Center for Freedom and Prosperity Strategic Memorandum

From: Dan Mitchell, Heritage Foundation Senior Fellow

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Re: Sneak Attack on Administration's International Tax Policy

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The House Financial Services Committee and Senate Banking Committee have drafted similar bills ostensibly designed to fight global money laundering. Unfortunately, both of these bills contain language designed to hinder international tax competition. This is bad tax policy, and it undermines the Administration's ability to counter the radical tax harmonization agenda of international bureaucracies like the European Union and the Organization for Economic Cooperation and Development.

More specifically, the bills include identical provisions (section 301 of the House bill and section 101 of the Senate bill) that describe criteria that the Treasury Secretary should use when identifying jurisdictions of "primary money laundering concern." Some of these criteria (reprinted at the end of this memo) are reasonable and appropriate, including the quality of a jurisdiction's laws, the level of corruption, and the existence of – and compliance with – a mutual legal assistance treaty.

Three of the criteria have nothing to do with money laundering and instead are designed to give an ideologically driven Treasury Secretary unchecked powers to impose sanctions on economically successful low-tax jurisdictions. As a matter of fact, the language in these provisions is identical to the language in a bill that the Clinton Administration sought last year. Here are the misguided passages, including an explanation of why they are wrong:

The language: "the extent to which that jurisdiction or financial institutions operating therein offer bank secrecy or special tax or regulatory advantages to nonresidents or nondomiciliaries of such jurisdiction"

Why the language is wrong: Bank secrecy is not a sign of money laundering. Every nation in the world, including the United States, has laws preventing financial institutions from divulging confidential client information. The key question is whether a jurisdiction will suspend those privacy protections when presented with evidence of a universally recognized crime such as the September 11 terrorist attacks. This is an argument for mutual legal assistance treaties (such as the ones America has with the Cayman Islands, Switzerland, and the Bahamas), not an argument against bank secrecy. Likewise, tax and regulatory advantages have nothing to do with money laundering. The United States, for instance, has very favorable tax and privacy laws for nonresident investors. These preferential policies have helped attract more than $5 trillion of capital to our economy, but there is no reason to believe that this makes America a jurisdiction of "primary money laundering concern." If this provision is enacted, it will create a precedent that high-tax nations can use to demand changes in U.S. law.

The language: “the relationship between the volume of financial transactions occurring in that jurisdiction and the size of the jurisdiction's economy”

Why the language is wrong: A successful financial services industry is not a sign of money laundering. If having a large volume of financial transactions relative to the size of an economy is evidence of money laundering, then New York City and London should be padlocked. South Dakota also should be shut down because of its credit card operations, and Tokyo and Hong Kong should be sanctioned as well. If this provision is enacted, it will create a precedent that could be used by our competitors to undermine America’s world-class financial services sector.

The language: “the extent to which that jurisdiction is characterized as a tax haven or offshore banking or secrecy haven by credible international organizations or multilateral expert groups”

Why the language is wrong: Congress should not cede power to bureaucracies like the Organization for Economic Cooperation and Development, the European Union, and the United Nations. These “international organizations” have been fighting to undermine and inhibit international tax competition and have targeted successful, low-tax economies. Yet the United States is a low-tax country by global standards, with attractive tax and privacy laws designed to lure foreign capital to our economy. As a result, America is the world’s biggest beneficiary of tax competition. If this provision is enacted, it will create a precedent that will be used to attack our fiscal sovereignty and could result in policies such as “information exchange” that give other governments the power to tax income earned in America.

How to fix the problem: The provisions listed above should be stripped from the bill. They have nothing to do with money laundering and could be misused by a future Treasury Secretary. Supporters argue that the provisions – and the implicit threat of sanctions – would give America leverage when seeking information from foreign governments. It is more likely, however, that this approach would undermine the fight against crime by causing animosity between the United States and various low-tax jurisdictions around the world.

The real solution: Instead of targeting governments for the “sin” of low tax rates, legislators should pursue changes that encourage international cooperation. The other provisions (reprinted below) from sections 101 and 301 are a good step in this direction. In particular, policy makers should expand America’s network of mutual legal assistance treaties. These bilateral pacts would create an international alliance in the battle against terrorist and criminal acts that violate the commonly shared laws of civilized nations. The criterion dealing with money laundering laws could be strengthened by replacing the current vague language with specific conditions, such as whether a jurisdiction has laws at least equal to those in the United States or is listed as “non-cooperative” by the Financial Action Task Force. It is worth noting, incidentally, that most of the jurisdictions on the FATF list are not tax havens.

Potentially helpful criteria, with suggested changes:

The following criteria, with one exception, also are in both bills. These provisions address important issues, but in many cases could be improved.

- "evidence that organized criminal groups, international terrorists, or both, have transacted business in that jurisdiction" [In Senate version only].

  According to news reports, the terrorists used the financial systems of the United States, Canada, Germany, and England (along with many others). Needless to say, none of these jurisdictions – and none of the financial institutions in those nations – wanted to help the terrorists. This criterion therefore could be substantially strengthened by adding language such as "and the jurisdiction knew in advance that the accounts were being used for criminal purposes or refused to freeze the account and provide information when informed that the beneficial owner(s) were criminals."

- "whether the United States has a mutual legal assistance treaty with that jurisdiction, and the experience of United States law enforcement officials, regulatory officials, and tax administrators in obtaining information about transactions originating in or routed through or to such jurisdiction"

  This is a very good criterion and should be the focus of the entire section.

- "the substance and quality of administration of that jurisdiction's bank supervisory and counter-money laundering laws"

  As discussed above, this vague language could be strengthened if replaced by language such as "whether the jurisdiction is listed as non-cooperative by the Financial Action Task Force and whether the jurisdiction has money laundering laws at least equal to those in the United States."

- "the extent to which that jurisdiction is characterized by high levels of official or institutional corruption"

  This is a good criterion, but the meaning is vague. In part, this issue is addressed by the section on MLATs, particularly the degree to which jurisdictions cooperate with information requests from the U.S. government. A potential improvement would be to link this criterion to an independent rating.