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# The benefits of information exchange: an estimate of undeclared assets held abroad and tax evasion

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*Roma, 12 aprile 2017*

# Agenda

- Information exchange identified as the best tool to curb international tax evasion
- What happens without information exchange?
  - Widespread anedoctal evidence of undeclared assets held abroad and tax evasion by individuals
  - But no or little information on their potential magnitude
- A tentative estimate:
  - Metholodogical issues
  - Results and comparison with other estimates
- Conclusions and future research prospects

# Widespread anedoctal evidence of undeclared assets held abroad and tax evasion by individuals

- Overtime, the transfer of assets abroad has been increasingly used as a way to conceal unreported income and wealth
- Bank secrecy jurisdictions and offshore financial centers used as preferred «first destination» of funds or «hubs», but wide diversification of investments and frequent «round-tripping»
- Concealment techniques more and more complex, with widespread use of layers of offshore vehicles, as shown by recent data leaks
- Insights on the possible magnitude of tax evasion linked to undeclared foreign assets only from occasional assessment and offshore voluntary compliance programmes

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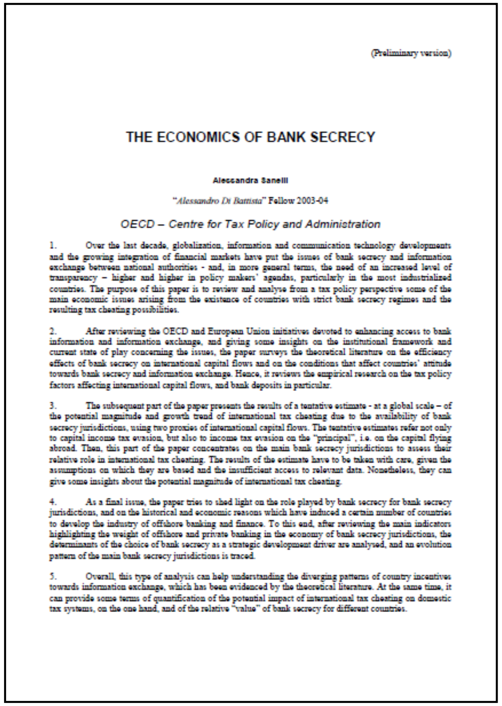
# An estimate of unreported assets held abroad and the related tax evasion



(Preliminary version)

THE ECONOMICS OF BANK SECRECY

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1. Over the last decade, globalization, information and communication technology developments and the growing integration of financial markets have put the issues of bank secrecy and information exchange between national authorities - and, in more general terms, the need of an increased level of transparency – higher and higher in policy makers' agendas, particularly in the most industrialized countries. The purpose of this paper is to review and analyse from a tax policy perspective some of the main economic issues arising from the existence of countries with strict bank secrecy regimes and the resulting tax cheating possibilities.

2. After reviewing the OECD and European Union initiatives devoted to enhancing access to bank information and information exchange, and giving some insights on the institutional framework and current state of play concerning the issues, the paper surveys the theoretical literature on the efficiency effects of bank secrecy on international capital flows and on the conditions that affect countries' attitude towards bank secrecy and information exchange. Hence, it reviews the empirical research on the tax policy factors affecting international capital flows, and bank deposits in particular.

3. The subsequent part of the paper presents the results of a tentative estimate - at a global scale – of the potential magnitude and growth trend of international tax cheating due to the availability of bank secrecy jurisdictions, using two proxies of international capital flows. The tentative estimates refer not only to capital income tax evasion, but also to income tax evasion on the "principal", i.e. on the capital flying abroad. Then, this part of the paper concentrates on the main bank secrecy jurisdictions to assess their relative role in international tax cheating. The results of the estimate have to be taken with care, given the assumptions on which they are based and the insufficient access to relevant data. Nonetheless, they can give some insights about the potential magnitude of international tax cheating.

4. As a final issue, the paper tries to shed light on the role played by bank secrecy for bank secrecy jurisdictions, and on the historical and economic reasons which have induced a certain number of countries to develop the industry of offshore banking and finance. To this end, after reviewing the main indicators highlighting the weight of offshore and private banking in the economy of bank secrecy jurisdictions, the determinants of the choice of bank secrecy as a strategic development driver are analysed, and an evolution pattern of the main bank secrecy jurisdictions is traced.

5. Overall, this type of analysis can help understanding the diverging patterns of country incentives towards information exchange, which has been evidenced by the theoretical literature. At the same time, it can provide some terms of quantification of the potential impact of international tax cheating on domestic tax systems, on the one hand, and of the relative "value" of bank secrecy for different countries.

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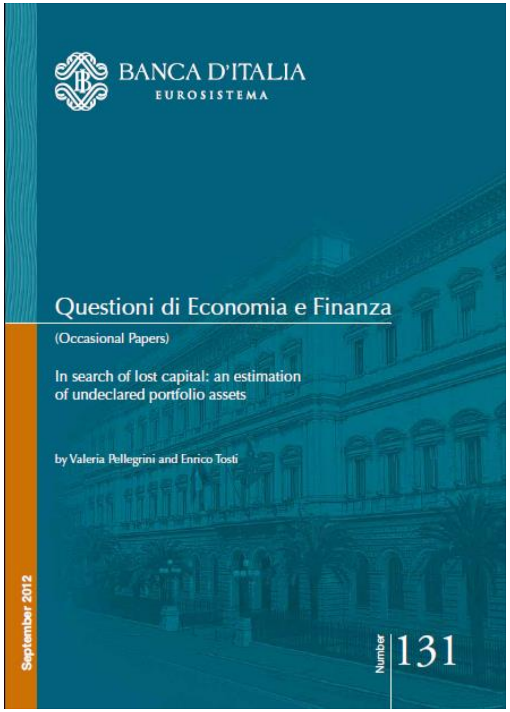


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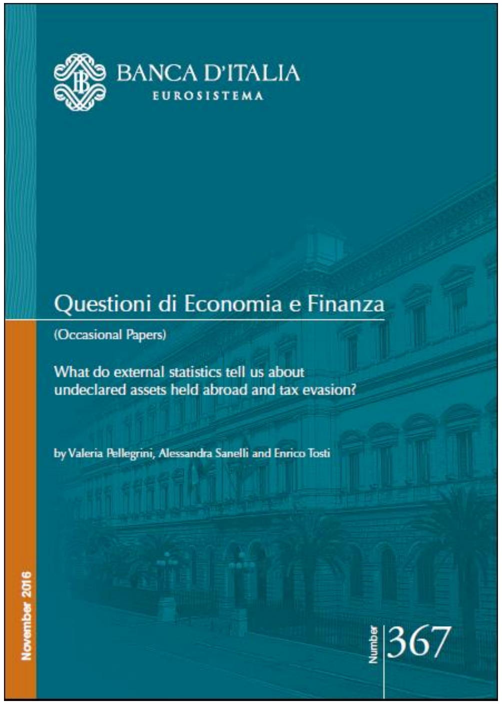

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# The estimation methodology: portfolio assets

- Debt securities, shares (< 10% of share capital), mutual fund shares:
  - «Global discrepancies» between total portfolio liabilities and total portfolio assets as reported, respectively, by debtor and creditor countries. Sources:
    - IMF ***Coordinated Investment Portfolio Survey*** (CPIS) for foreign portfolio assets
    - **International Investment Position** (IIP) for foreign portfolio liabilities
  - On a global basis reported liabilities are sistematically higher than reported assets: the difference is nothing other than the «mirror image» of the unreported portfolio investments and is therefore taken as a **proxy of foreign asset under-reporting**

# The estimation methodology: cross-border bank deposits

Source: **BIS Locational Statistics**

The estimate includes **deposits with "a high risk of tax evasion":**

- **deposits held in OFCs by non-bank investors**
- **deposits held in non-OFCs by non-bank investors resident in OFCs**: individuals may use offshore companies and other vehicles to open bank accounts in non-OFCs

Given that bank accounts of non-bank investors include both deposits held by individuals and non-bank businesses, we assume that the **share** of these deposits **held** – directly or indirectly (through intermediate vehicles) - **by individuals** ranges **between 1/3 and 2/3** of the total, on the basis of statistics on deposit holders published by the ECB and other central banks

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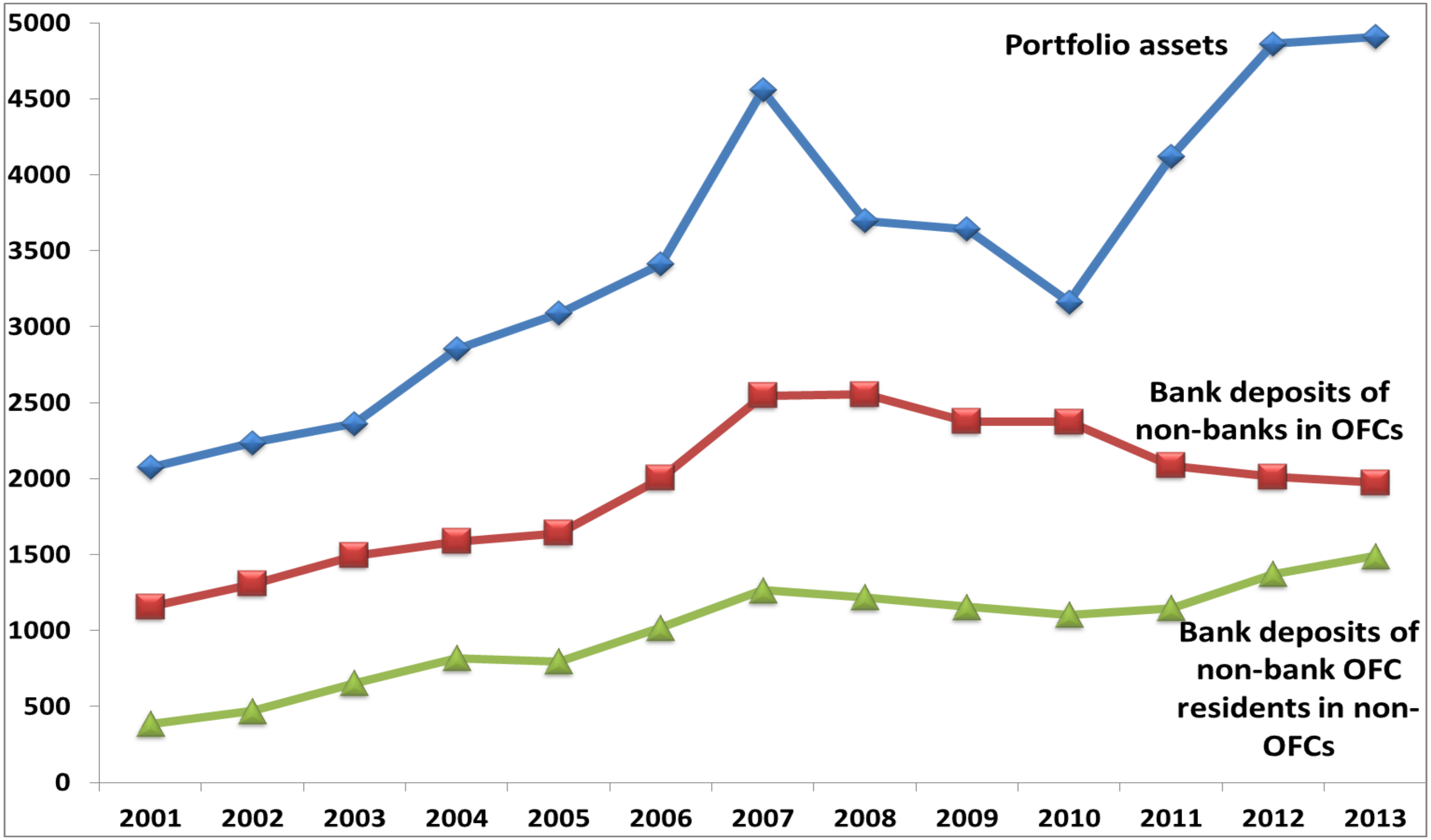
# Unreported portfolio assets and non-bank foreign bank deposits



# Unreported assets held abroad: A comparison with other estimates

*(USD billion)*

| | | | |
|---|---|---|---|
| **7,200 (max)** | **Sanelli et al. (2016)** | *Global discrepancies in portfolio investments (4.9 USD tn.) + share of bank deposits of non-banks (2.3 USD tn.).<br>Does not include other financial instruments and non-financial assets* | **10% of World GDP (or 8% of total financial wealth)** |
| **7,600** | **Zucman (2015)** | *Global discrepancy in portfolio investments (6.1 USD tn.) + share of bank deposits of non-banks in OFCs (1.5 USD tn.).<br>Does not include other financial instruments and non-financial assets* | |
| **21,000 - 32,000** | **Henry (TJN, 2012)** | *a) Overall amount of foreign bank dep. x 3;<br>b) Financial wealth held by the first 50 private banks x 2 + 25%;<br>c) capital flights in the 139 poorest countries x 4* | **30% of World GDP** |

# Tax evasion estimates: methodological issues

- **<u>Which taxes?</u>**
  - Annual financial income tax (2001-2013)
  - Personal Income Tax on stocks outstanding at end-2013
- **<u>«Non-compliance» rates:</u>**
  - 60%-80% for bank deposits
  - 90% for portfolio assets
- **<u>Rates of return:</u>**
  - actual rates for deposits (sources: ECB and IMF);
  - «derived» rates for portfolio securities (do not include unrealized capital gains/losses)
- **<u>Tax rates</u>**:
  - Weighted average top rates, separately for OECD and non-OECD countries; statutory tax rates for Italy
  - Global unreported assets attributed to single countries according to a combination of «reported assets» and GDP criteria

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# Our estimate vs Zucman's and Henry's

*(USD billion)*

| | Sanelli et al. (2016) | Zucman (2015) | Henry (2012) |
|---|---|---|---|
| Annual tax evasion on financial income | 20 - 42 (0.03%-0.06% of World GDP): 94% OECD, 6% Non-OECD | 127 | 189 |
| Personal income tax evasion on unreported assets at end-2013 | 2,100 – 2,800 (2.9%-3.8% of World GDP) | OECD: 86%, 3.9%-5% of GDP; Non-OECD: 14%, 1%-1.6% of GDP | |
| Wealth tax evasion | | 10 | |
| Inheritance tax evasion | | 52 | |

# Estimate of tax evasion linked to unreported assets for Italy

*(Eur bn.)*

| | |
|---|---|
| **Unreported financial assets held by Italian individual holders** | **150 – 200** |
| **Financial income tax evasion (average 2001-2013)** | **0.4 – 1.4** |
| • *As percentage of GDP* | *0.03% - 0.08%* |
| • *As percentage of annual tax revenue from financial income (11,8 Eur bn., average 2001-2013)* | *3.4% - 11.9%* |
| **Personal income tax evasion (on unreported assets held at end 2013)** | **49.4 – 99.2**<br>**(PIT revenue 2013 = 164 bn.)** |
| • *As percentage of GDP* | *3.1% - 6.2%* |
| **Financial Assets reported under the 2015 VD** | **51**<br>**(on a total of 62 including non-financial assets)**<br>**= 30%-25% of unreported financial assets** |

# Conclusions and future research prospects

- The magnitude of unreported assets held abroad and the related tax evasion can only be estimated through Indirect statistical evidence and strong and often over-simplified methodological assumptions
- Further research in this area could exploit the data made available by recent data-leaks and other statistical evidence available at national and international level, included that arising from automatic information exchange
- Among others, the following aspects deserve further analysis:
    - Who holds unreported assets?
        - Individuals vs firms («belgian dentist» vs black funds)
        - Countries of origin (e.g. OECD vs developing countries, etc.)
    - Change in evasion techniques (exploitation of CRS and FATCA loopholes, Bitcoin, etc.)