Qualitative and Quantitative Approach for Identifying the Largest Tax Havens in the World

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Abstract

Tax havens are associated with avoiding the payment of tax obligations, whose origins are as old as taxation itself. Different set of criteria are used for defining tax havens, from very low or zero taxes to lack of transparency, financial secrecy and amount of profits reported in other jurisdictions.

The purpose of this paper is the identification of the jurisdictions considered the largest tax havens in the world. On one hand, the qualitative list of tax havens provided by OECD and the European Union are strongly politicized, mentioning none of its members and misidentifying the real tax havens, and on the other hand, analyzing the qualitative studies performed by internationally recognized economists that use different research methodologies, revealed the largest tax havens as being: Ireland, Cayman Islands, British Virgin Islands, Singapore, Switzerland, Netherlands, Luxembourg, Hong Kong and Bermuda.

Key words: tax havens list, qualitative, quantitative.
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1. Introduction

In the context of fierce competition between jurisdictions for attracting international financial capital, tax havens and offshore financial centers provide the framework in which a multitude of opportunities for economic-financial crime can be identified. Also, inconsistencies and ambiguities in the tax legislation are exploited to reduce tax obligations through mechanisms that, although comply with the letter of the law, they are not in accordance with its spirit.

The most amazing tax haven in the ancient world dates back in the 2nd century BC, and is attributed to Romans that established it on the Delos island of the Aegean (Adams, 2011). In that area the commercial giant was the Rhodian Empire, Athens and Sparta being overtaken by the island of Rhodos, which was a natural stop for business. Thus, all traders traveling from the eastern Mediterranean, especially from Rome and Greece, passed through Rhodes and paid a 2 per cent tax in exchange for Rhodians protection provided against pirates. Also, the Rhodians had an agreement with the Romanians to act as intermediaries between Rome and Macedonia, who were at war at that time. To the disappointment of the Romans who saw the Rhodians as allies, Rhodos adopted a neutral attitude, offering to act as a mediator in the war. As a punishment, the Romanians decided to set up in the nearby island, Delos, a port in which no taxes were levied, and that generated in Rhodes, in the first year, the 85% decrease of the revenues from the taxes levied, shortly not constituting any more an option for merchants. Thus, the Romans succeeded in gaining a victory against the Rhodians without resorting to military or naval action. Moreover, Rome used to use fiscal policy to reward its friends, the loyal cities being exempted from taxes, but also to punish their enemies by means of tax requests.

Tax havens, as we know them today, began their development in the late nineteenth century, when, considering a strict regime of setting up companies in the US, states like New Jersey and Delaware patented the technique of fast registration, which is today one of the key aspects of the tax haven strategy. Through this technique, due to the permissive legislation, in less than a day, transactions in the newly registered company can already be initiated.

Another important moment in the development of tax havens was the one in which the residents of the United Kingdom, intending to escape the payment of tax obligations for their activities within the UK territory and abroad, have chosen to transfer their tax residence outside the country. Decisions of the British courts have confirmed that if a company did not have activities developed in United Kingdom, although having the tax residency there, it should not be taxed by the British authorities. Consequently, the rule was extended to the entire British Empire, an aspect subsequently exploited by jurisdictions such as Bermuda and the Bahamas and perfected in the 1970s by the Cayman Islands.

In the early 1900s, directly after the Great War, a large number of war-torn governments in Europe raised taxes sharply in the context of reconstruction efforts. Switzerland, remaining neutral during the First World War, avoided these high costs of infrastructure reconstruction. Therefore, it has used this strategic advantage to maintain a low tax base. With taxpayers looking for ways to avoid paying taxes, there was a substantial flow of capital into Switzerland, where the wealthiest Europeans were relocating their assets. The Swiss banking law, since 1934, in Article 47, reinforced the principle of banking secrecy, placing it under the protection of criminal law. The law makes the investigation of the commercial secrets of banks and other organizations a criminal offense, so that, once the borders are crossed, the capital enters an inviolable legal sanctuary guaranteed by the penal code and supported by the power of the Swiss state (Palan, 2009).

Thus, these elements developed by the USA, regarding the rapid registration, and by the United Kingdom, regarding the tax residence, together with the legislative regulations elaborated by Switzerland regarding banking secrecy, constitute the bases on which the tax havens were developed later.

2. Literature review

The Organization for Economic Cooperation and Development (OECD), in April 1998, defined tax havens as jurisdictions that meet 3 of the following 4 criteria.

The first is that the jurisdiction charges very low or zero taxes. However, the fiscal criterion is not enough for characterizing a jurisdiction as being a tax haven. The OECD states that each jurisdiction has the right to impose direct taxes and to determine the level of tax rate. An analysis of the other key factors is necessary to consider a jurisdiction as tax haven. Three other factors to consider are:

- lack of transparency in legislative and administrative practices. Transparency ensures uniform application of tax laws among similarly situated taxpayers and the tax authorities have the accounting records that allow them to determine the tax obligations of taxpayers.
- the existence of legislative provisions that encourage financial secrecy and prevent the efficient exchange of tax related information, with other authorities regarding taxpayers who benefit from low or zero taxation. The OECD encourages countries to adopt "on demand" exchange of information, which describes the situation in which the entitled authority of one country requests from their counterpart of another country specific information in relation to an ongoing tax investigation, generally based on a bilateral exchange agreement between the two countries.
- the absence of the requirement that the activity be substantial. The criterion of non-existence of substantial activity was included in the 1998 OECD report as a criterion for identifying tax havens, to prevent a jurisdiction from attracting investments and transactions that are only determined by fiscal causes.

In the 2000 report, the OECD, according to the criteria it established, identified 35 tax havens. According to OECD, the report does not include a number of countries that, although at the time of publication of the report meet the criteria for being considered tax havens, have made commitments at the highest level to progressively eliminate harmful tax practices by December 31, 2015.

Table no.1 List of tax havens according to OECD

Andorra	The Republic of the Maldives
Anguilla – Overseas Territory of the United Kingdom	The Republic of the Marshall Islands
Antigua and Barbuda	The Principality of Monaco
Aruba – Kingdom of the Netherlands[a]	Montserrat – Overseas Territory of the United Kingdom
Commonwealth of the Bahamas	The Republic of Nauru
Bahrain	Netherlands Antilles – Kingdom of the Netherlands[a]
Barbados	Niue – New Zealand[b]
Belize	Panama
British Virgin Islands – Overseas Territory of the United Kingdom	Samoa
Cook Islands – New Zealand[b]	The Republic of the Seychelles
The Commonwealth of Dominica	St Lucia
Gibraltar – Overseas Territory of the United Kingdom	The Federation of St. Christopher & Nevis
Grenada	St. Vincent and the Grenadines
Guernsey/Sark/Alderney – Dependency of the British Crown	Tonga
Isle of Man – Dependency of the British Crown	Turks & Caicos – Overseas Territory of the United Kingdom
Jersey – Dependency of the British Crown	US Virgin Islands – External Territory of the United States
Liberia	The Republic of Vanuatu
The Principality of Liechtenstein	

a) The Netherlands, the Netherlands Antilles, and Aruba are the three countries of the Kingdom of the Netherlands.
b) Fully self-governing country in free association with New Zealand.

Source: OECD, https://www.oecd.org/ctp/harmful/2090192.pdf

Subsequently, in 2001, the OECD Committee on Fiscal Affairs agreed that the fourth criterion, regarding the absence of the requirement that the activity be substantial, will not be used to determine if a tax haven is cooperative or non-cooperative considering only two of the other three criteria.

Between 2000 and 2002, most of the 35 identified jurisdictions formally committed to implementing the OECD standards on transparency and information exchange, followed between 2003 and 2009 by Nauru and Vanuatu, Liberia and the Marshall Islands, Andorra, the Principality of Liechtenstein and the Principality of Monaco.

However, according to the Tax Justice Network (2018), the criteria used by the OECD are not appropriate and the outcome of the reports are politicized, inefficient and meant to mislead by misidentifying the tax havens. As none of its members has not been included in the list of tax havens, countries such as Ireland, Luxembourg and Switzerland are sometimes ironically referred to in the literature as OECD tax havens (Weyzig, 2012).

Also, a number of objective quantitative analyzes, have been carried out by internationally recognized economists for the quality of their work:

1. James R. Hines Jr. is an American economist, his work being among the first that mentioned the quantitative features of tax havens. According to the author, these are countries and territories that offer low tax rates and regulatory policies favorable to foreign investors. Tax havens usually tax investments at zero or very low rates and encourage investments by offering telecommunications and transportation facilities, business development infrastructure, favorable legal environment and limiting bureaucracy for setting up new companies. The tax havens are small in size, most are islands, characterized by a good and efficient governance, political stability and effective corruption control. With a few exceptions, they have populations below one million inhabitants and above average incomes. Although in the past tax havens were associated with banking secrecy and corporate anonymity, organizations such as the OECD have determined all countries, including those in

the tax haven category, to implement measures regarding the exchange of information in the tax field.

His work, and the one of PhD student Rice, E., "Fiscal Paradise: Foreign tax havens and American business, 1994", is the most cited research paper in the history of tax havens, being mentioned also in the research papers of the following authors: Desai, Dharmapala, Zucman. It contains the first coherent academic list of tax havens and refers to the group of the largest tax havens (Big 7): Switzerland, Hong Kong, Ireland, Liberia, Lebanon, Panama, Singapore.

In the 2010 research paper, Hines published a revised list of 52 tax havens, the top 10 positions being held by Luxembourg, Cayman Islands, Ireland, Switzerland, Bermuda, Hong Kong, Jersey, Netherlands Antilles, Singapore, British Virgin Islands.

Table no.2. List of tax havens according to Hines, 2010

Tax Havens

	Andorra	11	Guernsey		Nauru
	Anguilla	6	Hong Kong	8	Netherlands Antilles
	Antigua and Barbuda	3	Ireland		Niue
	Aruba	18	Isle of Man	12	Panama
14	Bahamas	7	Jersey		Samoa
16	Bahrain		Jordan		San Marino
	Barbados		Lebanon		Seychelles
	Belize	17	Liberia	9	Singapore
5	Bermuda		Liechtenstein		St. Kitts and Nevis
10	British Virgin Islands	1	Luxembourg		St. Lucia
2	Cayman Islands		Macao		St. Martin
	Cook Islands		Maldives		St. Vincent and the Grenadines
	Costa Rica		Malta	4	Switzerland
13	Cyprus	15	Marshall Islands		Tonga
	Djibouti	19	Mauritius		Turks and Caicos Islands
	Dominica		Micronesia		Vanuatu
	Gibraltar		Monaco		
	Grenada		Montserrat		

Source: Hines (2010) Table 1

2. The Institute for Taxation and Economic Policy is an independent, non-profit research organization in the United States that provides in-depth analyzes of the effects of fiscal policies at local and national level. It ranks tax havens based on profits reported as belonging to subsidiaries in offshore financial centers and focuses the study on Fortune 500 companies. The strong correlation of these companies with tax haven listings derives from global studies that show that US MNEs are a dominant presence in tax havens. The study on "The use of tax havens by Fortune 500 companies" shows that at the level of 2017 at least 366 companies, representing 73% of them, established at least one subsidiary in one of the countries considered tax havens, demonstrating how extensive the use of tax havens is by big companies. The most used tax haven in the Fortune 500 ranking is the Netherlands, most of the companies reporting at least one subsidiary there. The mentioned study shows that 2,213 subsidiaries are owned by only 30 companies with the highest amounts reported in tax havens.

In 2016, 293 from Fortune 500 companies reported profits outside the borders totaling $ 2.6 trillion, with 30 companies accounting for 68% of the total, with Apple, Pfizer, Microsoft, General Electric leading the list.

Table no.3 Classification of the 10 most used tax havens considering the amount of profits reported as being obtained by the subsidiaries from different jurisdictions

Tax Haven Country	Reported Profits of U.S.-Controlled Subsidiaries (dollars in billions)	Gross Domestic Product (billion dollars of GDP)	Subsidiary profits as % of GDP
Bermuda	$104	$6	1884%
Cayman Islands	46	3	1313%
British Virgin Islands	7	1	746%
Bahamas	23	8	282%
Luxembourg	68	56	121%
Ireland	135	225	60%
Netherlands	165	829	20%
Singapore	23	290	8%
Switzerland	44	665	7%
Hong Kong	10	263	4%
Total:	$625	$2,346	Avg: 27%
Total for all other countries in IRS Data	$428	$45,616	Avg: 1%

Source: Institute on Taxation and Economic Policy (2017) p. 16.

3. Gabriel Zucman is a well-known French economist, his research work on quantifying the financial dimension of the techniques of tax avoidance by base erosion and the transfer of profits (BEPS) in tax havens is among the most cited.

In his paper, "The missing profits of nations" (2018), he shows what is the value of the global profits transferred outside the borders to speculate the differences in the taxation of the profit. Zucman bases his analysis on the directly observable value of profits recorded globally by multinational companies with subsidiaries in tax havens, using data that was not available until recently. Thus, it produces a new database containing the jurisdictions in which multinationals register their profits.

According to Zucman, Ireland is the preferred destination for profit shifting, leading the list of tax havens, followed by Singapore, the Netherlands, the Caribbean and Switzerland.

Table no.4 Profits transferred to tax havens (in USD billion)

No.	Tax haven country	Reported profits	Of which local firms:	Of which foreign firms:	Shifted profits:
1	Ireland	174	58	116	-106
2	Caribbean	102	4	98	-97
3	Singapore	120	30	90	-70
4	Switzerland	95	35	60	-58
5	The Netherlands	195	106	89	-57
6	Luxembourg	91	40	51	-47
7	Puerto Rico	53	10	43	-42
8	Hong Kong	95	45	50	-39
9	Bermuda	25	1	24	-24
10	Belgium	80	48	32	-13

Source: Author's processing based on data from Zucman *et al* (2018)

3. Data and method

To better understand the case, several written documents from various sources have been analyzed. Secondary data collection method was used, in particular official reports published by OECD, but also studies performed by internationally recognized economists for the quality of their research. The most relevant data was selected to increase the research reliability and validity.

To perform the analysis a process of iterative readings of the texts was conducted, the findings being refined during the analysis. At the level of the theoretical research, generally a deductive approach was used, starting from existing concepts, theories and regulations, that were particularized in order to emphasize the most utilized tax havens in the world.

4. Findings

Reviewing the literature, two types of lists that contain tax havens could be distinguished:

• Governmental - these lists are qualitative and strongly politicized, being neglected by academic research. Surprisingly, both the OECD, which in the 2017 report lists only one country - Trinidad and Tobago, as well as the European Union, whose list in June 2019 was made up of American Samoa, Belize, Fiji, Guam, Marshall Islands, Oman, Samoa , Trinidad and Tobago, United Arab Emirates, Virgin Islands, Vanuatu (Official Journal of the European Union, 2019), does not mention any of their member states.

• Non-governmental - these lists are produced following objective quantitative analyzes, carried out by internationally recognized economists for the quality of their work:

From Tables no. 2, 3, 4. we can conclude that in Zucman's research paper, 9 of the top 10 tax havens are the same as in the top 10 of the two quantitative studies previously mentioned, belonging to James R. Hines Jr. (2010) and the Institute of Taxation and Economic Policy (2017).

Although in each of the 3 studies the research methodology was different, the similar results obtained validate the list of the largest tax havens as being: Ireland, Cayman Islands, British Virgin Islands, Singapore, Switzerland, Netherlands, Luxembourg, Hong Kong and Bermuda.

6. Conclusions

Tax havens in the modern sense began their history at the end of the nineteenth century, but only after the First World War states began to develop coherent legislation and policies for this purpose, being aware of the benefits they were going to obtain.

Globalization has caused large corporations to expand their structures outside the borders, one of the considerations being the future fiscal implications, so countries with low or non-existent tax levels are preferred. These jurisdictions maintain attractive tax regimes and administrative formalities to a minimum to attract foreign investment, create employment opportunities within the local community, and encourage a transfer of competences within their jurisdictions.

Tax havens encourage unfair tax competition by reducing the tax base of other countries where taxes should have been paid and deprive governments of tax revenues that are so needed for socio-economic development.

Increasing institutional capacity, international tax reforms and collaboration between states can counteract this threat and may support governments to increase revenue collected to the budget.

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