Countering Offshore Tax Evasion: A Comparative Look at Initiatives by the United States, Canada, the United Kingdom and Japan

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Abstract

This paper provides a comparative review and analysis of anti-avoidance initiatives the United States, Canada, the United Kingdom and Japan have implemented to counter offshore tax avoidance and evasion schemes employed by multinational entities and individual taxpayers. Increased globalization and the ease of conducting international business and financial transactions have created opportunities for a plethora of tax loopholes that incentivize cross-border tax-evasive strategies that have become commonplace in the international landscape. Governments worldwide have turned their attentions to the idea of systemic tax reforms or, minimally, implementation of targeted anti-avoidance measures anticipated to curtail cross-border tax avoidance evident among the relevant groups of taxpayers. A main objective is to control expansion of their tax-gaps. Beyond identifying adopted anti-avoidance measures, the purpose of this comparative review and analysis is to survey the effectiveness of these initiatives and to offer observations as to limitations and recommendations. As the U.S. looks toward major international tax reform to reduce revenue loss attributable to foreign tax avoidance and evasion, it can benefit from observing the outcomes of tax policy and other tax reform measures Canada, the United Kingdom and Japan have implemented.

Keywords: Tax gap, tax avoidance, tax evasion, territorial tax system, tax havens, tax loopholes

1. Introduction

The Tax Justice Network (TJN) (2012) has reported that "$21 - $32 trillion as of 2010 of global private financial wealth … has been invested in offshore secrecy jurisdictions" (p. 5). The top 50 international private banks "collectively managed $12.1 trillion in cross-border invested assets from private clients, including trusts and foundations" (TJN, 2012, p. 8). The estimated aggregate loss to tax authorities worldwide is $255 billion (Neslund, 2009). For the United States, the estimated revenue loss from profit shifting by businesses is in the range of $10 billion to $60 billion per year; and the estimated revenue lost from individual evasion is between $40 billion to $70 billion (Gravelle, 2013). The pervasiveness of offshore tax avoidance/evasion schemes has, for the U.S. and other developed nations, been the impetus for several anti-avoidance initiatives undertaken. These initiatives have gained increased importance, particularly in light of the adverse fiscal ramifications of the great recession and the resulting urgency for countries to fully restore their respective economies.

Indeed, increased globalization and the ease of conducting international business and financial transactions are conducive to cross-border tax evasion practices. The sustainability of tax evasion strategies has been advantaged by the fact that elements inherent to the global landscape hinders tax authorities' ability to determine taxpayers' liability and poses collection difficulties. In particular, tax evaders have long depended on the existence of barriers to intergovernmental exchange of information and privacy protections strict secrecy law countries provide. Disparities in tax law regimes between international jurisdictions further incentivize cross-border tax avoidance behaviors. Fundamentally, tax avoidance maneuvers seek to leverage inter-jurisdictional differentials in effective tax rates, rules pertaining to tax deferrals and deduction, and, broadly, rules of territorialism versus worldwide regimes.

Examples include shifting income from high-tax jurisdictions to low-tax ones; establishing overseas tax shelters; maintenance of fictitious foreign subsidiaries to facilitate offshore investment of capital to indefinitely avoid profit repatriation to high-tax home countries; or even maintenance of legal foreign subsidiaries coupled with reaping benefits of legitimate tax loopholes of home-country rules (such as those that permit tax deferral and non-apportionment of deductions). Tax deferral rules cause deferral of imposition of home-county tax on unrepatriated foreign subsidiary earnings. Non-apportionment rules permit a home-country's taxpayer to deduct certain expenses against home-country sourced income without disallowing the portion of such expense allocable to foreign subsidiary profits that have not been repatriated to the home-country.

Desiring to counter cross-border tax avoidance evident among the relevant groups of taxpayers, governments worldwide have turned their attentions to the idea of systemic tax reforms or, minimally, implementation of targeted anti-tax-avoidance measures anticipated to thwart specific cross-jurisdictional income shifting practices commonly practiced by the relevant groups of taxpayers (Slemrod, 2009). A principal objective is to control expansion of the tax gap. This paper provides a comparative review and analysis of anti-avoidance initiatives the United States, Canada, the United Kingdom and Japan have implemented to counter offshore tax avoidance and evasion schemes employed by multinational entities and individual taxpayers. In addition to identifying adopted anti-avoidance measures, the purpose of this comparative review and analysis is to survey the effectiveness of these initiatives and to offer observations as to limitations and recommendations in response to those limitations.

This paper proceeds in the following order. The section immediately below provides fundamental overviews of the tax systems of the United States, Canada, the United Kingdom and Japan. The next section discusses the various anti-avoidance initiatives these countries have adopted, with emphasis on the United State's FATCA legislation and intergovernmental Tax Information Exchange Agreements (TIEAs). FATCA and TIEAs stand center-stage among the actions that member countries of the Organization for Economic Cooperation and Development (OECD) and several others have taken to effect and enforce compliance with inter-governmental information exchanges standards and, thus, facilitate collection of foreign bank account and investment information. Subsequent sections discuss the effectiveness of these initiatives, followed by observations of limitations and, later, suggested responses to these limitations.

2. Tax Regimes of the United States, Canada, the United Kingdom and Japan

Tax regimes of governments worldwide rest on one of two distinct methods for taxing the domestic and foreign earnings of corporations and individuals: the territorial system or the worldwide tax system. Countries using the territorial system tax only income earned within their borders. This territorialism design generally exempts from home-country taxes dividends from foreign affiliates (PWC, 2013). These exemptions are augmented by those derived from tax treaties (PWC, 2013). In addition, many OECD countries with territorial systems permit exemptions on active income from foreign operations conducted directly by domestic companies through foreign branches (PWC, 2013). Under the worldwide tax system, a home country generally impose tax on all the income of its multinational corporations and individuals, regardless of whether such earnings were sourced within or outside territorial borders (Internal Revenue Service, 2012). However, double-taxation of income is prevented through the application of foreign tax credit provisions.

The prominence of territorial systems represented among the 34 countries that comprise the membership of the OECD indicates an indisputable trend toward adaptation of territorialism. By 2000, 17 (50%) of the 34 OECD member countries had adopted the territorial tax system. Today, a total of 28 (82%) OECD members now employ the territorial system (PWC, 2013). These countries include Canada, the U.K., and Japan. The U.S. (along with Chile, Ireland, Israel, Korea and Mexico) continues to implement the worldwide system. Figure 1 (Combined Corporation Income Tax Rates (2013): Comparison of OECD Countries) identifies all OECD members and their corresponding tax systems. The "T" and "WW" designations following each country name indicates a country's use of either the territorial system or worldwide system, respectively.

2.1 United States

Section 61 of the U.S. Internal Revenue Code (Code) articulates the U.S.'s worldwide tax system. It states that all income of U.S. taxpayers "from whatever source derived" is subject to U.S. tax, with the exception of income items the Code specifically exempts from tax (26 U.S.C. Sec. 61). The Code defines the term "income" broadly to include all types of income not specifically excepted.

One of the major income exemption rules can be said to have set the stage for U.S. fiscal avoidance and evasion by U.S. taxpayers. Under Sections 11(d) and 882 of the Code, the income of foreign corporations is not subject to tax, irrespective of whether ownership is wholly or primarily held by U.S. taxpayers (26 U.S.C. Sec. 61; 26 U.S.C. Sec. 882). Smiley (2011) suggests that this policy is pivotal to tax-dodging strategies U.S. corporations (except banks and insurance companies) employ to operate overseas through foreign subsidiaries. This is because income from such foreign subsidiaries is not subject to U.S. tax until repatriated by way of dividends to U.S. shareholders. This opportunity of indefinite deferral of U.S. taxation on unrepatriated income inherently induces manipulated deferrals based principally on tax avoidance or evasion motives, rather than substantive economic or business objectives.

Another driver of tax avoidance and taxpayers' evasive behaviors is a home-country's high-tax rates. The U.S.'s combined corporate income tax rate of 39.1% (Figure 1) provides incentive for multinational corporations to avoid repatriation of earnings to the U.S. The 39.1% represents the statutory rate of 35%, net of adjustments, plus the weighted average state corporate marginal income tax rate (Table 1 – Corporate Tax Rates: A Global Comparison of OECD Countries). Moreover, this comparatively high tax rate encourages tax evaders/avoiders to establish artificial foreign corporations and non-substantive tax shelters in low-tax jurisdiction, as well as engage in other methods of shifting income to these jurisdictions. Review of corporate tax rates in Figure 1 and Table 1 reveals that the U.S. is the only developed country with a worldwide system *and* a tax rate above 25%. Its combined statutory corporate tax rate (39.1%) is 14% higher than the average statutory rate of 25.1% for all other OECD members. Over the last two decades, corporate statutory rates of non-US OECD countries have trended downward – in some cases from 50% – while the U.S. rate has remained steady (Mucenski-Keck, 2012). Notably, Ireland boasts the lowest combined corporate income tax rate of only 12.5% (Figure 1 and Table 1)

The extent of U.S. corporations' aggressiveness and persistence toward tax avoidance and evasion endeavors is evidenced by their ability to lower their effective tax rate to near-negligible levels. The United States Government Accountability Office (2008) reported that "the average U.S. effective tax rate on [2004] foreign-source income of … large corporation was around 4 percent…" (p.14). The tremendous gap between this 4% effective rate and the 35% basic statutory rate (Table 1) brings perspective to the magnitude of revenue loss governments suffer. Also, it contextualizes the cross-border tax avoidance/evasion concerns and the critical role of anti-avoidance measures.

2.2 Canada

Canada's territorial tax system is essentially hybrid in nature. Effective 1976, the government adopted foreign affiliate rules, the modified version of which continues to apply today (Tax Foundation, 2012b). The system applies a combined exemption/credit mechanism to dividends from foreign affiliates and FAPI (Foreign Accrual Property Income) to prevent deferral of Canadian tax on passive income through the use of tax havens (Slaats & Woolford, 2010). Importantly, the hybrid tax system effectively alleviates double taxation on active foreign income. Dividend exemptions apply only to dividends derived from active business income earned by affiliates situated in countries with which Canada has treaty agreements (Tax Foundation, 2012b). By contrast, dividends sourced in non-treaty countries are eligible for credits for withholding tax and foreign tax paid on the associated earnings (Tax Foundation, 2012b). The passive income derived from controlled foreign corporations (CFCs) is taxed to Canadian shareholders on a current basis, mirroring U.S. rules. Canada's 91-country treaty network causes its tax system to effectively operate as a territorial one. Its central government corporate income tax rate stands at 15% (OECD, Basic (non-targeted) corporate income tax rate). However, the combined corporate tax rate is 26.1%, which include the sub-central government's corporate income tax rate of 11.3% (Figure 1 and Table 1).

As the U.S. contemplates restructuring of its international tax laws, Canada's tax system is a model to study closely, particularly for purposes of gaining insight on economic and tax revenue ramification Canada experienced during post-reform years. Slaats and Woolford (2010) observed that many consider Canada's international tax system one of the better tax regimes in effect, causing other countries to draw on certain aspects of Canada's tax rules as they contemplate reforms of their respective international tax systems. Canada is reported to have experienced improved economic performance after adoption of a competitive tax rate of 26.1% (Figure 1 and Table 1) within its territorial regime (Tax Foundation, 2012b).

2.3 United Kingdom

Until very recently, the United Kingdom's international tax system resembled that of the U.S. model. The government's aim to bolster competitiveness, mitigate compliance costs and strengthen anti-avoidance measures of the prior system motivated its adoption, in 2009, of a territorial system (Budget 2011: Chancellor George Osborne's Speech, 2011). As reformed, the U.K. system allows full exemption for various categories of foreign source dividends and permits domestic tax deductions for foreign-source expense, paralleling the majority of other territorial systems. Prominent anti-avoidance provisions include limits on the deductibility of excessive interest payments (i.e., application of "thin capitalization rules," relative to controlled foreign affiliates located in low-tax jurisdictions, where effective tax rates are lower than 75% of comparable U.K. liability), and regulations which impose tax on diverted intellectual property income (Tax Foundation, 2012a).

The U.K. has established a competitive and comprehensive regime that is favorable to the development and exploitation of international property (IP) (UK Trade & Investment (UKTI), 2013). The policy objective is to guard against migration of intangible property to foreign jurisdictions and, at the same time, induce an influx of IP development and exploitation activity to the U.K. (UKTI, 2013). The "patent box" regime assists this goal by lowering the costs of IP exploitation. It applies a preferential 10% tax rate to intangible property royalties and income on sale of on qualifying patents (UKTI, 2013). This tax relief also applies to profits on the sale of products that incorporate a patented invention (UKTI, 2013).

Although the U.K. tax system, by comparison to others, already treats foreign income favorably, the government has expressed plans to restrict controlled foreign company rules so that they extend only to profits determined to have been artificially diverted from the U.K. (Tax Foundation, 2012a). The U.K.'s combined corporate income tax rate is currently 23% (Figure 1 and Table 1). Her Majesty Revenue and Customs (HMRC) has announced plans to lower the tax rate to 21% in April 2014, and further to 20% in April 2015 (UKTI, 2013).

2.4 Japan

For approximately the last 50 years, Japan's international tax system paralleled that of the U.S., primarily because it had been modeled after the U.S. tax system. Accordingly, Japan formerly imposed corporate tax on worldwide income, including dividends received from foreign subsidiaries, with the availability of a foreign tax credit to avoid double taxation. In April 2009, Japan adopted a territorial tax regime with the inclusion of a dividend exemption systems and the simultaneous repeal of the indirect foreign tax credit system. The government's desire to stimulate repatriation of profits from foreign subsidiaries for use in fueling much needed revitalization of the Japanese economy, as well as its determination to enhance Japanese firms' competitiveness, strongly motivated Japan's tax reform (How Other Countries, 2011). Japan's international tax system permits a 95% exemption for foreign-source dividends and allows deductions of necessary and reasonable expenses attributable to foreign income on home country taxes (Joint Committee on Taxation, 2011). Rigorous transfer pricing documentation requirements were enacted to deter income shifting and consequently prevent corporate tax base erosion (How Other Countries, 2011). Dividend exemption privileges are denied in cases where controlled foreign corporations (CFCs) enjoy effective tax rates of less than 20% and CFCs are unable to produce evidence of active engagement in business. Similar to the U.K., "thin capitalization rule" apply to curtail acquisition of excessive debt on behalf of foreign affiliates, to prevent deductibility of interest on tax-exempt foreign earnings (Joint Committee on Taxation, 2011). Lowered from 40.7%, Japan's combined corporate tax rate is currently 37%, inclusive of the sub-central government's corporate income tax rate of 10.8%. (Figure 1 and Table 1).

3. Comparison of Anti-avoidance Legislation

3.1 International Tax Reforms: Anti-avoidance Provisions

Canada, the U.K. and Japan's international tax reform legislations each integrate anti-avoidance measures that purposefully negate tax benefits tax avoiders and evaders have systematically achieved under the former legislations. These new provisions, which seemingly rest on a type of "economic substance over form" theory, operate to counter taxpayers' persistent and intentional frustration of legislative purpose, customarily achieved through purely artificial transactions, aimed at capturing tax benefits, despite known contradictions to the spirit and intent of tax legislation. As the U.S. deliberates proposals of comprehensive international tax reforms, close consideration should be given to several provisions, as summarized below, reflected in Canada, U.K. and Japan's current legislations.

Even with respect to those measures U.S. legislators are now considering, benefits can be gained from observing the provisions in practical contexts as they operate within these other economies.

Canada's new thin capitalization rules are more rigorous than the former ones. Thin capitalization (usually termed "earnings stripping" in the U.S.) rules attempt to foil inter-company transfer-pricing arrangements that strategically burden one related party (usually in high-tax jurisdiction) with excessive debt borrowed from a related party (usually in low-tax jurisdiction). Generally, thin capitalization provides a net tax benefit only if the foreign recipient of the interest income incurs a lower amount of foreign tax on the income compared to the net value of the deduction of interest. Each country has established a debt-to-income benchmark for determining whether an entity is thinly capitalized. Tax laws limit the deductibility of interest for companies with debt-to-income ratios that exceed the prescribed threshold. Canada's revised rules lowered the debt-to-income threshold to 1.5:1 from 2:1. This new debt-to-income threshold aligns with that of the U.S., and is comparatively more restrictive than Japan's 3:1 ratio. Additional modification of Canada's thin capitalization rules include: the extension of thin capitalization to partnership debts (i.e., those debts that a partnership (with a resident partner) owes to specified non-residents); and the treatment of deemed dividends as interest expense. These latter two additions to Canada's thin capitalization regime are ones the U.S. might consider when strengthening "earnings stripping" rules. These new rules should be effective in closing additional loopholes, as they help prevent revenue base erosion.

The U.K.'s "patent box" regime, which applies a favorable 10% tax rate to intangible property (IP) income, is an important tax policy for inducing companies to retain IP within the U.K. An additional benefit to retention of IP within the jurisdiction is that IP income would be sourced domestically, rather than overseas. In addition, the "patent box" regime would be an incentive for non-domestic companies to transfer IP asset into the U.S. and invest in the development of such assets in the U.S. Neither the U.S., Canada nor Japan have legislated "patent" box regimes. While, the advantages of a "patent box" regime are many, and adoption may likely support U.S. tax policy, application of the regime in the various countries should first be closely examined for determining implementation details and cost-benefit factors.

The stricter transfer pricing documentation rules Japan introduced should be effective in combating income shifting. This forthright approach of denying dividend exemption privileges to CFCs with below-20% effective tax rates and who cannot prove the legitimacy of their business operations would cancel the tax benefits of most evasive transfer-pricing income shifting transactions. The differential between the 20% benchmark and Japan's 37% tax rate (Figure 1) is important to achieving the deterrence effect intended by anti-shifting rule. A U.S. counterpart to this U.K. provision pursues the same objective, but with lower tax rate benchmarks. The U.S proposed legislation to tax certain excess income derived from transfer-pricing "if a U.S. person transfers (directly or indirectly) an intangible from the United States to a related CFC." If the CFC's effective tax rate is 10% or less, all of the excess income would be taxed. For cases of effective tax rates of 10 to 15%, a ratable phase-out would apply. The U.S. might, instead, consider mirroring the more direct and simpler formula of the Japan provision. With adoption of this formula, the U.S. should also consider raising the tax rate benchmark(s) to narrow the differential between the benchmark(s) and the statutory corporate income tax rate applicable to the corporation in question or, in the case of a more restrictive approach to the rule, the top statutory corporate income tax rate (39.1%) in effect. Notably, Japan's rate gap is 17%, compared to the U.S. rate gap, which ranges from 24.1 – 29.1%. The deterrence effect of this policy should increase as the rate gap narrows.

3.2 Transparency and Intergovernmental Exchange of Information Measures

Governments concede that achievement of meaningful progress in the battle against cross-border tax avoidance and evasion demands heightened transparency and coordinated intergovernmental effort. Just as globalization has eliminated boundaries to cross-border investment and commercial activities, barriers to transparency should likewise vanish. Over the past several years, the U.S., Canada, the U.K. and Japan – as well as many other countries – have implemented many intergovernmental-based exchange initiatives focused on achieving transparency. Following are brief discussions of these initiatives, which include: The Joint International Tax Shelter Information Centre (JITSIC); Disclosure of Tax Avoidance Schemes (DPTAS) regime, the Foreign Account Tax Compliance Act (FACTA), and Tax Information Agreements (TIEAs). JITSIC is an anti-tax abuse alliance initiated in 2006 by the U.S. Internal Revenue Service, in coordination with the tax agencies of the U.K., Canada and Australia. China, Japan, and South Korea have since joined JITSIC (Australian Tax Office, 2007).

Pursuant to a signed Memorandum of Understanding, these agencies collaborate and exchange multiple facets of support pertaining to their mutual goal of "identifying and curbing abusive tax avoidance transaction, arrangements, and schemes" (IRS, 2007). JITSIC members have effectively challenged artificial transactions, and these efforts have, for example, enabled prevention of $100,000,000 in revenue loss for a particular category of schemes (IRS, 2007). Its purpose seems to be narrower in focus, when viewed in light of the far-reaching and more impactful approaches of FACTA and TIEAs.

The Disclosure of Tax Avoidance Schemes (DOTAS) regime is a U.K. legislation that supports the tax authority's objective to proactively obtain information about tax avoidance schemes and immediately respond to loopholes discovered with corrective legislative action (HM Revenue & Customs (HMRC), (n.d.)). Enacted January 2011, DOTAS requires tax avoidance reporters to disclose information about the promoted scheme, as well as information that identified the promoter. Harsh penalties are assessed for failure to comply with DOTAS. The information gathered under DOTAS assists the U.K. in spotting, early on, the need for legislative revisions. Thus far, DOTAS has helped avert the loss of billions of pounds (HMRC, n.d.).

The U.S.-legislated Foreign Account Tax Compliance Act (FATCA) has played a pivotal role in the global movement toward transparency and governments' shared goal of curtailing tax base erosion and revenue loss. The provisions of FATCA were enacted in March 2010 under the umbrella of the Hiring Incentives to Restore Employment (HIRE) Act (HIRE Act, 2010). FATCA provisions hinder U.S. taxpayers' efforts to conceal income and assets overseas. These rules impose new disclosure requirements on U.S. taxpayers who own foreign financial accounts and other assets, as well as new tax withholding requirements. The law requires foreign financial institutions (FFI) to report information about U.S. taxpayers' bank account ownership and any substantial ownership interest in foreign entities. FFIs that enter into an agreement with the U.S. Internal Revenue Service to report on their account holders could be required to withhold 30% on certain payments to foreign payees if such payees do not comply with FATCA (Internal Revenue Service, FATCA information for U.S. financial institutions and entities).

Because implementation of FATCA calls for inter-governmental information exchange, reliance on provisions of tax treaty exchange articles and, more recently, bilateral and multilateral Tax Information Exchange Agreements (TIEAs, or IGA) became necessary to support FATCA objectives. Treaty articles and TIEAs both require disclosure of banking and financial information. Through the collaborative efforts of the U.S. and other governments, two model TIEAs were developed to implement FATCA. Under the TIEAs, partner governments agree to require all non-exempt foreign financial institutions (FFIs) within its jurisdiction to identify U.S. accounts and report information about U.S. accounts. Although both Model 1 and Model 2 TIEAs can be implemented in the absence of a double tax convention or a tax information exchange agreement with the U.S., signed TIEAs with partner jurisdictions are crucial to effective and efficient implementation of FATCA. Importantly, they eliminate the obstructions domestic laws pose to compliance (e.g., non-disclosure rules). As a result, they reduce burdens on FFIs located in partner jurisdictions (IRS, FATCA Information for governments.)

4. Observations

Not surprisingly, limitations accompanied early-stage implementation of FATCA. These included FFIs' resistance to becoming qualified intermediaries (a FATCA requirement); the impediment of domestic laws which prohibited information disclosure, making FATCA and TIEAs void of effect; and the existence of a lengthy roster of tax haven jurisdictions, many of which strictly enforced secrecy laws. While some of these limitations continue, substantial mitigation of many has occurred. Since FATCA's enactment more than three years ago, countries worldwide have come to recognize and accept the irreversible and impactful force of this legislation.

Moreover, there is substantial evidence indicating that the FATCA/TIEA push has been effective in causing a significant global transition towards transparency and intergovernmental coordination. First, 700 OECD model bilateral and multilateral TIEAs have been signed to date (Gravelle, 2013). Along these lines, a model enhanced automatic exchange agreement, based on FATCA, has been developed, and in September 2012, the U.K. became the first jurisdiction to sign such an agreement. Since then, the U.S. has concluded more of these agreements, and it is now in negotiations with over 75 jurisdictions (HMRC, 2013).

Second, a drop in the number of uncooperative tax havens is noted, as these jurisdictions are increasingly implementing the internationally agreed tax standard (Table 2).

This is a transparency standard under which countries commit to exchange of information on all tax matters in support of administration and enforcement goals of domestic tax laws and agree to disregard, for example, domestic tax secrecy for tax purposes. Further explanation is included in footnote 1 of Table 2 (Progress Report on Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard). It is significant that 42 of the 92 countries named in this 2012 report (Table 2) have been included on the OECD Tax Haven List. This indicates a meaningful trend toward compliance with FATCA/TIEAs objectives and increased cases of secrecy law abandonment. The eradication of secrecy laws is important, given that they are capable of altogether impeding enforcement of TIEAs. Third, the above two points of evidence suggest that the FATCA/TIEA movement is irreversible.

While the anti-avoidance measures reviewed play an important role in the effort to thwart off-shore tax avoidance and evasion through income shifting and other maneuvers, there is an inherent weakness in the FACA/TIEAs system of approach. In particular, even though there has been dramatic global movement, the existence of even a few non-compliant tax-haven countries pose a critical threat to anti-avoidance progress attributable to inter-country collaborative efforts toward information-exchange and transparency. Metaphorically, such tax havens represent holes in the network of FATA/TIEA system and other anti-avoidance initiatives. Countries that continue to uphold strict bank secrecy laws are likely to attract offshore investors who had formerly invested in jurisdictions that have abandoned secrecy laws and have embraced the transparency and coordination movement (Leikvang, 2012). The threat of tax-haven hold-outs necessitates continued strengthening of anti-avoidance initiatives through cooperative and uniformed efforts across international jurisdictions. Still, the current network of anti-avoidance initiatives must be complemented by adaptation of comprehensive reforms of U.S. tax regime that enhances the nation's competitiveness. This is important to significant success in curtailing leakage of tax revenues to off-shore jurisdictions. The pairing of such tax reforms with the anti-avoidance initiatives targeted at illegal offshore tax avoidance schemes would help to close loopholes.

It is well known that tax rate differentials between countries influence tax and investment decisions of taxpayers who desire to engage in cross-border transactions to minimize or escape income tax. De Silva (2011) offers that tax avoidance is made possible by the existence of three key conditions: (1) a difference between the effective marginal tax rates imposed by taxing jurisdictions on economic income; (2) a taxpayer's ability to take advantage of the differential in tax rates by causing high-tax activity to be treated for tax purposes as low-tax activity; and (3) the ability of the high-rate taxpayer to receive income in a low-tax form, thus causing income to fall within low-tax income categories. Based on this reality, anti-avoidance efforts would be further enhanced by cross-country harmonization of principal tax policies. This is not to say that tax policies across jurisdictions should align in perfect congruence, but instead that they should more closely align than they are today. This should reduce the impetus for income shifting. Absence of harmonization creates loophole opportunities for taxpayers who persist on engaging in income shifting. For the U.S., considerations for harmonization efforts would potentially include the adoption of a territorial tax system in place of its current world-wide tax system. In addition to bringing the U.S. system more in line with tax systems of its international trading partners, a territorial tax system may likely cause reduction in cross-border income shifting.

5. Conclusion

While the current intergovernmental transparency and anti-avoidance efforts against cross-border transaction are forming an undeniable stronghold in the global landscape and significant progress has been noted in regards to mitigation of anti-avoidance factors, for the U.S., comprehensive international tax reforms still remains urgent (Department of the Treasury, 2012). As long as the U.S. continues in its status as the only developing country with a worldwide tax system and a corporate tax rate of above 25%, U.S. taxpayers will remain motivated to practice income-shifting tactics. Also, although a seismic shift of tax havens away for secrecy and toward commitment to upholding transparency standards has been noted, the existence of only a few non-cooperative jurisdictions increases vulnerability for any jurisdiction with unfavorable tax regimes. History has shown, for example, that despite U.S. tax law amendments to include anti-avoidance legislations, taxpayers have continued to devise new schemes to defer U.S. income tax on their foreign earnings (Smiley, 2011). In this light, it appears that the U.S.'s adoption of a territorial system and lower corporate and individual rates is inevitable. In addition to bringing the U.S. tax system more in line with tax systems of international trading partners, the conversion is important to closing the U.S. tax gap attributable to off-shore tax avoidance/evasion, as well as to enhance global competitiveness.

As the U.S. formulates comprehensive international tax reforms, it can benefit from observing the outcomes of tax policy and other tax reform measures Canada, the United Kingdom and Japan have implemented.

Figure 1. Combined Corporation Income Tax Rates (2013): Comparison of OECD Countries

(Based on Table 1 data) (T= Territorial Tax System; WW= Worldwide Tax System)

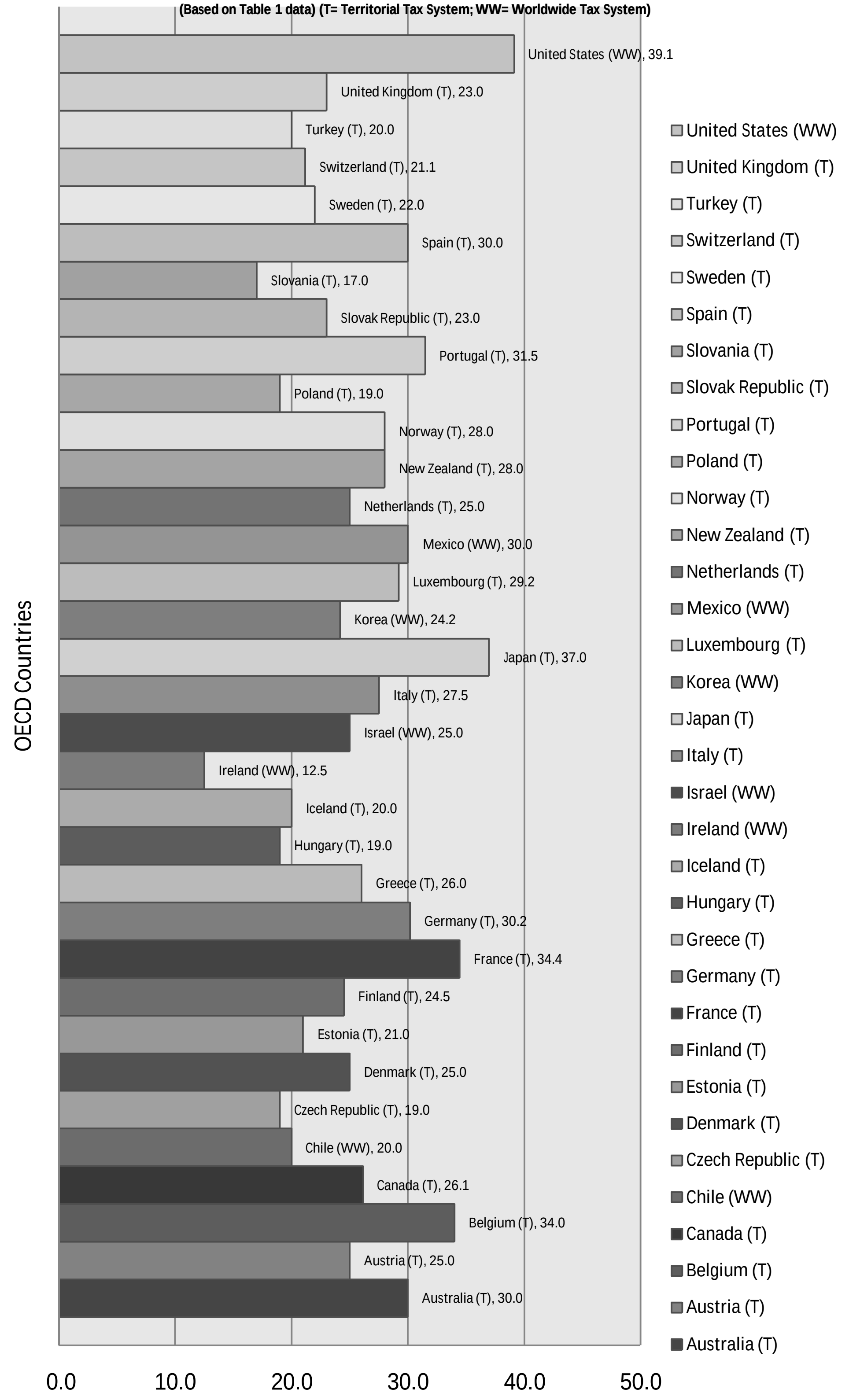

Table 1: Corporate Tax Rates: A Global Comparison of OECD Countries[1]

	Country	Tax System (T=Territorial; W=Worldwide)	Central government corporate income tax rate (2013)[2]	Adjusted central government corporate income tax rate[3]	Sub-central government corporate income tax rate[4]	Combined corporate income tax rates (2013)[5]
1	Australia*	T	30.0	30.0		30.0
2	Austria	T	25.0	25.0		25.0
3	Belgium*	T	33.99(33.0)	34.0		34.0
4	**CANADA**	**T**	**15.0**	**15.0**	**11.3**	**26.1**
5	Chile*	WW	20.0	20.0		20.0
6	Czech Republic	T	19.0	19.0		19.0
7	Denmark	T	25.0	25.0		25.0
8	Estonia*	T	21.0	21.0		21.0
9	Finland	T	24.5	24.5		24.5
10	France*	T	34.4	34.4		34.4
11	Germany*	T	15,825(15,0)	15,825	14.4	30.2
12	Greece	T	26.0	26.0		26.0
13	Hungary*	T	19.0	19.0		19.0
14	Iceland*	T	20.0	20.0		20.0
15	Ireland	WW	12.5	12.5		12.5
16	Israel*	WW	25.0	25.0		25.0
17	Italy*	T	27.5	27.5		27.5
18	**JAPAN***	T	**28.05 (25.5)**	**26.2**	**10.8**	**37.0**
19	Korea	WW	22.00	22.0	2.2	24.2
20	Luxembourg*	T	22,47(21,0)	22.5	6.8	29.2
21	Mexico	WW	30.0	30.0		30.0
22	Netherlands*	T	25.0	25.0		25.0
23	New Zealand*	T	28.0	28.0		28.0
24	Norway	T	28.0	28.0		28.0
25	Poland*	T	19.0	19.0		19.0
26	Portugal*	T	25.0	30.0	1.5	31.5
27	Slovak Republic	T	23.0	23.0		23.0
28	Slovania	T	17.0	17.0		17.0
29	Spain	T	30.0	30.0		30.0
30	Sweden	T	22.0	22.0		22.0
31	Switzerland*	T	8.5	6.7	14.4	21.1
32	Turkey	T	20.0	20.0		20.0
33	**UNITED KINGDOM***	**T**	**23.0**	**23.0**		**23.0**
34	**UNITED STATES***	**WW**	**35.0**	**32.8**	**6.3**	**39.1**

*** -** Country specific footnotes (see OECD-prepared footnotes for this table at www.oecd.org/ctp/tax-policy/Table%20II.1_May%202013.xlsx

Explanatory notes about the content of the table:

1. This table shows 'basic' (non-targeted) central, sub-central and combined (statutory) corporate income tax rates. Where a progressive (as opposed to flat) rate structure applies, the top marginal rate is shown. Further explanatory notes may be found in the Explanatory Annex.
2. This column shows the basic central government statutory (flat or top marginal) corporate income tax rate, measured gross of a deduction (if any) for sub-central tax. Where surtax applies, the statutory corporate rate exclusive of surtax is shown in round brackets ( ).
3. This column shows the basic central government statutory corporate income tax rate (inclusive of surtax (if any)), adjusted (if applicable) to show the net rate where the central government provides a deduction in respect of sub-central income tax.
4. This column shows the basic sub-central (combined state/regional and local) statutory corporate income tax rate, inclusive of sub-central surtax (if any). Where a sub-central surtax applies, the statutory sub-central corporate rate exclusive of surtax is shown in round brackets ( ).
5. This column shows the basic combined central and sub-central (statutory) corporate income tax rate given by the adjusted central government rate plus the sub-central rate.

Source: OECD (www.oecd.org/ctp/tax-policy/Table%20II.1_May%202013.xlsx)

Table 2. Progress Report on Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard * [1]

Progress made as of 18 May, 2012 (Original Progress Report 2nd April 2009)

Jurisdictions that have substantially implemented internationally agreed tax standard

Andorra	Curacao	Japan	**St Kitts and Nevis**
Anguilla	**Cyprus**	**Jersey**	St Lucia
Antigua and Barbuda	Czech Republic	Korea	**St Vincent and the Grenedines**
Argentina	Denmark	Liberia	**Samoa**
Aruba	**Dominica**	**Liechtenstein**	**San Marino**
Australia	Estonia	**Luxembourg**	Seychelles
Austria	Finland	**Macau, China**	**Singapore**
The Bahamas	France	Malaysia	Saint Maarten
Bahrain	Germany	**Malta**	Slovak Republic
Barbados	**Gilbraltar**	**Marshall Islands**	Slovania
Belgium	Greece	Mauritius	South Africa
Belize	**Grenada**	Mexico	Spain
Bermuda	**Geurnsey**	**Monaco**	Sweden
Brazil	**Hong Kong, China**	**Montserrat**	**Switzerland**
British Virgin Islands	Hungary	**Netherlands**	Turkey
Brunei	Iceland	New Zealand	**Turks and Caicos Islands**
Canada	India	Norway	United Arab Emirates
Cayman Islands	Indonesia	**Panama**	United Kingdom
Chile	**Ireland**	Philippines	United States
China	**Isle of Man**	Poland	Uruguay
Cooks Island	Israel	Portugal	**US Virgin Islands**
Costa Rica	Italy	Qatar	**Vanuatu**
		Russian Federation	

Jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented

Jurisdiction	**Year of Commitment**	**Number of Agreements**	**Classification** (Tax Haven or Other Financial Centre)
Nauru [2]	2003	0	See note 2 (below)
Niue [2]	2002	0	See note 2 (below)
Guatemala	2009	11	Other Financial Centre

Jurisdictions that have not committed to the internationally agreed tax standard

All jurisdictions surveyed by the Global Forum have now committed to the internationally agreed tax standard.

* Readers are referred to the outcomes from the Global Forum peer reviews for an in-depth assessment of a jurisdiction's (a) legal and regulatory framework (Phase 1 reviews) and (b) implementation of the standard in practice (Phase 2 reviews). [http://www.oecd.org/tax/transparency].

1. The internationally agreed tax standard, which was developed by the OECD in co-operation with non-OECD countries and which was endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 and by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting, requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged.

2. These jurisdictions were identified in 2000 as meeting the tax haven criteria as described in the 1998 OECD report.

Source: OECD [http://www.oecd.org/ctp/harmful/43606256.pdf].
Note: **The names of countries that have appeared on the OECD Tax Haven List** (Gravelle, 2009)**are marked by "bold" lettering.** The bold-style lettering was added by this author, and it is not reflected in the original OECD Table.

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26 U.S.C. Sec. 11(d)

26 U.S.C. Sec. 61

26 U.S.C. Sec. 882

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