Invade the Caymans!

By David Cay Johnston

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> The solutions we seek must be equitable, with no one group singled out to pay a higher price.
>
> — Ronald Reagan, Jan. 20, 1981

Remember when our parents told us there was no money tree in the backyard?

Well, in Washington our government leaders have made a huge breakthrough in botanical finance. Evidently they have discovered a whole orchard lush with trillions of greenbacks just waiting for politicians to pick them.

By some counts Washington has now committed more than $8.5 trillion to bailouts, from cash infusions to unlimited money market fund guarantees. That's a hard sum to imagine: an amount equal to a million dollars times a million times 8 and a half.

Here is one measure that may help with a sense of proportion — the bailouts equal all of the individual income taxes collected during the George W. Bush years, plus the last year of the Clinton administration.

There is no magic money tree, of course, so eventually the taxpayers must bear the burdens of the bailouts.

The government may yet make money on some part of the bailouts — remember Chrysler three decades ago? — but the more likely scenario is that as with the savings and loan debacle, the costs will be higher than originally estimated.

What minimal facts we have been given so far about the government's skill at negotiating deals that treat taxpayer money with respect are not comforting. According to an analysis of Treasury reports by financial advisers for the United Steelworkers, taxpayers paid twice as much per unit for Goldman Sachs as Warren Buffett.

And just as the Bush tax cuts were heavily weighted to benefit the richest among us, so is the Bush administration's bailout a huge redistribution scheme that transfers wealth upward. Indeed, a report by two IMF economists on how governments handled 42 banking crises in the past 37 years found that bank bailouts generally result in a redistribution of wealth upward and, somewhat, to borrowers who took on too much debt.

Notice that in the current bailouts, foreclosure relief has been minimal and the official debate is wrapped in language about moral hazard and borrowers who were irresponsible. Unmentioned is the role of the 2005 bankruptcy law in prompting people who are in a financial squeeze to choose, intelligently, to stop the mortgage payments so they can keep up with their monthly credit card payments, fueling a surge in foreclosures that threatens the value of even soundly financed or paid-off homes. A New York Federal Reserve report estimates that almost 11,000 extra subprime mortgage foreclosures each month are traceable to the 2005 law, a model of favoritism for those who lavish campaign contributions on lawmakers. (For the report, see http://www.newyorkfed.org/research/staff_reports/sr358.pdf.)

That the terms and beneficiaries of these bailouts reflect official bias in favor of Wall Street and against side-street America is shown most glaringly by the lack of controls on the money and guarantees doled out to the financial and insurance industries in contrast to the demands for controls and givebacks from blue collar auto workers as part of proposals to direct just 2 percent of the bailout money to Detroit.

The vast majority of Americans are being forced to sacrifice for the few who grew fabulously rich by trafficking in derivatives, issuing toxic mortgages, and investing in opaque entities offshore. All of their schemes were enabled by an administration that brought truth to Ronald Reagan's famous assertion that "government is the problem." The Clinton and George W. Bush administrations and both parties in Congress all failed miserably in their core duty to ensure the economy was sound and the fisc was protected.

Now the many are sacrificing, and will be forced to sacrifice much more for a very long time to come, to pay for the follies of the few on Wall Street and in Washington.

On George W. Bush's watch, the oversight of financial firms virtually vanished while the federal debt nearly doubled *before* the bailouts began. Bankers, insurers, and hedge funds running wild brought us the bailouts that equal the nation's entire economic output for about seven months. The wild spending of the Bush administration means that the equivalent of all the individual income taxes paid from January through sometime in May go just to pay interest on the national debt.

The bailout costs and the interest obligations are crowding out spending on the public investments vital to future economic growth — research and development, maintaining and expanding the infrastructure, and educating young minds. In a technological age, robbing investments in knowledge and young minds, and failing to develop an Internet worthy of, say, Korea, is a form of mass economic suicide, equivalent to an agrarian society eating its seed corn to get through the winter.

So how do we start digging ourselves out of this awful hole, which grows deeper by the hour, while a tide of red ink floods the space, threatening to drown our future?

Comparing Taxpayer Investment to Warren Buffett Investment in Goldman Sachs		
Assumes redemption after 10 years		
Strike Price	$115.00	$121.68
Warrants Issued	43.5 million	9.2 million
Black-Scholes Value per Warrant	$40.95	$51.81
Term of Warrant (Years)	5	10
Dividend for First 5 Years	10%	5%
Dividend Thereafter	10%	9%
Call Premium	10%	0%
Amount Invested	$5 billion	$10 billion
Plus (Less) Warrant Value	$1.78 billion	
Implied Value Preferred Shares	$3.22 billion	
Yield to Call for Preferred	19%	
Derived Preferred Value at 19% Yield		$4,516 million
Warrant Value (Black-Scholes)		$479 million
Market Value Preferred & Warrants		$4,995 million
Higher Price Paid by Taxpayers		$5,005 million
Source: Steelworkers Union from Goldman Sachs and Treasury TARP documents.		

Let's start with going after people who cheated and abused the tax system. There is no moral argument for cheating on taxes, especially calculated cheating that requires the use of tax professionals and planning. If you do not like our tax system, then work to elect a different Congress.

But just as official policies and actions enabled the banking, insurance, and investment lunacies that prompted the bailouts, so have those policies enabled and even empowered tax cheats.

Now America needs to raise a lot of tax revenue to pay for the bailouts. And the best place to start raising that money is in the Cayman Islands, a British protectorate that could properly and accurately be called the Cheaters Islands.

And because all public policy must be branded these days, let's call this Operation CHEAT (Conquering Havens Evading American Taxes).

The Caymans should get attention first because they are the biggest known hosts to entities that exist only on paper at Ugland House, the five-story, colonial-style headquarters of the law firm of Maples and Calder. Going after the Caymans first will get the attention of individuals and businesses that rely on the Caymans to hide their criminal activity.

Cracking down on "governments" that enable tax cheats is an idea embraced by at least one prominent head of state: French President Nicolas Sarkozy. President Bush rejected any such notion in October (*Doc 2008-22183*).

We don't know how much tax evasion the Cayman government is facilitating, but we do know that it boasts that it is doing nothing wrong. When the Government Accountability Office issued a gingerly worded report last July 24, the Caymans publicity apparatus was eager to obscure what the report said. (For the GAO report, see *Doc 2008-19132* or *2008 TNT 175-24*.)

Caymans publicists said that the GAO report supports "our position that tax compliance in relation to U.S. persons is an obligation of those persons" and even claimed the report showed a "high degree of transparency and assistance" from Caymans authorities in pursuing tax cheats, drug traffickers, terrorists, and other malefactors of hidden wealth. The GAO report does not use the words "high degree." Read closely, it says that when American authorities have already identified a suspect and are in pursuit, then they get cooperation.

That is an utterly unreasonable standard of cooperation in light of what the Cayman Islands government went on to say in its statement:

> As the report recognizes . . . the U.S. Congress and those who are responsible for drafting and enforcing U.S. tax laws and regulations necessarily must play the principal role in enhancing compliance with those laws and regulations by U.S. taxpayers.

In plain English, that means tax cheats are free to use the Caymans, and abuse the United States, unless they are identified one by one by the American government.

But ignore what the Caymans says and just look at its budget. The George Town government spends less than 1 percent of the $499 million total budget on financial intelligence matters. (See http://www.gov.ky/pls/portal/doc/PAGE/CIGHOME/FIND/ORGANISATIONS/AZAGENCIES/PFE/THEBUDGET/20082009BUDGET/20089ANNUALBUDGETSTATEMENTS.PDF.)

Here is a way that we can stop enabling the damage done to America, and the burden shifted onto American taxpayers, by the Cayman government's parasitic conduct.

First, Congress should pass a new Taxpayer Abuse Act, making it easier to convict serious tax cheats by making the signing of multiple tax returns with more than $50,000 of tax not reported a felony on its face. This law should be designed to minimize the Snipes defense, in which jurors bought the argument that the advisers alone were truly culpable. This law should also bar any connection between American and Caymans businesses without explicit government permission, modeling this action on the one taken more than four decades ago against Cuba. That would mean not just no banking and business deals, but no tourists, either.

Second, Congress should fund a law enforcement program based on specific deterrence, not general deterrence, under which every major tax cheat (see threshold above) will be prosecuted. Think of it as part of a stimulus package, creating jobs for lawyers, auditors, economists, computer technicians, and guards.

Third, this law should contain a provision that any taxpayer that the IRS believes shorted the government $50,000 or more for two or more years using any offshore arrangement will have his or her name, tax returns, and government calculation of his or her income and tax obligations made public.

Fourth, each taxpayer who comes forward within 30 days and acknowledges that he did not pay his taxes in full should be exempt from disclosure and from prosecution provided that, within six months, a new set of tax returns reflecting the sums actually owed is submitted and payment is made or arranged. This is the carrot — fess up and you can go on with your secret intact; lie and deny, and you will be prosecuted.

Fifth, demand that the Caymans government make available all records on American-related entities and individuals, which is apparently half of its business, according to public statements by Maples and Calder.

Sixth, if the Cayman government refuses, send in the Marines — and a legion of computer technicians, auditors, and clerks. The Caymans has no military, only about 300 cops, so marching up the tourist-laden beaches should be a breeze. The U.S. Joint Forces Command says it has never conducted a war game on invading the Caymans, though a decade ago a class at the Army War College once did a class exercise on invading St. Kitts to oust imagined narco-traffickers.

(A Caymans spokesman, Ted Bravakis, notes that the Caymans are supposed to get any needed military protection from the British.)

Once the Caymans records are in hand, whether by obtained request or invasion, the president should announce that Bermuda is next. Long before we get to Switzerland, the point should be well made that America has zero tolerance for offshore tax cheats. But if that doesn't happen, perhaps we can count on the French to help with an invasion of Lichtenstein.

Your thoughts? E-mail me at *JohnstonsTake@tax.org*.