

Tax Havens in the Offshore World

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Abstract

The research on tax havens started because of the “Panama Papers” scandal. Tax havens exist because of taxation. Taxation is vital for any society because it is a revenue source for government. Through taxation governments get money to fulfil their role in society. It plays a major role in investment decisions and can be also an innoportunity for taxpayers. Tax havens are tax free areas that have the status of states and function legally. Their main business is to attract money by creating taxpayers friendly environments and by total secrecy. Panama is the biggest US-influenced tax haven. Tax evasion through tax havens is illegal and is the evading of declaring and paying taxes. Tax avoidance through tax havens is the legally avoiding of declaring and paying taxes. Tax havens are not illegal but are immoral because vast amounts of money drain from the states around the world to them.

Key words: tax havens, taxation, tax evasion, tax avoidance, Panama

J.E.L. classification: F65, H25, H26

1. Introduction

This article will clarify the concepts of tax haven, given the recent ‘Panama Papers’ scandal, exposing a widespread system of global tax evasion. According to this scandal, the state of Panama is considered a tax haven part of the offshore world. A part of the media and journalists presented that offshore jurisdictions are illegal and this needs clarification. In order to understand the concepts, taxation has to be defined and clarified first. Because of taxation, tax havens do exist and make the offshore world.

In any society, the need of the state for taxation is vital, nothing else replacing this source of revenue for funding and support (Constantin, 2014a).

By Bacanu (2016) “through taxation are determined, verified and collected the revenues of the general consolidated budget which finance the public expenses”. Taxation objective aims to collect the money owed by the taxpayers to the state budget. Analyzing this objective, can be observed two parties involved in the fiscal and legal relations: the State and the taxpayers (Bacanu, 2016). So, the state through government collects money from taxpayers.

Taxpayers’ welfares are taxed to generate revenues for government to provide essential services for society, so taxes are the lifeblood of governments. Through taxation governments get money for health care, social care, environment protection, education, research, infrastructure, investments all these necessary for development. Economically, some sectors of the economy are developed with tax revenues from more developed sectors.

“On the other hand, if one company operates on a market, it takes part to the society and if it takes part to the society it must take part to the realization of the state incomes. All the persons, juridical or natural persons, who obtain an income, or are owners of a wealth, must pay a certain tax. ...

Taxation objective is also to determine the way in which the taxes are computed, the size of the taxes, but also how to declare and collect them. The taxes are the state incomes, which are collected for the good functioning of the society” (Bacanu, 2015).

Taxation plays a major role in investment decisions since it represents a business cost, whatever

its type, size or geographical area. When making investment decisions, the business environment is judged also according to the level of taxation and to the fiscal system.

Taxation can be also an insupportable burden for taxpayers, however honest they prove to be. Taxes are universally hated, because taxpayers must share their wealth with the government. Moreover, taxation becomes the cause of public dissatisfaction when the government wastes the money it administers, pushing the taxpayer to dodge taxes (Constantin, 2014a).

The ability or inability to collect taxes points to the strength of the tax system of a country, saying a great deal about its stability.

If the fiscal system is characterized by a poor collection of taxes, with inefficient tax authorities, excessive bureaucracy, lack of transparency, corruption and very hard tax legislation then some taxpayers (especially rich persons or entities) to move their activities or capitals, abroad to more tax friendly environments. This can happen also because of the high tax pressure, the official scope being to legally optimize their taxes. These taxpayers succeed in avoiding taxes (legally or not legally), and more frequently, in transferring their money to the more tax friendly environments called tax havens.

2. Tax havens and the offshore world

Tax havens are tax free areas, which are genuine territorial enclaves that benefit by customs extraterritoriality and are not subject to states legislations, having a legal status of genuine state entities. Most of tax havens are sovereign states. By themselves, tax havens do not have anything illegal, because all procedures, exemptions or confidentialities are provided in the local law (Virjan, 2011).

The scope of tax havens is to attract rich people, rich entities (companies, trusts, foundations) and investment of capital to ensure the economic and social balance. Their main goal is to attract money from abroad so they make the local tax legislation accordingly. Tax exemptions are used widely by tax havens in order to achieve this goal (Constantin, 2014b).

The advantages of doing business in a tax haven are given, on the one hand, by zero or very low taxation, and on the other hand, by the protection under the law of financial or commercial operations performed by individuals or legal entities. These financial centres play a destructive role for the states the money comes from because they serve as subterfuge in those states tax systems. Capital export, associated with tax evasion, deprive especially poor and developing countries (and not only) of the sources necessary for sustainable development (Constantin, 2014b). So tax havens attract money by helping taxpayers escape taxes (legally or illegally) from countries they are tax residents; they help rich taxpayers stash their money.

In order to ensure a privileged tax system, these entities permanently adapt their friendly tax legislation in accordance with international evolutions and international environment.

According to Shaxson (2012), tax havens don't just offer an escape from tax; they also provide secrecy, an escape from financial regulation, and are indifferent to the laws and rules of other jurisdictions, the countries where most of the world lives. A tax haven is a place that seeks to attract business by offering politically stable facilities to help tax payers (people or entities) from other countries get around the rules, laws and regulations. The whole point is to offer escape routes from the obligations and the responsibilities that come with living in an obtaining benefits from society – tax, responsible financial regulation, criminal laws, inheritance rules and so on (Shaxson, 2012, p.8).

The offshore world is made of tax havens and is all around us. More than half of the international commerce is made, at least on paper, through tax havens. Over half of all banking assets and a third of foreign direct investment by multinational corporations come from offshore jurisdictions.

The development of a bank system without restrictive regulations and constraints, which ensures the rapidity of operations inside and outside the borderline, absence of a strict control of exchanges, except the operations related to foreign currencies, and also the provision of means of communication at high functional level, are characteristics which also define tax havens.

The offshore world is divided roughly into three main groups. First are the European tax havens - Andorra, Madeira, Switzerland, Liechtenstein, Monaco, The Netherlands, Cyprus, Dutch Antilles,

San Marino, Aruba. Second is a zone of influence focused on the United States – island of Manhattan, Delaware, Nevada, Wyoming, US Virgin Islands, Liberia, Marshall Islands, Chile, Costa Rica, Guatemala, Uruguay, Panama, Philippines. Third and the most important group is made of tax havens located in the British former colonies still under the British sphere of influence and centered on the City of London - Anguilla, Alderney, Antigua and Barbuda, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Dubai, Dominica, Cayman Islands, Gibraltar, Guernsey, Grenada, Ireland, Isle of Man, Jersey, Malta, Hong Kong, Singapore, Turks & Caicos Islands, Malaysia, Maldives, Mauritius, Nauru, Niue, Seychelles, St. Vincent and the Grenadines, St. Kitts & Nevis, St. Lucia, Tonga, Vanuatu (Shaxson, 2012, p.8-10 and Constantin, 2014b).

It can be seen that most of the tax havens are located in the British former empire. The money that goes in these tax havens is afterwards managed by (and not only by) London's financial institutions, the main beneficiaries of this business of tax havens being both the underworld and the high class of the world's political and economic elite. Hence, London is the financial centre in the centre of a spider web, which connects it to many of the tax havens, being considered the greatest tax haven from the world (Constantin, 2014b). Tax havens from the former British Empire located nearby United States of America tend to be slowly but surely under its sphere of influence.

Panama is the biggest tax haven within the United States sphere of influence. Republic of Panama is within United States sphere of influence from the very beginning and has a free trade agreement with it. It is also of a great interest for United States because of the Panama Canal, which the Americans built between 1904 and 1914.

Panama began registering foreign ships in 1919 to help Standard Oil escape American taxes and regulations. Offshore finance followed in 1927, when Wall Street interests helped Panama introduce lax company incorporation laws, which let anyone start tax free, anonymous corporations, trusts and foundations, with few questions asked (Smith, 2016). Panama started the real business of "offshoring" in the 1970s during the OPEC oil crisis when the shipping industry was hit hard. This meant that Panama needed to attract foreign investors and adopted legislation specific for tax haven. This involves exempting foreign investors and their international business companies from taxes, corporate shareholders are not required to be publicly registered, enforcing strict banking secrecy laws, and offering competitive incorporation laws.

Republic of Panama has no tax treaties with other countries so they don't share tax and financial information about its investors with other nations, further protecting the financial and fiscal privacy. The secrecy laws don't apply only if a court order in conjunction with a criminal investigation does exist (Maverick, 2016).

The country is filled with lawyers, tax advisors, accountants, bankers, company formation agents and companies specialized in the offshore industry, that make Republic of Panama very prosperous. All these are happening under the watchful eye of the United States of America. This strange and little-known US centered pattern, echoing the somewhat colonial role of the secrecy jurisdictions in the British zone, is a pointer to the fact that offshore finance has quietly been at the heart of schemes to project US power around the globe for years (Shaxson, 2012, p.9).

3. Tax evasion through tax havens

Tax evasion is the illegally evading of declaring and paying taxes to the state budget and it is committed through violation of the tax law. Tax evasion is escaping taxes by illegal means. So, tax evasion is illegal and it is pecuniary and criminally sanctioned (Virjan, 2011).

One form of tax evasion consists in fictitious economic operations through offshore companies from tax havens. Using this form of tax evasion, profits are transferred to tax havens by doing fictive businesses with offshore companies from tax havens. By artificial shifting of profits from a high-tax jurisdiction to a low-tax jurisdiction, taxes of a company will be reduced, without affecting the business.

Offshore companies provide services that are not real to companies from different countries of the world. These services are of consultancy, management, marketing, and they cannot be quantified because they are fictitious. Such services are not really provided, only a circuit of documents is created and such documents do not reflect real business. These fictitious services are regulated based on civil contracts concluded between parties, which contain a series of advantages

in order to favour the transfer of profits to a certain tax haven. Many of these contracts stipulate the confidential character of the business precisely because the business is without a real base. In order for the services to look more real, written reports and estimates of works are made also. The fictitious services are used as instrument of transfer of an important part of the taxable profit to tax havens. By accounting these services as deductible expenses, less profit tax is declared and paid to states budgets. More expenses means less dividends and less dividend tax to pay (Constantin, 2014b).

The offshore business is also used in exports. Indigenous goods are exported at modest prices to an offshore company, which carries a price adjustment, in the meaning of raising it up to the real value of the export, and, subsequently, the said product reaches the final destination. The taxable profit is visibly diminished with the hidden price of the goods that are to be “exported” to other offshore companies, and the effect is represented by the diminishing of the corporate tax due in the country of origin. Goods may be also exported to offshore companies and then imported back in the same country, illegally requiring the VAT reimbursement in the Customs (especially in the EU countries where VAT does exist).

4. Tax avoidance through tax havens

Tax avoidance must be distinguished from tax evasion. Taxpayers, who use offshore jurisdictions but respect the local legislation, cannot be sanctioned by authorities.

Tax avoidance is the legally avoiding of declaring and paying taxes to the state budget. It is the use of legal methods in order to declare and pay the least amounts of taxes possible, to the state budget. In other words tax avoidance is the lawful minimization of taxes, is escaping taxes by legal means using legislative gaps in taxpayers favor (Suresh, 2011). This practice is legal and differs from tax evasion, which is illegal so tax payers are not considered tax dodgers.

Tax avoidance is possible only when the law is incomplete or has inaccuracies. Taxpayers are trying to put themselves in a favorable position in order to benefit of tax regulations, as much as possible. It is natural and normal for taxpayers to leave from high-tax jurisdiction to low-tax jurisdiction, as long as they don't break their national laws.

A tax haven is an instrument, of international tax avoidance, used by the taxpayers who are looking (by legal means) for more advantageous tax treatments. It is the right of every taxpayer to identify the perfect tax haven which maximizes the advantages and minimizes the risks in order to legally optimize their taxes. Persons or entities will choose a tax haven after a careful juridical, financial and fiscal analysis. A person may establish the center of vital interests in a certain tax haven and get tax residency.

If anyone chooses to invest or to start a business in a certain tax haven because taxes are lower than the country of origin, it is legal and we talk about tax avoidance.

Persons or entities cannot be accused of tax evasion for the simple fact that they carry out their activities in offshore jurisdictions called tax havens. In order to be considered tax dodgers, tax payers should break the tax law in their countries but in these cases this doesn't happen.

Thus offshore business is a device to avoid taxes.

5. Conclusions

The main conclusion is that tax havens are not illegal but are immoral.

Directing the world's finances towards offshore centres from tax havens can be compared with blood loss. Blood means life and sustains life; money means welfare, sustains the state and the economy of the state. The flow of blood in our veins is the same with the flow of money in the economy. The flow of blood in our veins means that we are healthy and alive but if we lose blood we become sick and we could die. If a state loses too much money could get sick and go into recession.

Part of the money in the economy is visible to the authorities, the other part, which is quite substantial “drains” towards the tax havens. In this way, tax havens have become genuine “blood banks” of huge amounts of money “drained” through methods more or less fraudulent of avoiding taxation. Tax revenues have been drained out to tax havens.

Because of the drainage of money vast amounts financial resources are kept offshore and go untaxed in the world countries. States need to stop and prevent this drainage of money to tax havens. This requires a simple, transparent, diminished and stable fiscal system which allows companies and investors to implement long-term strategies and to cater for a coherent management of daily business activities. This rule becomes more stringent in difficult periods, whenever the financial constraints affect the normal run of business. In such a situation, the state economic machinery should intervene to ease fiscal burden and to help the business environment get out of crisis.

A successful economic environment can only be maintained through a close relationship between the legislator and the tax payers. There should be a permanent improvement of the fiscal system, since it keeps the balance of benefits both for tax payers and the state, and for the economy as a whole, implicitly.

Yet, Britain and United States are protectors of the offshore world and the offshore system continue to process vast amounts of money.

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