**OVERVIEW**

“Tax shelter” is often used as a pejorative term, but it is only a legal way to reduce tax liabilities. Someone who thinks a feature of the tax code giving taxpayers the right to reduce taxes is not a good idea will label it a shelter. Someone else might call that feature of the tax code an incentive.

Individuals and corporations can reduce their final tax liabilities by allocating some proportion of their incomes in tax shelters. Although they are classically associated with incredibly wealthy households and corporations with anonymous Swiss bank accounts, tax shelters are more accessible and widespread than the usual association may suggest. For example, employer-sponsored 401(k) programs and individual retirement accounts are widespread and accessible ways individuals can “shelter” some of their income from taxation.

**ABUSIVE TAX SHELTERING**

The Internal Revenue Service makes a distinction between tax sheltering (which encompasses legal forms of reducing tax liability, like the aforementioned retirement plans) and “abusive” tax sheltering (i.e., tax evasion, which is illegal). One example of an abusive tax-sheltering scheme is the use of trusts to reduce tax liability by over-claiming deductions or even by hiding assets from taxation.

**EFFECTS**

Tax shelters are mostly beneficial when considered at the individual and firm levels. Some tax shelters may even be desirable despite their distortionary effects (namely, the substantive burden placed on the tax system, primarily through tax base erosion). Although the erosion of the tax base may be an acceptable loss for largely beneficial tax shelters (e.g., charitable contributions), some tax shelters have little to no benefits.
or are even harmful. For example, some individuals and firms are able to store wealth in offshore accounts, usually located in countries with advantageous tax rates or laws. According to Gabriel Zucman (2015), approximately $1,200 billion of wealth was stored in offshore tax havens in 2014, resulting in a tax revenue loss of around $35 billion.

Beyond eroding the tax base, tax shelters can have a host of other distortionary effects. For example, corporate wealth stored in offshore tax havens cannot be repatriated to the US without incurring the tax burden the corporation was trying to avoid. This inability to access wealth may drive firms to seek more debt financing, and can depress valuation on the market.

**TAX HAVENS**

“Tax havens” are a specific means of tax sheltering. A tax haven is a locality—be it a state, country, or region—that often has a lower corporate or personal income tax rate. Tax havens may also have other properties that make storing income there desirable, such as bank secrecy or ease of incorporation (for forming shell companies).

**WORK CITED AND FURTHER READING**

