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Offshore Tax Evasion –
How can California help close the gap?

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Last March, Senator Lois Wolk, chair of the Revenue and Taxation Committee, asked the oversight office to explore roles California might play in reining in tax abuse involving foreign tax havens. In her letter, Senator Wolk decried the refusal of UBS to provide the names of thousands of Americans who were using secret Swiss bank accounts to evade federal and state income taxes. She asked if the Legislature could help the federal government by penalizing banks and individuals that use such "offshore secrecy jurisdictions."

In April, President Obama issued a sweeping call for a crackdown on overseas tax havens. His reforms mirror those in the Stop Tax Haven Abuse Act that is now working its way through Congress.

Here is how U.S. Senator Carl Levin, a principal author of the Stop Tax Haven Abuse Act, describes the crux of the problem:

> *Secrecy breeds tax evasion. Tax evasion eats at the fabric of society, not only by starving health care, education and other needed government services of resources, but also by undermining trust – making honest folks feel like they are being taken advantage of when they pay their fair share.*

Meanwhile, California's bruising financial crisis has worsened by the day, further increasing the impetus to close the tax gap. The oversight office's review of federal documents shows that California is in the center of this international storm:

- The GAO reported in December on large U.S. corporations with subsidiaries in jurisdictions listed as foreign tax havens. A quick examination shows several are headquartered in California: Oracle (77 subsidiaries), Cisco Systems (38), Chevron (23), Wells Fargo (18), Hewlett-Packard (14), Intel (6), Disney (3), and Apple (1). http://www.globalpolicy.org/nations/launder/haven/2008/12GAOReport.pdf

- Senator Levin estimates the federal government loses $100 billion each year “from U.S. taxpayers using offshore tax schemes to dodge their U.S. tax obligations.” California taxpayers’ share would be about $11 billion annually, based on our state’s percentage of federal revenues.
- The Permanent Subcommittee on Investigations released a report last summer on tax haven banks. The heart of the report is a series of case studies that demonstrate the machinations millionaire tax evaders and their bankers use to thwart the IRS. Four of the eight cases involve California residents, including Igor Olinicoff, an Orange County billionaire who has admitted to hiding $200 million in assets offshore (as well as the title to a 147-foot yacht). http://hsgac.senate.gov/public/_files/071708PSIReport.pdf
    - Olinicoff is a key figure in the federal case against UBS, the Swiss bank that has refused to release the names of 19,000 Americans with secret bank accounts. UBS has a variety of California connections – including a Web page on the bank’s “Wealth Management US” site titled *Investing in California General Obligation Bonds.* In 2007, UBS opened a Private Wealth Management Office in Los Angeles, aimed at customers with assets greater than $10 million.

This report summarizes ideas the oversight office gathered from experts and from poring over documents from Congressional hearings, federal lawsuits, state tax offices and the IRS, GAO reports, and media accounts. Ideas were also collected from interviews and email exchanges with law professors Joe Bankman at Stanford and Dan Simmons at UC Davis, as well as Brian Putler of the Franchise Tax Board and Ian Pulsipher of the National Conference of State Legislatures.

Especially generous with time and ideas was **Bob Roach**, counsel and investigator for Sen. Levin’s Permanent Subcommittee on Investigations. Among his suggestions:

- California could take the lead among states by enacting some provisions from Levin’s sweeping 2009 Stop Tax Haven Abuse Act (S. 506). (Professor Bankman also suggested this tactic.) Among the possibilities: hefty increases in penalties for violators, codify the economic substance doctrine, and impose sanctions on tax-haven banks and other entities doing business in California. Here’s a link to a summary of the bill: http://levin.senate.gov/newsroom/release.cfm?id=308949
- Also: The Stop Tax Haven Abuse Act’s list of 34 Offshore Secrecy Jurisdictions can give California a handy benchmark for identifying these havens.
- “What you need to do is starve off the enablers – the banks, the accounting firms and the law firms,” Roach said. “You need to establish a regime of penalties large enough to get their attention. For example: If they knowingly facilitate the creation or servicing accounts which have not been properly reported to tax authorities, they will be barred from doing business with the state of California.”
- On another front, the Senate could press the California Secretary of State for a change in the reporting requirements for incorporation. Levin and others want the states to collect the names of the *beneficial owners*, but the secretaries of state have balked at that. (For one thing, states compete with each other for incorporations and don’t want to make the process too onerous.) The lack of

documentation "impedes federal efforts to investigate and prosecute criminal acts such as money laundering, securities fraud and tax evasion." Since the states have failed to comply, in March Levin introduced the Incorporation Transparency and Law Enforcement Assistance Act to require them to collect the information and to provide it to law enforcement under subpoena or court summons.

- The California Senate could publicly endorse the Stop Tax Haven Abuse Act and the Incorporation Transparency Act -- and lobby the state's Congressional delegation to pass them.
- Finally, Roach recommends two staffers at California's Franchise Tax Board who "have the policy experience and the practical day-to-day knowledge to really help you." They are Debra Peterson and Mike Hamersley.

Professor Joe Bankman was intrigued by AB 1178, a bill introduced this year by Assemblyman Marty Block. (Block's office says that AB 1178 is now a two-year bill.) Here's information on that bill:

- According to the FTB's analysis, "This bill would require multinational corporations that elect to file tax returns based only on income earned inside the U.S. (known as the water's edge method) to include the income of related corporations in a tax haven country." If enacted, the analysis projects revenue gains of $130 million in 2010-11 and $160 million in 2011-12. The full analysis: http://www.ftb.ca.gov/law/legis/09_10bills/ab1178_022709.pdf
- The state of Montana enacted a law in 2003 with a similar tax-haven provision. Montana fiscal analysts reckon their state has seen a 5% increase in corporation tax revenue from water's-edge filers. Bankman – who has questions about the FTB's revenue projections -- plans to research how the law is working in Montana and "go deep" with experts at the FTB.
- There are constitutional issues at play here, with opponents arguing that the Foreign Commerce Clause of the U.S. Constitution gives Congress the exclusive right to regulate commerce with foreign nations. Minnesota is considering a measure that is similar to AB 1178. In a letter opposing Minnesota's bill, Joseph R. Crosby of the Council on State Taxation called it "ill-informed and Constitutionally suspect." Perhaps the Legislative Counsel would provide an opinion on this constitutional issue?
- In another letter, this one opposing anti-tax-haven legislation in West Virginia, Crosby said: "Just based on constitutional principles, state revenue directors shouldn't have the authority to declare a foreign country a tax haven."

Professor Bankman recommended several top **legal experts** who could provide insights to the Rev and Tax Committee about possible roles for California in the fight against offshore tax evasion:

- One is Reuven S. Avi-Yonah, a University of Michigan law professor – and a star expert for Senator Levin. Bankman says he is an advocate for cracking down on foreign tax havens. Email: Aviyonah@UMich.edu Bio: http://cgi2.www.law.umich.edu/_FacultyBioPage/facultybiopagenew.asp?ID=29

- Another, the polar opposite politically, is Jim Hines. Email: JRHines@UMICH.edu) Bio: http://cgi2.www.law.umich.edu/_FacultyBioPage/facultybiopagenew.asp?ID=337
- A third, not a professor, is lawyer Prentiss Willson. Email: p.willson@yahoo.com Bio: http://www.nccusl.org/Update/Docs/UDITPA/Willson%20CV.pdf

The **Franchise Tax Board's Brian Putler** collected some thoughts from experts there, including Debra Peterson – one of the experts Roach also suggested. Here's a summary of ideas from the FTB:

- On the question of penalizing foreign banks that refuse to provide information on tax evasion (such as Switzerland's UBS): Peterson cautioned that there may be a federal preemption issue if the bank is federally chartered.
- She asked how the state would penalize a bank without knowing how many secret accounts were not disclosed. "Perhaps we could build something into the statute regarding subpoenas and court enforcement," she said.
- Another FTB expert, John Pavalasky, noted that the board's auditors already use IRS contacts to develop leads and are discussing whether to include offshore accounts in any new amnesty program offered to taxpayers.

In addition, several documents on the **Franchise Tax Board's website** -- http://www.ftb.ca.gov/ -- describe programs and processes for stemming offshore tax evasion. These documents raise questions. Legislators might want to ask the FTB about the outcomes of the following initiatives:

- Under 2005 legislation, the FTB identified strategies for reducing the state's tax gap. An FTB update in December of that year said: "California is an integral player in creating the tools and techniques state governments can use to address the use of offshore financial arrangements and offshore entities to underreport or simply evade income taxes." The FTB's stated objective was to evaluate non-traditional approaches, including test cases, applicability of penalties, and addressing the enablers. *Question: What is the result?*
- In August 2005, an FTB staff report offered suggestions from Jack Blum, "a noted expert" in the field of tracking offshore assets. Blum suggested the FTB should develop a database for tracking the financial activities of likely tax evaders – particularly the very wealthy. Things to look for, he said, are homeowners with mortgages from an offshore bank, yachts stored in California but registered offshore, and corporate filings that reveal the names of those who sell businesses or corporations. *Question: Has such a database been developed?*
- In September 2008, FTB's "Tax News" newsletter noted that tax haven countries can be used to divert untaxed income and conceal assets, evade taxes or launder money, and generate bogus expenses. The article asked for names of taxpayers who enage in these unlawful arrangements. *Question: How effective was this effort?*

In conclusion, here is another quote from Senator Levin. This one, from a March 4 statement, on the issue that initially caught Senator Wolk's attention:

> *Out of the 52,000 UBS account relationships and estimated 19,000 U.S. clients, guess how many U.S. clients the Swiss have determined can be provided us under the tax treaties? Twelve*.

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Experts interviewed for this report:

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- Ian Pulsipher, National Conference of State Legislatures. Ian.Pulsipher@ncsl.org
- Brian Putler, Franchise Tax Board legislative liaison. Brian.Putler@ftb.ca.gov
- Bob Roach, counsel for US Senate Permanent Subcommittee on Investigations. Bob_Roach@hsgac.senate.gov
- Professor Daniel L. Simmons, UC Davis Law School. dlsimmons@ucdavis.edu