WHAT TAX HAVENS ARE?

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Abstract:

Everyone has heard about countries such as Antigua and Barbuda, Bahamas, Costa Rica, Guernsey, Cayman, Isle of Man, Vanuatu, Liechtenstein, Switzerland being tax heavens. Who would not want to pay lower taxes, if not at all? Probably it's a dream for any person or company to take part from a jurisdiction which does not impose taxes or impose it low. They are not a recent invention of globalization, tax free zones appeared in the same time as commerce, but nowadays they play a much more important role than in the past for finance and commerce worldwide. Tax havens are not necessarily island territories. While many tax paradises are situated in the tiny islands spread in the Caribbean or Pacific, others are in the middle of or near the richest regions of the world, in Europe or Asia.

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Tax is the foundation of good government and a key to the wealth or poverty of nations (http://www.taxjustice.net/cms/front_content.php?idcatart=2). It is under attack. Tax havens, which offer secrecy, low or zero taxation, and lax regulation allow big companies and wealthy individuals to benefit from the onshore benefits of tax – like good infrastructure, education and the rule of law – while using the offshore world to escape their responsibilities to pay for it. Tax havens take many forms. Some have appeared in post-war period, others were born in the last two decades. All have advantages and disadvantages. Some of them meet high ethical standards, others have hosted fragrant scams.

There does not is a single, unambiguous definition of a tax haven. Some regulatory criteria, such as secrecy and low or zero taxes, appear in one form or another in each definition. Tax havens give opportunities to taxpayers to avoid or evade tax in their home countries.

A financial dictionary defines a tax haven as a country or other political entity that offers outside businesses and individuals a climate of minimal or nonexistent taxation. In some cases, the low taxes apply not only to those levied by the tax haven itself but also to the possibility of reducing or avoiding taxes levied in the investor's home country. Gheorghe Bistriceanu (Lexicon de finante, banci si asigurari, Vol. III, Editura Economica, Bucuresti, 2001) defines a tax heaven as a country or an area that

provides to non-residents a tax environment more favorable than that applicable to the territory of residence. In the last time the term of “fiscal paradise” turned into “offshore center”. Business field uses the term "offshore" for locations with such a tax system. Richard Murphy shows, in a report for the Tax Justice Network, that “tax havens and offshore financial centres are not the same thing. Tax havens are the countries that create the laws designed to undermine other states. Offshore financial centres are made up of the lawyers, accountants and bankers who sell the resulting products to people from other countries who want to abuse the law of the place in which they live.

However we define them, tax havens are characterized by low or zero taxation, a lack of transparency and a refusal to provide information to foreign tax authorities. The main listings of tax havens have been developed by OECD. A 1998 publication entitled *Harmful Tax Competition - An Emerging Global Issue*, set out a series of criteria on which it based its subsequent work: “The absence of tax or a low effective tax rate on the relevant income is the starting point of any evaluation. No or only nominal taxation combined with the fact that a country offers itself as a place to be used by non-residents to escape tax in their country of residence may be sufficient to classify that jurisdiction as a tax haven.” The OECD 1998 Report defined a tax heaven as a jurisdiction which has:

(a) no or only nominal taxes (generally or in special circumstances) and offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence;

(b) laws or administrative practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdiction;

(c) lack of transparency, and

(d) the absence of a requirement that the activity be substantial, since it would suggest that a jurisdiction may be attempting to attract investment or transactions that are purely tax driven.

However, the fourth criterion of “no substantial activities” was rejected in July 2001, and it was formally withdrawn in the OECD’s 2002 Progress report. The OECD recognizes that every jurisdiction has a right to determine whether to impose direct taxes and, if so, to determine the appropriate tax rate.

No or only nominal taxation combined with serious limitations on the ability of other countries to obtain information from that country for tax purposes would typically identify a tax haven. They offer a way to minimize taxes and to obtain financial confidentiality.

Tax havens serve three main purposes: they provide a location for holding passive investments, they provide a location where “paper” profits can be booked and they enable the affairs of taxpayers, particularly their bank accounts, to be effectively shielded from scrutiny by tax authorities of other countries (OECD Report, *Harmful Tax Competition - An Emerging Global Issue*, OECD Publications, Paris, 1998). Low or zero taxation allows investors to avoid their taxes but also facilitate illegal activities, such as tax evasion and money laundering. The lack of effective exchange of

information is one of the key factors in identifying a tax haven, it does not allow tax administrations access to bank information for the critical purposes of detecting and preventing tax avoidance. Lack of transparency means that banking secrecy is strictly enforced. No bank can say what they are doing for anyone without severe penalties applying. If a register of companies exists it does not require the names of the beneficial owners to be published, the names of the people who really control the company to be published, accounts to be put on public record. In other words, it‘s almost impossible to find out who is doing what in a tax haven.

What are the reasons for using a tax haven? There are three reasons why anyone would ever use a tax haven (Murphy Richard, Fiscal Paradise or Tax on Development, Tax Research Paper, 2005):

1. they want to avoid tax;
2. they don’t want people to know what they are doing;
3. they want to avoid regulation.

Tax havens and offshore financial centre have created an interface between the illicit and licit economies, corrupting national tax regimes and onshore regulation. The result is a shift of the tax burden away from capital and onto labour, and a dramatic rise in income and wealth inequality, as well as the corruption of democracies around the world as élites escape from their responsibilities (http://www.taxjustice.net). Tax havens are used to attack the sovereignty of nation states and they harm the efficiency of globalized markets.

Oxfam, an international organization which fights for ending poverty and injustice between people, advises that “urgent action is also needed to crackdown on tax havens, which deprive developing countries of hundreds of millions of pounds of tax revenue every year – much more than they receive in development aid.” (http://www.oxfam.org/en/pressroom/pressrelease/2009-04-01/bank-bailout-could-end-poverty) Oxfam is calling for new rules requiring tax havens to disclose information on money entering their jurisdiction and for multinational companies to report the taxes they pay in each country in which they operate. This would allow countries to identify individuals and organizations that illegally avoiding tax and take action to recover it.

Many specialists tried to quantify how much money is held in tax heavens. It is difficult to give any reliable figure since timely information is not widely available An analysis conducted for Oxfam by James Henry, former Chief economist at McKinsey & Co, found that at least $6.2 trillion of developing country wealth is held offshore by individuals, depriving developing countries of annual tax receipts of between $64-124bn” (http://www.oxfam.org/en/pressroom/pressrelease/2009-03-13/tax-haven-could-deliver-120bn-year-fight-poverty).

Tax is the link between state and citizen, and tax revenues are the lifeblood of the social contract (http://www.taxjustice.net/cms/front_content.php?idcatart=2). Tax havens are heightening inequality and poverty, corroding democracy, distorting markets, undermining regulation and curbing economic growth, accelerating capital flight from poor countries, and promoting corruption and crime around the world. So far the developed countries tolerate the existence of tax heavens, even if there are

countries that punish the jurisdictions which are considered as non-cooperative tax havens. We have to keep in mind that many of these countries would not be able to survive and provide for their citizens without their current offshore legislation and it is a know fact that more instances of tax evasion occur onshore than offshore.

References:

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