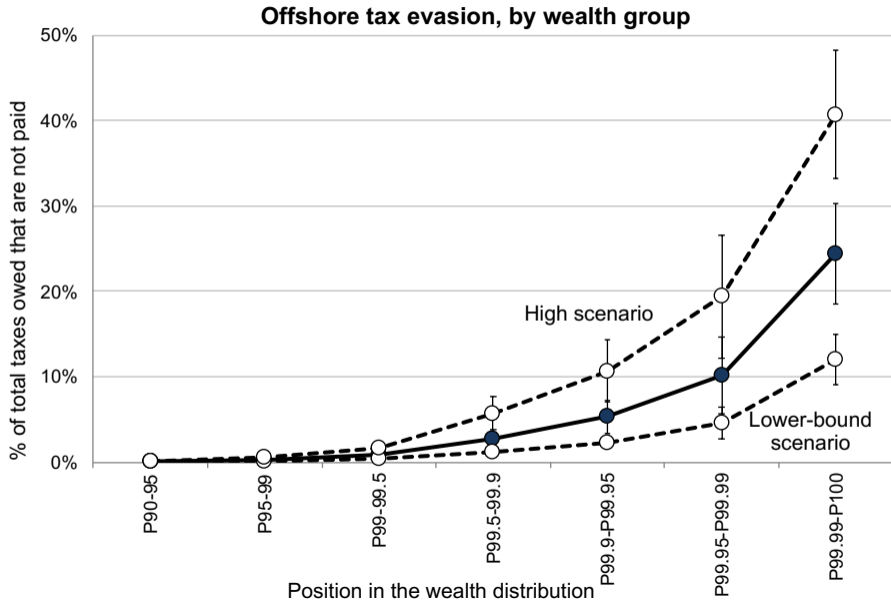
	Offshore wealth (billions USD)	Share of financial wealth held offshore	Tax revenue loss (billions USD)
Europe	2,600	10%	75
USA	1,200	4%	36
Asia	1,300	4%	35
Latin America	700	22%	21
Africa	500	30%	15
Canada	300	9%	6
Russia	200	50%	1
Gulf countries	800	57%	0
<b>Total</b>	<b>7,600</b>	<b>8.0%</b>	<b>190</b>

# HSBC: Extensive margin increasing with wealth

Probability to own an unreported HSBC account, by wealth group  
(HSBC leak)



# A strong concentration of tax evasion at the top



## What has already been done?

- Automatic exchange of information: "Common Reporting Standard", effective since 2017. Financial institutions have to report the identity of their non-resident clients to the tax authorities where they are located, as well as the amount of assets held and income received by these clients.  
⇒ **Limits:** many developing countries still excluded; financial opacity; only fin. assets
- EU Directive CRD IV: EU banks have to disclose their activity on a country-by-country basis.
- Regarding tax avoidance: Arm's length principle in transfer pricing: the price agreed in a transaction between two related parties must be the same as the price agreed in a comparable transaction between two unrelated parties.

## What could be done?

- A global asset register: more systematic registration of financial wealth, this register could be national, European, or global.
- End of bank secrecy



# Offshore Real-Estate in Dubai

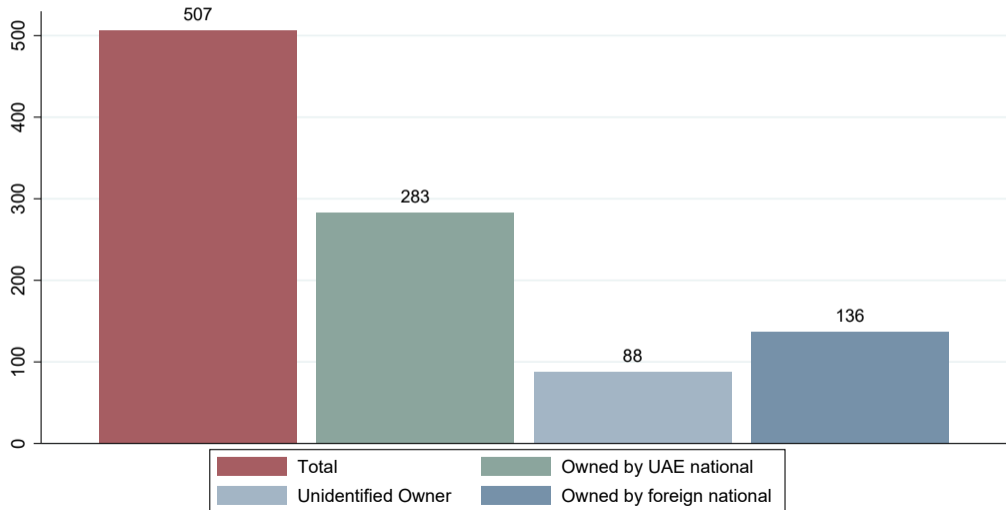
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Offshore real estate not covered by automatic exchange of bank information

How big? What fraction evades taxes?

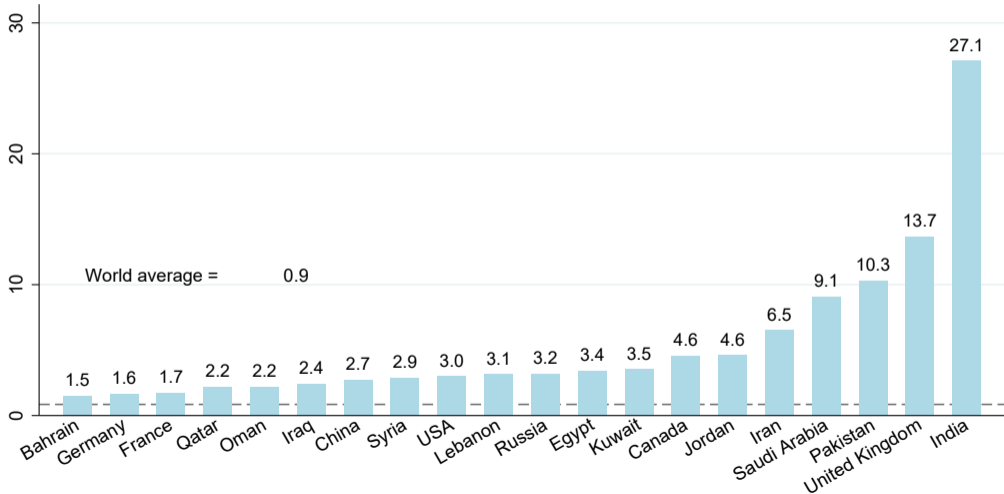
# Offshore real-estate in Dubai is large

## Value of Real Estate in Dubai in 2020 (USD Billion)



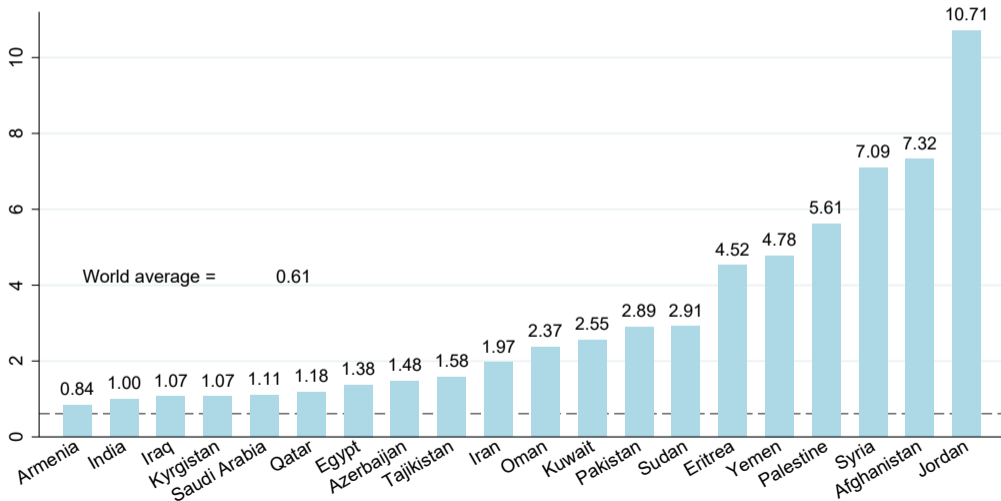
# Geographic and historical ties?

## Real Estate Held in Dubai in 2020: Top 20 Countries

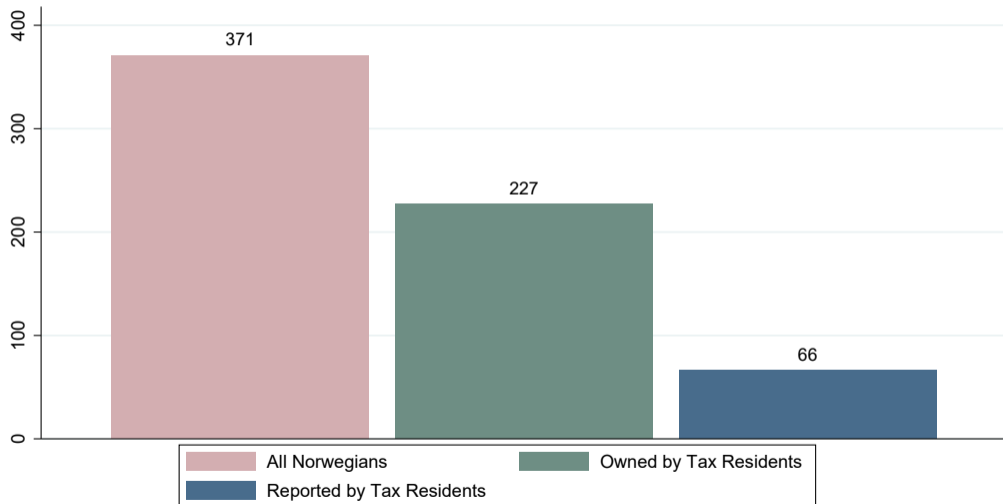


# Highest value/GDP ratio for neighboring and conflict-ridden countries

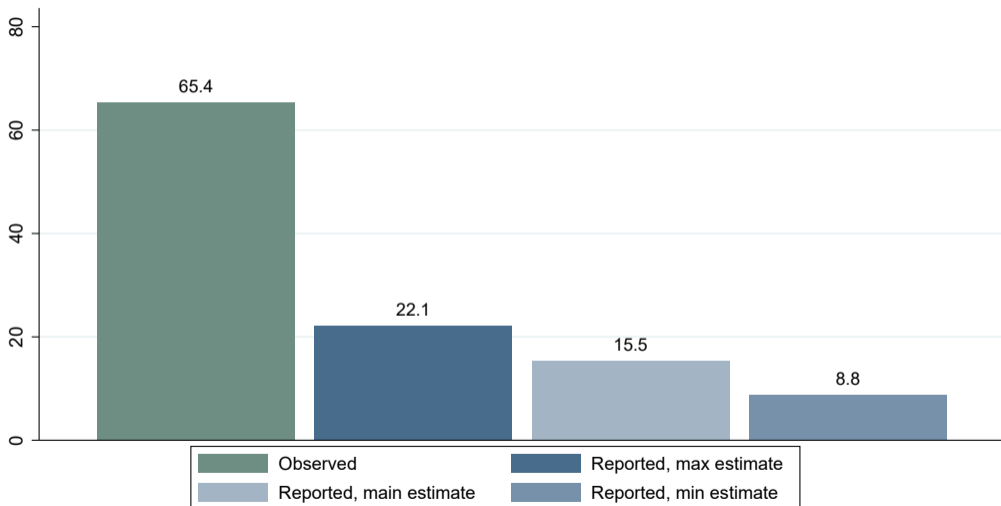
Total Value (% of GDP)



## 70% of unreported properties



# 75% of value not reported



# THANK YOU!

*These slides are available on my website: <https://bluebery-planterose.com/teaching>*