Tax haven research paper

Finance, Investment

Tax Haven is a country or an area where either taxes are not levied at all or are levied at a lower rate as compared to other areas or countries. International taxation may lead to higher tax rate and hence a higher amount of payment, due to this the various entities having subsidiaries may establish themselves in a tax haven. Different countries are a tax haven for different entities and businesses. Such a situation may lead to competition among governments. Various business houses prefer to establish themselves in an area where the tax rates are low. As per a report in 2012, the amount of unreported tax haven estimated worldwide is between $21 trillion to $32 trillion. Tax haven can be identified as an area with nominal rate of taxes or nil rate of tax, this could be due to lack of transparency and protection of financial information of the tax payers. This prevents any chance of scrutiny or discovery of information.

There are basically three types of tax havens. These can be classified as primary tax haven, semi tax havens and conduit tax havens. Primary tax haven is the place where financial capital ultimately winds up. Semi tax haven are areas where production of goods for export is carried out. An example of a semi tax haven is a free trade zone. Conduit tax haven is the place where income from export sales is collected and then allocated. Semi tax havens transfer the amount after allocation of costs to the primary tax haven. There is no clear matching of income to the outflow of money. Due to this there is no clarity in the financial information and no scrutiny of the same.

Tax haven provides a chance for various international organizations to establish and pay tax at a low rate or a negligible rate of tax. Tax havens are

also known as offshore jurisdictions which work as an advantage for investors. For foreign investors who invest in the tax haven, the taxes are almost negligible or at a lower rate. This is applicable only for investors who do not carry any business in the tax haven. Many states do this to encourage investment in their economy. Individuals residing in countries like Europe with a very high rate prefer to invest in tax havens. This method is not appreciated by government or the tax department because it leads to a loss of revenue for the government. Government has been attempting to control the free cash flow and restrict the movement of money into the tax haven. It is easy to hide the ownership of a business in a tax haven which is why it is preferred by many nowadays.

Any information about the bank account holders is not available to the authorities unless information about crime against that person is discovered. This ensure secrecy of the data and personal information of the account holders. Personal information of a company or its owner is not listed anywhere. This is preferred by the business owners. Not all tax havens are same, some choose to serve individual investors while there are few who choose to serve corporations. There are also some who choose both. Another characteristic of a tax haven is that mostly affluent investors choose to invest in the tax haven. Individuals with income from various sources choose to invest in tax haven and maintain secrecy with their accounts. Though investing in tax haven has become available for all people. It is mostly the affluent who choose to invest and maintain accounts in such areas so as to avoid excessive tax payments.

Tax haven has increased the work and earnings of tax planners and

accountants who are constantly trying to minimize tax burden and increase the wealth of their employees. A strategy to use tax haven is to evade tax, which means simply avoiding the payment of taxes. There are various organizations and corporations which are established to launder money. These organizations are headquartered in tax havens and hence allow the tax evaders to maintain secrecy. It becomes difficult for authorities to trace transactions or to locate the identity of a person. Another strategy is debt and earnings stripping, which involves moving money from a high tax area to a low tax jurisdiction or a tax haven. A company may show borrowings in a high tax jurisdiction while transferring the profits in a low tax jurisdiction. Transfer pricing is similar to this, it basically involves multinational companies with subsidiaries around the world. The goods are sold from one subsidiary to another and then to the subsidiary in the tax haven. The goods in the tax haven are sold at a fraction of a cost making it easy to show higher earnings and distributing the earnings in the tax haven itself. Tax haven also helps in transferring money through patent and intellectual property licensing. With a patent registered at the company’s name, it can transfer it to a tax haven and then charge a huge amount from the parent company. It is difficult to establish a proper market price for patents or intellectual property. Hence it becomes difficult to detect such types of arrangements. Many hi tech organizations are implementing this method to pay less taxes. Limited availability of information and maintenance of secrecy among jurisdictions makes it lucrative for the organizations to invest in a tax haven. They may choose any of the methods discussed above or may use another method and pay lesser or negligible taxes.

The advantages of tax haven is viewed in the following contexts. Personal residency which means that individuals with high income choose to move or shift residency in a jurisdiction which is a tax haven or where the rates of taxes are low or negligible. This will ensure that such affluent individuals will not have to pay taxes on their income. This also ensures that the individual will not have to pay any kind of capital gain tax or inheritance tax on his income. Another method is corporate residency which is the shifting of a corporate residency from a high tax jurisdiction to a low tax jurisdiction. Organizations can own subsidiaries in various countries which allows them to take advantage of the laws and regulations of various countries. Hence an organization may have subsidiaries situated in low tax jurisdictions and benefit from the advantage available there.

Another method is holding assets of financial interest or benefit in the tax haven. Changing the ownership of an asset which is not a resident in the high tax jurisdiction allows the entity to hold assets in a tax haven and pay negligible tax on it. On event of death of the holder of the assets, they automatically pass to his children who are not required to pay inheritance tax. Businesses which do not require a physical location of labor are established in tax havens. The best example is internet based services which require no specific location. Such organizations choose to establish themselves in a tax haven so as to avoid high rate of taxes. Many tax codes attempt to prevent transfer pricing in this manner. Bearer shares are a means which increase tax evasion and money laundering. They are anonymous shares held by nonresidents and increases chances of money laundering in the country. They have been criticized and the government has

tried to stop tax evasion through them.

A solution to tackle tax haven is application of a country by country reporting method. In such a case, the tax havens will have to break the information on a country to country basis and then provide detailed information about each country's earnings. This will ensure that no tax havens are maintained and no secrecy of information will be possible. The easiest method to tackle tax haven is to establish a unitary tax method. This will ensure that the organizations are made to pay taxes where they do business. No tax evasion will be possible in the given case. A benefit of tax haven is the fact that all information is kept confidential and secrecy is tightly maintained. Exchange of information will also make it easier for the government to know more about the wealthiest customers. Automatic exchange of information should be established which would provide adequate information to the government and it will help take necessary steps. Availability of information will also ensure that there is disclosure of actual owners of the multinational organizations. Many organizations would prefer to stay away from tax havens if information of their identity and business maybe revealed. This will ensure that the account holders and owners of various companies are identified and information about them is made available to the government. Lastly, tax evasion or willful blindness should be made a criminal offence and anybody who attempts to do it should be punished. No person should be spared and awareness about the magnitude of the offence and its punishment should be spread so that such an offence is not taken lightly. Anybody who helps tax evaders should be punished as this will ensure nobody in the future attempts to do it again. Authorities dealing with money

laundering and the taxation department should take actions against the people who are involved in such issues. Tax havens lead to a large amount of unreported money which could be put to good use by the government. US companies are making huge profits in tax havens. For some companies, the profits exceed the GDP of the country. Major organizations like Apple, Google have been accused to investing money in tax havens and not contributing enough to the US economy. The tax rate in US is 40% which is higher than any other country and hence most companies choose to establish a subsidiary in a tax haven. The 5 most common tax havens of the US are Bermuda, Cayman Islands, British Virgin Islands, Bahamas and Luxembourg. They report for a large amount of profits. The reported profits in Bermuda by the US controlled subsidiary is almost $94. The report showed that American Organizations were doing all that they can to report less profits where they were doing business and earn higher profits. The aim behind this is to pay less taxes and keep the money within the organization. Recently Columbia declared Panama as a tax haven so as to sign a information sharing document with America. This could push the investors out of Panama because the tax rate in Panama is three times as compared to the rate in other areas which share data with the country. In this way, the assets located in Panama will be taxed at the rate of 33% as compared to the normal rate of 10%. It also aims to introduce a punishment to tax evaders. The punishment would involve imprisonment of tax evaders for the first time. Many business leaders say that such a move could damage the economy and put a dent in the investments of the country. It could also affect the political and economic relations with the country. The move is

taken so as to ensure that organizations in the tax haven come out.

Many high tax jurisdictions have taken measures to counter the problems of tax havens. There are various fundamental steps taken which has reduced the tax havens to a certain extent. One means is to attribute the income or earnings of an individual in a high tax jurisdiction on an arising basis. A good example of such a regulation is the controlled foreign corporation legislation. Standardization of transfer pricing rules has greatly helped the jurisdictions. Also a restriction on the transfer pricing ensure that no advantage is taken of having subsidiaries in a low tax jurisdiction. When payments are made to offshore parties, there is a restriction on deductibility and imposition of withholding tax. This ensures that the organizations in tax haven do not benefit from the deductibility.

Taxing charges make a large part of income of tax havens, these are charges which are levied when an organization or entity or subsidiary leaves the tax haven. Such charges are taxed as exit charges or on unrealized capital gains which will ensure that when one leaves the tax haven, at least a part of the taxes are paid by such individual or organization. There are methods other than these. One of them is forced disclosure which involves the tax advisors and requires them to reveal all the details of the scheme thus ensuring that any loopholes in the scheme are amended in the next year. Organizations and the government are looking for ways to come to terms with the issues involved in the tax havens. The government is constantly trying to increase awareness and implement various measure which would at least reduce the effects of tax haven. It aims to reduce money laundering on a huge scale and to reduce tax evasion. Strict

measures are being implemented by various countries so as to stop organizations from taking benefits of the low tax jurisdictions.

In April 2013, details of many account holders of off shore companies was made available which was then made public in an attempt to reduce tax evasion. Also, in 2008, Germany paid $4. 2 million to the Liechtenstein bank to gain access to information of 1250 bank account holders. Thorough investigations and charges followed this move and led to bank investigations. The data was then shared with the United States. Such moves have shown that tax havens very well provide safety of information and security to the bank account holders in the jurisdiction. It also encourages them for tax evasion and thus has led to a call for crackdown of tax havens. How soon it could happen is not predictable. But if there are no tax havens, the various governments where the organizations are located will earn revenue from taxes and it could be put to good use of the country.

Many countries need to improve their ability to detect and prevent such crimes. Tax evasion could be small or huge, it needs to be detected and prevented to whatever extent possible. The amount lost in tax haven has reduced in the case of UK. Panama is trying to reduce the amount of investment in tax haven and hence encouraging the investors to come out and transfer their investments or assets in their country. The high rate of tax in Panama will ensure that the investors move out of tax haven and pay required taxes as per their holdings or income. Such actions show that the government is willing to take measures and punish the evaders. Various reports by different authorities are regularly prepared and delivered to the government. Exchange of information could be one medium which will

reduce the investors from spending money in the tax haven and also encourage transparency in the reports.

Panama aims to sign an information exchange treaty with the US. If the information is made available, there will be less chances of future tax evasions and money laundering. The government will also take action against the tax evaders and ensure that they are punished. Panama has given adequate time to its investors to move out of the tax haven and move to the jurisdiction where they reside or conduct business, if this is not done then the government will be compelled to punish the tax evaders with imprisonment. The actions maybe severe but it will ensure that the money laundering and evasion stops to a certain extent.

In the G20 summit at London, the participating countries agreed to define a black list for tax havens which did not follow the regulations or criteria. The four basic criteria's as defined at the summit were the ones who have successfully implemented all the standards, those that have agreed to implement but have not implemented the standards, financial centers that have also agreed to but not implemented the necessary standards and those that have not committed to the standards. There are no countries falling in the last category. The respective countries are required to take necessary steps to move out of the black list countries and increase transparency as well as cooperate with the government. Full commitment towards exchange of information will ensure that they are not in the black list. Many countries have criticized the list will some have been supportive towards the move.

Tax havens affect developing countries to a large extent because investors as well as organizations move out of their respective countries for the sake

of a low tax jurisdiction. This leads to a lack of infrastructure and development of the economy as well as the country as a whole. Tax havens are attractive for investors and organizations and it is difficult to restrict the personal or corporate residency of them. The government could attempt to provide measures and incentives for the organizations who do not move to tax havens. This will ensure that they see themselves as an equal to the companies working in the tax havens.

Though the simplest and easiest method is to establish and encourage exchange of information among various countries and providing the data publically so as to increase awareness and punish the defaulters. This will also damage the reputation of the organization and they will be forced to avoid taxes. Forcing through various policies could be achieved to some extent though not many organizations will agree to or implement the policies of the tax department.

There is no one solution to the issues related with tax haven. It is attractive for investors and affluent individuals who wish to avoid tax and generate more wealth. But there is no guarantee that it will go on for a long period of time. The government is always attempting to take measures to reduce tax evasion and generate means to bring all the tax havens under a unitary rate. Reporting by various countries and implementing a unitary rate will reduce the popularity of tax havens and will ensure that the countries provide necessary information about their income and about the various subsidiaries from where the income is generated. There is no means to curb transfer pricing due to which the tax evasion keeps increasing. The reporting of financial statements from all the countries could be of some help in such

cases. As long as information is made available, there can be various means to overcome the situation. More transparency and exchange of information is the need of the hour.

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