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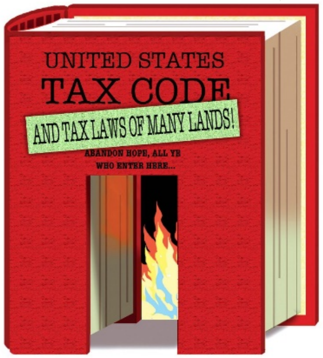

Killing the Rule of Law

by Richard W. Rahn

OVER-TAXATION HURTS NORMAL COMMERCE, TAXPAYERS, PRIVACY

Laws need to be few enough in number and readily understood by those they apply to in order to have an effective rule of law. The rule of law is necessary both for civil society and economic prosperity, but, unfortunately, it is being destroyed by governments that engage in endless efforts to increasingly micromanage the citizens.

Tax law, despite periodic claims of "simplification," is more and more repressive almost everywhere on the planet. This is particularly true of tax law that applies to individuals and businesses that may reside or engage in economic activity in more than one jurisdiction.

Global economic growth, particularly foreign investment, is slowing. One reason is likely the growing complexity of engaging in cross-border financial transactions. Major companies, banks and other financial institutions have been required to pay, in some cases, multi-billion-dollar fines to various governments for some alleged tax or other violation. The question is: Why is this occurring when virtually all of these institutions have compliance officers, tax lawyers, accountants, auditors, etc.? Much of the problem seems to stem from the everchanging regulations and laws among countries, which are increasingly impossible to understand and comply with, even by the most sophisticated businesses. A growing problem is that complying with laws and rules from one country may contradict rules from the country in which the company is doing business.

The Center for Freedom and Prosperity Foundation has just published an important paper by the highly regarded international tax lawyer Bruce Zagaris, titled "Why the U.S. and the Worldwide Tax Systems Have Run Amok." Mr. Zagaris notes: "A unique aspect of the U.S. tax system is that it requires citizens, permanent residents, and tax residents to report and pay taxes on their worldwide income even if they live overseas and their income is earned in other nations. To enforce this approach, the U.S. has imposed a plethora of byzantine overlapping reporting requirements and has levied heavy penalties for persons who run afoul of the regime."

It gets worse. The U.S. has prosecuted U.S. individuals for cross-border tax activities that do not violate U.S. laws. That is, the U.S. is enforcing foreign tax laws against U.S. citizens. At the same time, foreign banks, asset managers, lawyers and other professionals have been prosecuted by U.S. authorities for illegal activities of U.S. taxpayers, even though the activities were committed outside the U.S. and were not illegal in the home country of the foreign bank or professionals.

There are very extensive and time-consuming reporting requirements for U.S. taxpayers who have "a financial interest in, or signature or other authority over, foreign financial accounts in which the aggregate value of these accounts exceeds $10,000 at any time during the calendar year." That regulation is just the beginning. Overly complex and even incomprehensible rules govern many international wealth and business transfers, as well as very onerous reporting requirements for people that have foreign interests.

In March 2010, Congress enacted the highly intrusive and costly Foreign Account Tax Compliance Act (FATCA). FATCA imposes a huge legal burden on foreign financial institutions that deal with U.S. taxpayers. "The IRS has issued over 500 pages of technical guidance with over 100 technical terms that require an enormous investment of time to understand its concept and operation." The result has been that foreign banks and financial institutions are increasingly refusing to open bank accounts for U.S. taxpayers. This has made life very difficult for Americans living abroad who may need a local bank account. Victims include not only business people, but also retirees, employees of NGOs, and even U.S. diplomatic and military personnel stationed abroad.

Many countries have complained that complying with FATCA undermines their own laws and privacy protections. The U.S. had promised to reciprocate in the exchange of tax information, but because the U.S. has a federal system, and a number of these promises violate state laws, much information exchange is legally restricted or prohibited.

In response, many foreign countries have come up with their own versions of FATCA, and apply them against U.S. financial institutions often at great cost to these institutions. In his paper, Mr. Zagaris details the problems caused by FATCA and a number of other international tax-related rules and regulations. Many of the rules and regulations would never meet basic cost-benefit analysis. They create much pain for little or no gain.

Mr. Zaragis concludes: "Overly aggressive tax compliance and enforcement initiatives erode globalization, impede the ability of normal commerce and the movement of people, capital and goods, and threaten privacy. The confidential affairs of taxpayers are increasingly exposed and thus often find their way onto WikiLeaks or the media."

There have been recent reports of Venezuelans using Bitcoin and other cryptocurrencies, given the destruction of the government currency by the Maduro regime. In the digital age, people will find many legal or illegal ways to escape wasteful, incompetent, corrupt and/or oppressive governments without necessarily having to physically move. Using the keyboard, rather than the guillotine, to remove bad government actors is progress.

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