

Offshore tax gap – 6/11/06 update

Offshore Tax Gap 2004/05 – 6/11/06 update

The offshore tax gap was first estimated for 2001/02, in the paper entitled “Estimation of tax gap for direct taxes”, in April 2005. (See Annex 1 for the offshore part of this report.)

In it, the tax gap, on interest and capital, was estimated for each of 11 tax havens around the world.

Upper and lower estimates were produced, the former based on the assumption that 40% of capital went undeclared, and the latter assuming 20% of capital was undeclared.

The purpose of this paper is to update those estimates for 2004/05.

The same methods are used as for the earlier estimate. Firstly, the ELS SA returns were used to estimate the total income declared.¹

Secondly, data supplied by Datamonitor was used to estimate the amount of taxable interest and capital that should have been declared, using a number of assumptions.

As listed in the April 2005 paper, these assumptions were –

- 1 The difference between savings declared on SA and savings declared by the FSA/Datamonitor implies a tax risk.
- 2 Interest is earned at an average of 2% in all tax havens.
(Taken from a sample of banks in CI)
- 3 Income is subject to tax at an average rate of 33%
(This has been calculated from individuals in the CCP data and generally for individuals declaring offshore interest in SA, 60% are high rate tax payers and 40% are standard rate.)
- 4 A proportion of accounts hold undeclared capital, assumed to be between 20%-40%.
(From the BOI trust cases SCO established approximately 30% of the trusts with undeclared capital.)
5. 30% of the value of offshore accounts attributed to UK residents will be affected by domicile issues. (As experienced by the BOI trusts data).

An implicit assumption was that all money in deposits was owned by individuals.

The 2001/02 results were as shown in Table 1 –

¹ For this update, the total income declared was estimated from the 2005 Foreign Pages Survey, which is based on a random sample of the 2004/05 SA returns where the foreign pages were completed. The impact of this update on the tax gap figures was negligible.

Table 1 – Annual Tax Gap for 2001/02

Annual Tax Gap £millions					
	Interest Only	Capital @20% undeclared	Capital @40% undeclared	Total	
BAHAMAS	£12	£24	£48	£36	£60
BERMUDA	£2	£4	£8	£6	£10
BRITISH VIRGIN ISLANDS	£1	£2	£4	£3	£5
CAYMAN ISLANDS	£32	£63	£126	£95	£158
HONG KONG	£17	£34	£68	£51	£85
ISLE OF MAN	£28	£56	£111	£83	£139
LUXEMBOURG	£7	£15	£29	£22	£36
NETHERLANDS ANTILLES	£2	£4	£8	£6	£11
SINGAPORE	£18	£35	£71	£53	£88
SWITZERLAND	£56	£112	£224	£168	£280
CHANNEL ISLANDS	£120	£240	£479	£360	£599
Total	£294	£588	£1,177	£882	£1,471
CI & IOM	£148	£295	£591	£443	£738
Others	£146	£293	£586	£439	£732
Total	£294	£588	£1,177	£882	£1,471

Thus, the annual tax gap for 2001/02 was estimated to be between £0.9bn and £1.5bn. Also, in the original exercise, the proportion of income from tax havens that was declared was estimated to be 23%.

The Datamonitor data came from their publication “Offshore Financial Services Databook 2003”.

For the purposes of the 2004/05 exercise, an updated Datamonitor publication was obtained, in the form of an Excel spreadsheet. In it, it became apparent that, not only do Datamonitor revise their estimates in the light of further information, but they also update historical data. In particular, examination of the spreadsheet shows that their current estimates for 2001/02 are substantially different from those in the 2003 Databook.

Table 2 below shows the size of these changes to the Datamonitor estimates, for 2001/02, between 2003 and 2005.

Table 2 -Datamonitor data for 2001/02 – Deposits
(All currency figures are in millions of euros.)

	(a) As in 2003 Databook		(b) As in 2005 Database		(c) %age increases -	
	UK	All	UK	All	UK	All
Bahamas	e3,240	e106,925	e1,966	e13,953	-39%	-87%
Bermuda	e635	e13,398	e541	e10,187	-15%	-24%
BVI	e382	e1,274	e183	e1,016	-52%	-20%
Cayman	e8,629	e287,617	e11,973	e214,945	39%	-25%
Guernsey	e12,403	e103,361	e9,311	e89,433	-25%	-13%
HK	e4,596	e72,002	e10,146	e53,810	121%	-25%
IoM	e9,153	e21,679	e11,271	e16,202	23%	-25%
Jersey	e37,272	e172,556	e54,415	e156,630	46%	-9%
Luxembourg	e2,931	e124,974	e3,448	e93,397	18%	-25%
Antilles	e578	e10,506	e456	e5,205	-21%	-50%
Singapore	e4,712	e120,168	e4,664	e89,805	-1%	-25%
Switzerland	e16,625	e284,773	e70,034	e212,819	321%	-25%
Totals	e101,156	e1,319,233	e178,407	e957,401	76%	-27%

Broadly speaking, the Datamonitor estimates of total deposits invested in these tax havens has decreased (by an average of 27%), but their estimates of the amounts of this made by UK investors has increased (by an average of 76%), in some cases quite dramatically (eg Switzerland, by 321%, and Hong Kong, by 121%).

As a result, Table 1 was recalculated on the basis of the revised data, with the assumptions and input from the ELS cases unchanged. This showed a substantial rise in estimates of the 2001/02 tax gap, as shown in Table 3 -

Table 3 – as Table 1, but with updated data from Datamonitor, for 2001/02

Annual Tax Gap £millions						
	Interest Only	Capital @20% undeclared	Capital @40% undeclared	Total		
BAHAMAS	£7	£14	£29	£21	£36	
BERMUDA	£2	£3	£7	£5	£9	
BRITISH VIRGIN ISLANDS	£0	£0	£1	£1	£1	
CAYMAN ISLANDS	£44	£88	£176	£132	£220	
HONG KONG	£38	£76	£151	£113	£189	
ISLE OF MAN	£36	£72	£143	£107	£179	
LUXEMBOURG	£9	£18	£37	£28	£46	
NETHERLANDS ANTILLES	£2	£3	£7	£5	£8	
SINGAPORE	£18	£35	£70	£53	£88	
SWITZERLAND	£257	£513	£1,026	£770	£1,283	
CHANNEL ISLANDS	£173	£345	£691	£518	£863	
Total	£584	£1,169	£2,337	£1,753	£2,922	
CI & IOM	£208	£417	£834	£625	£1,042	
Others	£376	£752	£1,504	£1,128	£1,880	
Total	£584	£1,169	£2,337	£1,753	£2,922	

This shows an increase in our estimate of the 2001/02 tax gap from between £0.9bn and £1.5bn to between £1.8bn to £2.9bn, ie our estimates for 2001/02 have almost exactly doubled, purely as a consequence of using Datamonitor's updated data. Also, the estimated proportion of income declared has fallen from 23% to 13%.

This year's exercise uses ELS SA return data for 2004/05, and Datamonitor's current data for 2003/04, together with their projected growth rate in 2004/05, and the results are shown in Table 4 below.

(Note that, for the first time, we are including Ireland among the tax havens.)

Table 4 – Annual Tax Gap (See Annex 2 for a summary of calculations)

Annual Tax Gap £millions					
	Interest Only	Capital @20% undeclared	Capital @40% undeclared	Total	
BAHAMAS	£6	£13	£25	£19	£31
BERMUDA	£2	£3	£6	£5	£8
BRITISH VIRGIN ISLANDS	£0	£1	£1	£1	£1
CAYMAN ISLANDS	£40	£79	£158	£119	£198
HONG KONG	£36	£71	£143	£107	£178
ISLE OF MAN	£32	£65	£130	£97	£162
IRELAND	£73	£146	£293	£220	£366
LUXEMBOURG	£8	£16	£32	£24	£40
NETHERLANDS ANTILLES	£2	£3	£7	£5	£8
SINGAPORE	£17	£34	£69	£51	£86
SWITZERLAND	£228	£456	£911	£683	£1,139
CHANNEL ISLANDS	£179	£358	£715	£537	£894
Total	£622	£1,245	£2,490	£1,867	£3,112
CI & IOM	£211	£423	£845	£634	£1,057
Others	£411	£822	£1,645	£1,233	£2,056
Total	£622	£1,245	£2,490	£1,867	£3,112

The estimated 2004/05 tax gap is now between £1.9bn and £3.1bn.

(If Ireland is excluded, so as to make possible a like-for-like comparison, the gap is between £1.6bn and £2.7bn.)

The estimated proportion of income declared is now 7% (8%, if Ireland is excluded).

Annex 1

(This is copied from pages 49 – 51 of the report “Estimation of tax gap for direct taxes”, of April 2005.)

Use of Offshore Accounts for evasion

Most of the use of offshore accounts for **evading** tax is thought to lie with the self-employed and company directors. So logically the estimate of the use of offshore accounts for evasion sits within the estimate for small businesses. Nevertheless this type of tax evasion is thought to be so significant that it merits separate estimation of the consequent tax loss:-

- To help validate the overall tax gap estimates for small companies and the self employed;
- To inform initiatives designed to attack the use of offshore accounts to facilitate tax evasion.

The estimate of tax loss due to use of accounts of offshore accounts for evasion is based upon an analysis of bank deposits by UK individuals in tax havens.

The Financial Services Authorities (FSA's) in the Channel Islands and the Isle of Man collect statistical information of bank deposits held in their jurisdictions. Between them they have published £48bn saved in banks by UK residents. The information does not determine between different types of interest bearing or non interest bearing accounts.

Datamonitor collect statistics from the FSAs in CI and IoM and also in many of the worlds 'tax haven' countries. Since the source of the headline figures comes from the FSAs the Datamonitor figures are fairly robust.

The most recent data we have comes from the FSAs in CI and IoM. The Datamonitor figures are then used to apply an estimate for the other tax havens. This equates to over £80bn (£48bn in CI & IOM and £34b in the other tax havens).

From the ELS returns on SA we know how much interest was declared in each of these tax havens.

For CI & IOM this equates to £317m for the other tax havens this equates to £55m.

Assumptions:

- 5 The difference between savings declared on SA and savings declared by the FSA/Datamonitor implies a tax risk.
- 6 Interest is earned at an average of 2% in all tax havens.
(Taken from a sample of banks in CI)
- 7 Income is subject to tax at an average rate of 33%
(This has been calculated from individuals in the CCP data and generally for individuals declaring offshore interest in SA, 60% are high rate tax payers and 40% are standard rate.)

- 8 A proportion of accounts hold undeclared capital, assumed to be between 20%-40%.
(From the BOI trust cases SCO established approximately 30% of the trusts with undeclared capital.)
6. 30% of the value of offshore accounts attributed to UK residents will be affected by domicile issues. (As experienced by the BOI trusts data).

The accounts have been opened for an average of 5 years. (As experienced by the BOI trusts data).

% UK Domocile	% of hidden Capital	Number of years held	Average tax rate	Interest rate earned
70%	20%-40%	5	33%	2%

Annual Tax Gap £millions

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BAHAMAS	12	24	48	36	60
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BRITISH VIRGIN ISLANDS	1	2	4	3	5
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ISLE OF MAN	28	56	111	83	139
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Others	146	293	586	439	732
Total	294	588	1,177	882	1,471

Therefore our estimate of annual loss of tax through evasion using offshore bank accounts is between £0.9bn and 1.5bn. This level of evasion using offshore accounts is more compatible with the higher end of the ranges for the self employed and small companies.

Annex 2 - Summary of calculations

The Datamonitor estimate of total UK deposits is given by

Total UK deposits = e215,416m = £145,428m (@ e1.4794 / £)

Estimated taxable interest @ 2% = £2,908.56m

Estimated taxable interest declared (from ELS cases) = £213.81m

Estimated taxable interest undeclared = £2,908.56m - £213.81m = £2,694.75m

Tax at risk on interest = £2,694.75m * 33% (average tax rate) * 70% (domicile)
= £662.49m

Tax at risk from capital = (£2,694.75m / 2%) * 20% (or 40% - assumed proportions of capital hidden) * 33% (average tax rate) * 70% (domicile) / 5 (assumed number of years held), ie

Tax at risk from capital = £1,244.97m (20% hidden)
= £2,489.48m (40% hidden)

So,

Total annual tax gap = £622.49m + £1,244.97m = £1,867.46m (20% hidden capital),
or £622.49m + £2,489.48m = £3,111.97m (40% hidden capital).

Rounding, and assuming that these totals provide bounds for the estimate, then the annual tax gap lies between £1,867m and £3,112m.