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Taking Aim at Low Taxes

By Daniel J. Mitchell

Hong Kong and Singapore have enjoyed rapid growth and now rank among the world's wealthiest jurisdictions—thanks, in part, to their low tax rates and open markets. But no good deed goes unpunished. Today, both thriving jurisdictions face possible economic sanctions courtesy of the U.S. Congress.

Two proposals attacking low-tax jurisdictions are currently making the rounds in Washington. The first, Michigan Senator Carl Levin's "Stop Tax Haven Abuse Act," would change U.S. tax laws to deter Americans from investing in 34 low-tax jurisdictions. Inclusion on the list is based on Mr. Levin's claim that a jurisdiction has been described as a "secrecy jurisdiction" by the U.S. Internal Revenue Service in court filings against allegedly tax-dodging third parties. In Asia, Singapore and Hong Kong would be among the jurisdictions effectively blacklisted. Even worse, the bill authorizes sweeping financial sanctions for jurisdictions that do not changes their tax and/or privacy laws to facilitate the extraterritorial enforcement of U.S. tax law.

The other, equally pernicious, proposal is sponsored by Democratic Senator Byron Dorgan of North Dakota. His bill creates a blacklist of 40 nations and territories, though Senator Dorgan's two-page bill does not explain how nations got on his blacklist or how they could get off the list. The legislation would require American companies to act as if income earned in those jurisdictions were U.S.-source income, a change that would dramatically boost their tax burdens. Hong Kong and Singapore aren't currently on Senator Dorgan's list, though that could change as the bill wends its way through the legislative process.

> U.S. Senators try to raise Hong Kong tax rates.

Given the toxic combination of anti-free trade sentiment and hunger for new tax revenue bubbling in the Democratic Congress, there is speculation that the sponsors of the two bills may create a combined blacklist of 46 jurisdictions. But even if a jurisdiction escapes that list, both proposed bills would give the Treasury Secretary unchecked authority to add new "tax havens" to the list.

If enacted, these bills would inflict higher tax rates and economic uncertainty on Asia's most vibrant financial centers, discouraging American investors, entrepreneurs and companies. Equally worrisome, other nations might use the U.S. action as an excuse to impose similar blacklists. Politicians from Europe's high-tax welfare states have been staunch advocates of anti-tax-competition policies and they would be delighted if America took the lead in an attack on low-tax jurisdictions—especially since both Hong Kong and Singapore already have rejected participation in the savings tax directive, a scheme by the European Commission to track and tax flight capital.

These proposals, particularly the Levin legislation, already are causing unease in Asia. The Hong Kong and Singapore governments are very aware of the threat posed by these pieces of legislation. The private sector in both jurisdictions also is paying attention, particularly since Senator Levin implies that his legislation will boost tax collections by $100 billion yearly. This suggests a steep increase in the tax burden, though it is likely that there would be very little if any additional tax revenue since American investors and companies would change their behavior to avoid the tax—most likely by pulling money out of the blacklisted jurisdictions.

Ironically, America may be the biggest victim if the Levin and Dorgan bills are approved. The Center for Freedom and Prosperity already has sent a letter to Treasury Secretary Henry Paulson explaining why the Levin and Dorgan proposals are contrary to U.S. interests. Signed by representatives of 45 think tanks, free-market groups and taxpayer organizations, the letter attacks the proposals on three fronts.

First, in a competitive globalized world, discriminating against American investors, entrepreneurs and companies would create opportunities for other nations to grab market share. Second, the bills disproportionately target poor nations, as about three-fourths of the blacklisted jurisdictions are from the developing world, further reducing America's list of friends around the world. Lastly, the bills almost surely would get America in trouble with the World Trade Organization because of national-treatment and most-favored-nation obligations.

Ideally, the proposals will be stopped because they represent bad policy, not merely because they would harm American interests. Senators Levin and Dorgan are trying to undermine tax competition, yet this is a process that should be celebrated rather than persecuted. The mobility of labor and capital has forced governments around the world to lower growth-stifling tax rates and personal and corporate income. Beginning with the Thatcher and Reagan tax cuts, personal tax rates have dropped by an average of nearly 25 percentage points in the developed world and corporate tax rates have fallen nearly 20 percentage points. This liberalization, encouraged by fiscal rivalry, would be undermined if governments no longer had to worry that the geese that lay golden eggs could escape to other jurisdictions.

Fiscal protectionism is not the answer. If Senators Levin and Dorgan are worried that jobs and capital are migrating to places such as Hong Kong and Singapore, they might think about lowering U.S. tax rates instead. After all, America should be exporting freedom, not bad policy.

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