THE TAXONOMIST

The Tax Cheaters Lobby

By Robert S. McIntyre

I admit it. There are some subjects I just can't stop harping on. But there's a rationale for my repetition. Someday, I hope that the mere mention of "Cato Institute" or "Heritage Foundation" or "Bush" will make people immediately think, "yeah, those are the guys who support tax cheating." Here's the latest entry in the dossier.

In the waning days of the Clinton administration, the IRS proposed to require U.S. banks to report the interest they pay to foreign depositors, who are exempt from U.S. federal taxes but not from taxes where they live. The proposal's goal was to curb tax cheating, both by foreigners in their home countries and by Americans pretending to be foreigners in order to evade U.S. taxes.

The banking industry and right-wing taxaphobes were apoplectic. So was Florida Governor Jeb Bush, whose no-income-tax state harbors a large share of the tax-free deposits. But they all hoped that the change in management at the White House would mean a change in the proposed disclosure rule as well.

Soon after his brother George took office, Jeb Bush wrote to Treasury Secretary Paul O'Neill warning that adoption of the Clinton proposal "could trigger a massive withdrawal of [nonresident alien] deposits in U.S. banks." He was joined by the Florida International Bankers Association, which said disclosure would "denude the United States of billions of dollars." The American Bankers Association predicted "serious economic harm" to the United States, as did the Miami branch of the Chilean Banco de Credito e Inversiones. The Cato Institute argued that "more than US $1.1 trillion of foreign deposits in U.S. banks would flee to more attractive investment climates," a claim echoed by the Heritage Foundation.

Meanwhile, a number of House Republicans were clamoring for legislation to ban the proposed disclosure rules. Wisely, House Ways and Means Chairman Bill Thomas (R-Calif.) told them to calm down. Just wait until President Bush's appointees get their hands on the proposal, he advised. On cue, assistant Treasury secretary for tax policy (and Ernst & Young lobbyist) Mark Weinberger quickly wrote back to Jeb Bush assuring him that "we will keep [your] concerns regarding the proposed regulations very much in mind as we consider our next steps."

Eventually, the George Bush administration took action, and surprise! The tax cheats and their facilitators don't have to worry anymore. In August of this year, the Clinton disclosure proposal was officially "withdrawn," in favor of a new proposal so limited that it is almost meaningless. Under the revised plan, interest paid to residents of a handful of mostly European countries will have to be reported, but everyone else, including countries with the biggest tax-evasion offenders, such as Russia, Mexico, Chile and other Latin American nations, will be exempt.

You might think it obvious that the United States would want to crack down on tax evasion. First and foremost, of course, we want to collect the taxes rightfully owed to our government. In addition, we have a major stake in assisting other countries stop cheating by their citizens. That's not just because we have pretensions to morality. We also need the help of other countries in protecting our tax system—assistance we won't get if we don't help them protect theirs.

The opponents of disclosure sometimes admit that "a desire to assist foreign clients to evade local taxes" looks unseemly. But they argue that a higher value than honesty or government revenues is at stake here: U.S. investment capital. "Foreign deposits in U.S. banks are a source of capital that generates American jobs [and] promotes business expansion in the United States," says the Heritage Foundation. "A substantial amount of this capital will be withdrawn from the U.S. economy . . . if the IRS forces financial institutions to act as informers."

This is not a serious argument. Capital investments are made where profit opportunities are greatest. Whether or not the savings that finance those investments are filtered through a tax haven at some point makes no difference. Indeed, the claim that U.S. capital spending would plummet if we didn't countenance tax cheating by foreigners (and by American posers) is belied by the fact that Cato, Heritage, the Bush administration and the rest vociferously oppose efforts to stop rich people from evading taxes by running their money through Caribbean tax havens. If the location of the bank where deposits are made had any significant effect on business investment, then the Cayman Islands would be clogged with factories at our expense.

To be sure, corrupt American banks have a stake in maintaining tax cheating, since they make money from handling the crooks' deposits. Likewise, corrupt politicians and interest groups may appreciate the financial contributions that backing the banks engenders. But those are sad facts, not justification.

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