Indian Journal of Applied Business and Economi Research
Vol. 4, No. 2, 2023, pp. 221-254
https://DOI:10.47509/IJABER.2023.v04i02.07

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TAX HAVEN OR TAX EVASION: HOW DO MULTINATIONAL CORPORATIONS USE TAX HAVENS?

Kartik Lakhotia[1]

[1]Commerce Student, Step by Step School, Noida. E-mail: kartiklakhotia14@gmail.com

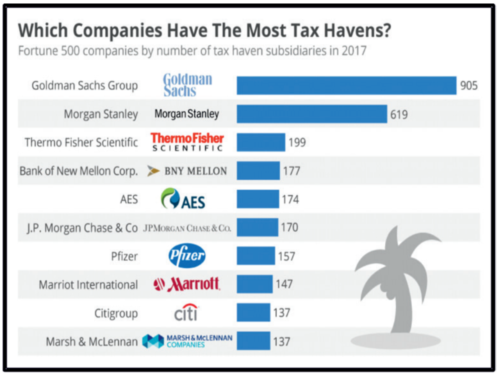
Received: 02 September 2023; Revised: 25 September 2023;
Accepted 5 October 2023; Publication: 29 December 2023

Abstract: Tax havens are sovereign jurisdictions which lure non-resident investors and foreign business entities to make external investments by offering lower tax structures, tax rebates and incentives, thereby stimulating economic activity. The majority of tax havens account for a minimum share of the globe's population, but in this proportion contribute significantly to the international gross domestic product, multinational business industries and the global employment structure. Furthermore, tax haven states seem to be sufficiently funded even though they charge negligible or low tax rates. The question arises whether the elevated economic worth of tax haven nations is derived at the cost of higher tax nations; for which the answer is ambiguous.

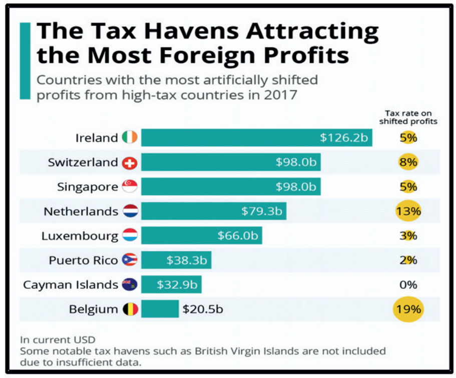
This white paper discusses some of the global prominent tax havens, their chief elements primarily the absence of prevailing structures of direct taxation like income, estate and gift taxes in such tax havens and the socio-economic conditions which stimulate their success. Furthermore, it talks about the modus operandi of tax havens and elevated profits due to foreign shell investments and the MNC's global corporate profits, the artificial shifting of these foreign profits to offshore tax havens and the subsequent loss of corporate taxes for high tax nations. The study highlights the tax loopholes which support such actions and the policies of transfer pricing. The study concludes to discuss how between 1985 and 2018 the global average statutory corporate tax rate fell by more than half, probably due to the fact that a majority of multinational profits were artificially shifted to tax havens for tax avoidance, the failure to curb it in the past and macroeconomic knowledge related to recent international tax treaties to curb such future consequences.

Keywords: Tax Haven, Transfer Pricing, Sovereign Jurisdiction, Profit Shifting, TIEAs, MLAT

To cite this paper:
Kartik Lakhotia (2023). Tax Haven or Tax Evasion: How do Multinational Corporations Use Tax Havens?. *Indian Journal of Applied Business and Economic Research*. 4(2), 221-254. *https://DOI:10.47509/IJABER.2023.v04i02.07*



Source: Statista



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INTRODUCTION

Tax havens are nations with unique tax regulations, offering tax rebates, low-to-no tax structure and tax incentives for luring as well as permitting non-residents to make external investments; making tax havens attractive for individuals and businesses to make investments. Tax havens permit individuals and businesses to safeguard their wealth from being heavily taxed, evading increased tax regulations in other countries, and thus bringing in investments from around the world. Furthermore, tax havens maintain the secrecy and security of personal financial data and do not mandate foreign entities to maintain a significant regional presence. Nonetheless, they have resulted in issues such as unlawful tax avoidance or money laundering.

Effectively, a tax haven is a nation where non-residents may acquire earnings or possess assets without expending elevated taxes upon them. In certain tax havens, the tax relief that non-residents enjoy arises from the absence of the prevailing structures of direct taxation like income, estate, and gift taxes; but in a majority of nations, this rebate originates from extraordinary characteristics of the tax strategy that result in an extremely low effective tax level on specific type of foreign investment. In reality, certain nations that enjoy a stature as a tax haven have developed it, however in other nations, the elements that create them as a tax haven are simply an outcome of their having pursued specific tax regulations such as rigorous territoriality in applying low structured income taxation, but without the intent of founding a tax haven. The legislative, legal and administrative machinery of a tax haven nation is not transparent and there are secret declarations and negotiated tax structures that are not out in the open.

The oldest tax havens comprise Liechtenstein, Switzerland and Panama; each of these is considered to date back to the 1920s. Although, the list of tax haven nations contains many developed nations, the majority of these tax havens are developing nations that are lured in the yearning that evolving as a tax haven will enable them to unravel a few of their economic crises. Nevertheless, the tax haven status does carry certain benefits for the related tax haven nation, and it is a myth that the tax haven status is an elixir for a nation's economic difficulties. Some examples of tax haven nations include the British Virgin Islands, United Arab Emirates, Bermuda, Mauritius, Guernsey, Taiwan etc. Listed here are a few global tax havens highlighting their tax structure?

- Mauritius – This country provides a low corporate tax rate and no withholding tax.
- Luxembourg – This nation provides tax incentive advantages and 0% withholding taxes.
- Bermuda – This nation was asserted as the globes worst corporate tax haven in 2016 by Oxfam with a 0% tax rate and nil personal income tax.
- Isle of Man – This country charges zero capital gains tax, turnover tax, or capital transfer tax and levies a low-income tax with a maximum rate going to 20%.
- Netherlands – This country is the globe's most favored tax haven nation among the World's Fortune 500. The government here utilizes tax incentives to lure companies to invest in the nation.
- Singapore – This nation mandates inexpensive nominal corporate taxes via tax incentives, lack of withholding taxes and substantial profit shifting.
- Cayman Islands – No personal income taxes, no capital gains taxes, no payroll taxes, no corporate taxes, and the country does not withhold taxes on foreign entities.
- Switzerland – This nation provides full or partial tax exemptions, depending on the banks utilized.
- The Channel Islands – This nation charges nil: - capital gains taxes, council taxes and value-added taxes.

Other than nominal tax structure and security of financial data, many additional socio-economic aspects create a certain destination as a favored tax haven which is listed here:

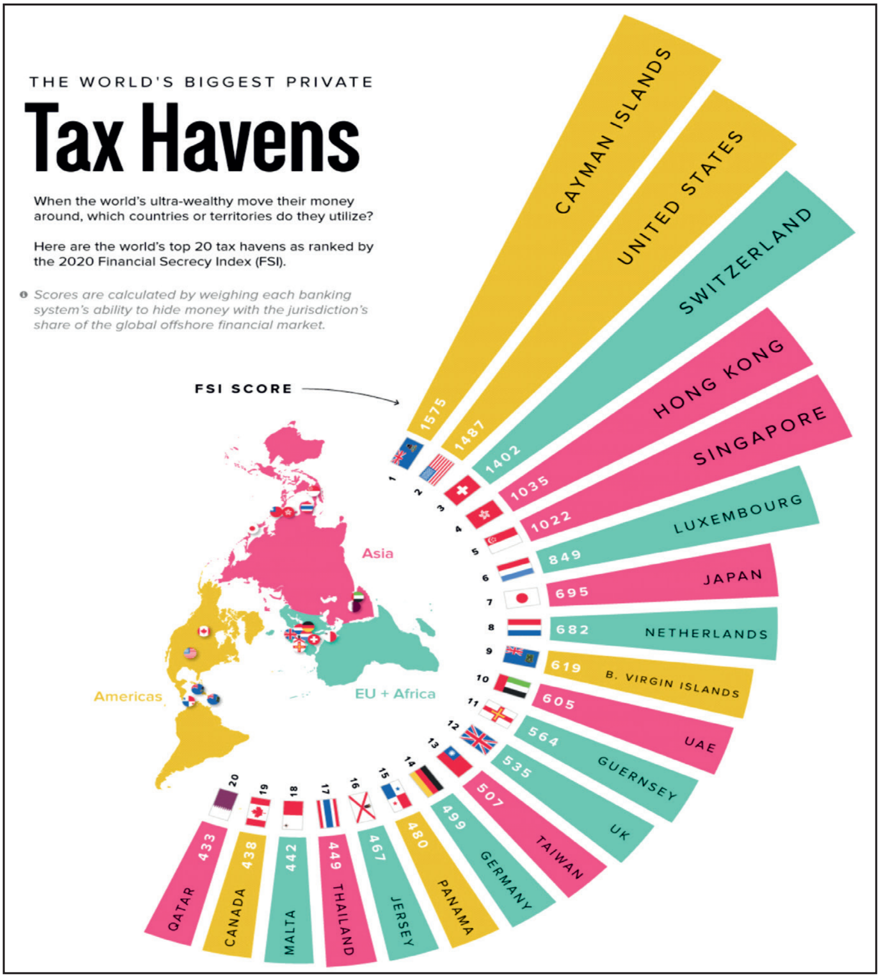


Figure 1 : List of a few global tax havens

Source: Visual Capitalist

Ideal geographical location: The proximity of tax havens to business centers assists in establishing offshore businesses in tax havens.

Treaties: Several tax havens have evolved to be famous due to loopholes in numerous tax avoidance pacts signed with various jurisdictions. However, certain tax havens are facing decreasing popularity due to different information-sharing pacts signed with various government administrations.

Political and economic stability: These two aspects are highly significant for a tax haven and no amount of tax incentive can lure foreign investors to invest without political and economic solidity.

Limited exchange controls: Foreigners would place their assets in another nation only when exchange controls are fixed to quite an extent.

Banking, business and professional support services: Tax havens should provide adequate and efficient banking and financial and supported business services to create a secure destination for foreign asset growth.

The benefits that tax haven nations deliver to taxpayers are well defined in guidelines put down by experts who specialize in accomplishing procedures in tax havens for their customers. Nonetheless, it is difficult to obtain accurate statistically significant data on the magnitude of the revenue casualties suffered by high-tax nations and the advantages which tax haven nations emanate from their status are inadequate. However, there is widespread consensus on the fact primarily that the magnitude of business exercises accomplished in tax havens is substantial, even though precise figures are not obtainable. Moreover, it seems that the usage of tax havens by businesses in high-tax structured nations, particularly by multinational corporations is thriving. Refer to Figures 2, 3, 4, 5, 6, 7 and 8 which highlight the evasion of taxes by entities in tax havens.

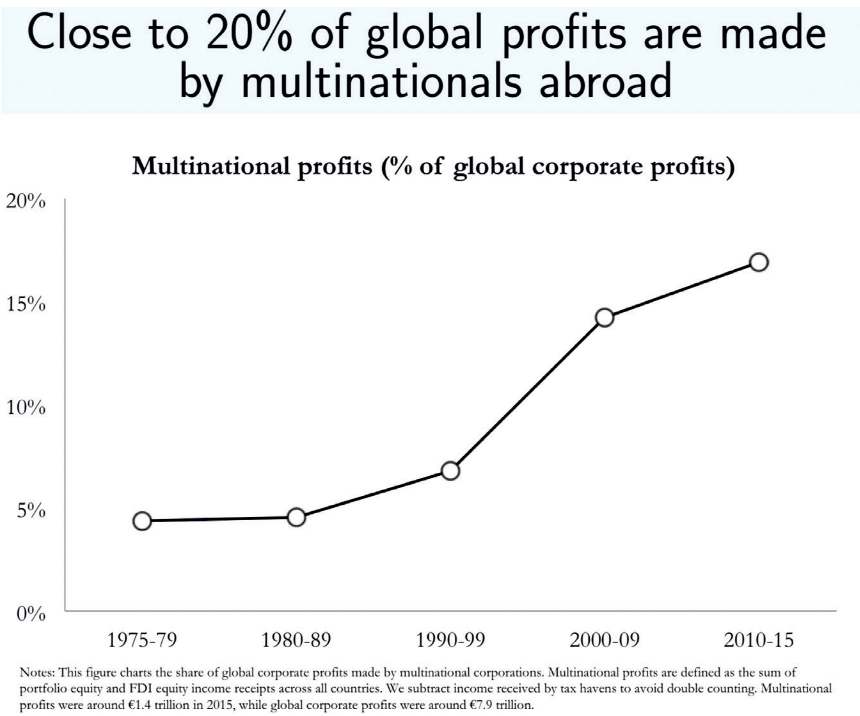


Figure 2: MNCs global corporate profits

Source: United Nations University World Institute for Development Economics Research

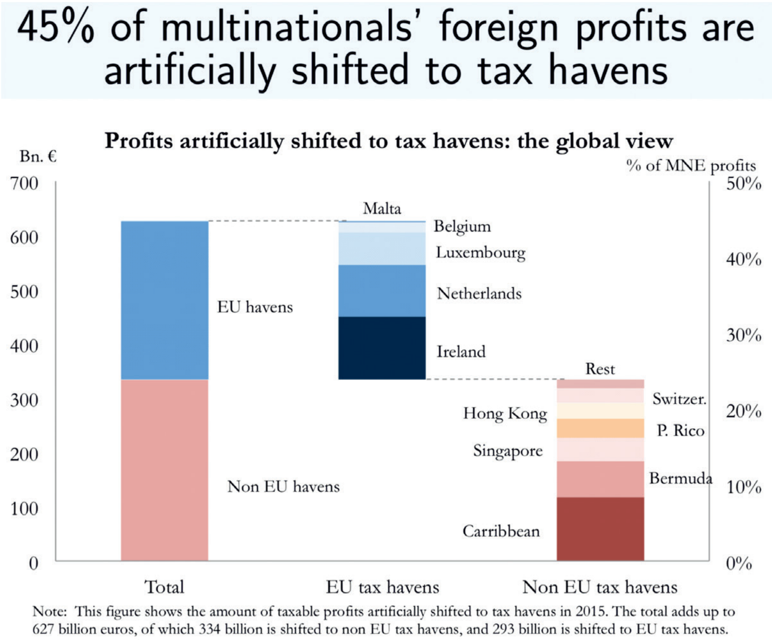


Figure 3: Shifting of MNCs profits to tax havens

Source: United Nations University World Institute for Development Economics Research

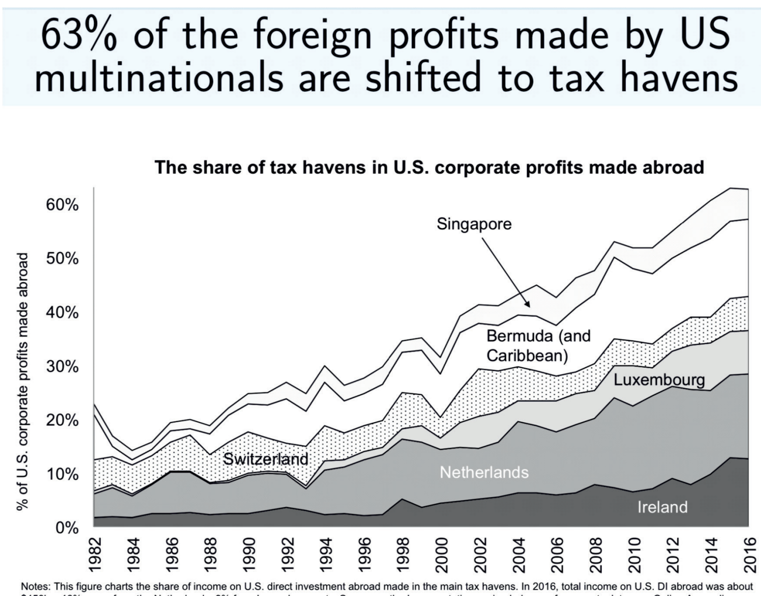


Figure 4: Profits of U.S. MNCs diverted to tax havens

Source: United Nations University World Institute for Development Economics Research

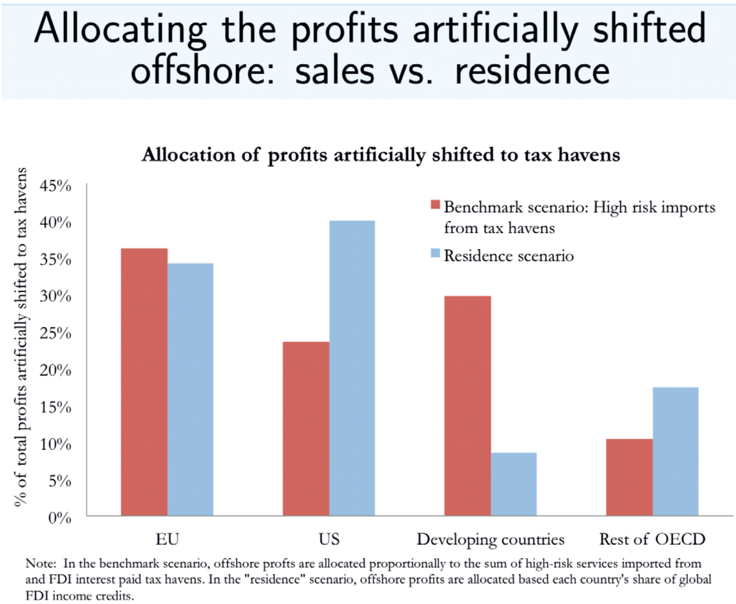


Figure 5: Appropriation of profits moved to tax havens

Source: United Nations University World Institute for Development Economics Research

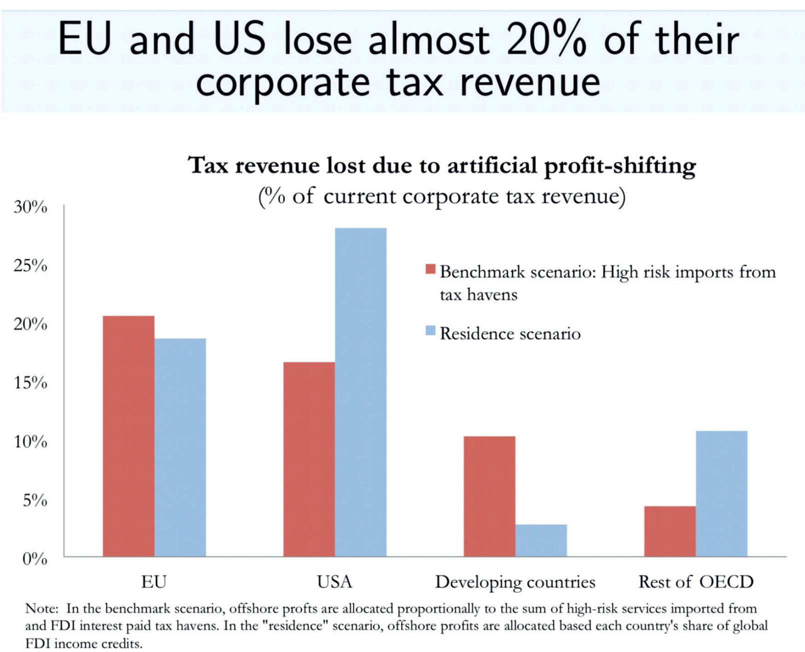


Figure 6: Decrease in corporate tax revenues in the E.U. and U.S.A.

Source: United Nations University World Institute for Development Economics Research

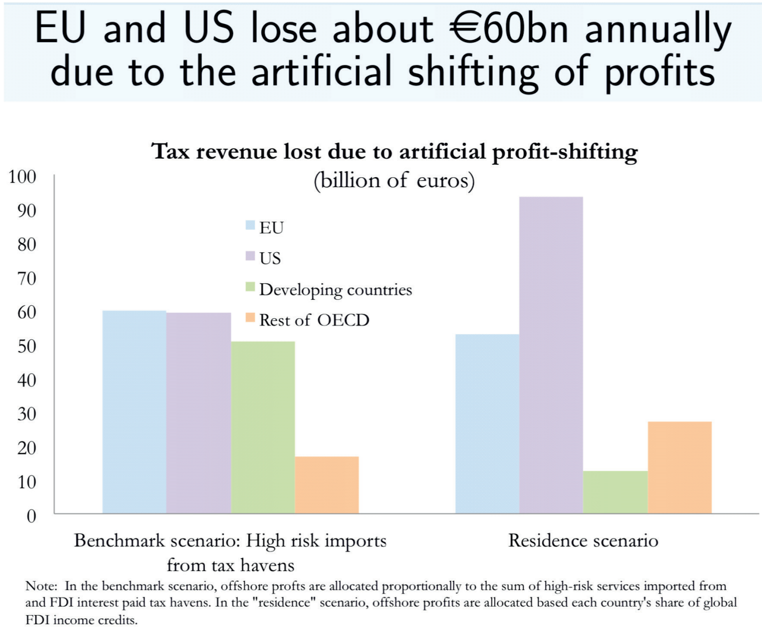


Figure 7: Loss of revenue in the E.U. and U.S.A. due to artificial profit shifting

Source: United Nations University World Institute for Development Economics Research

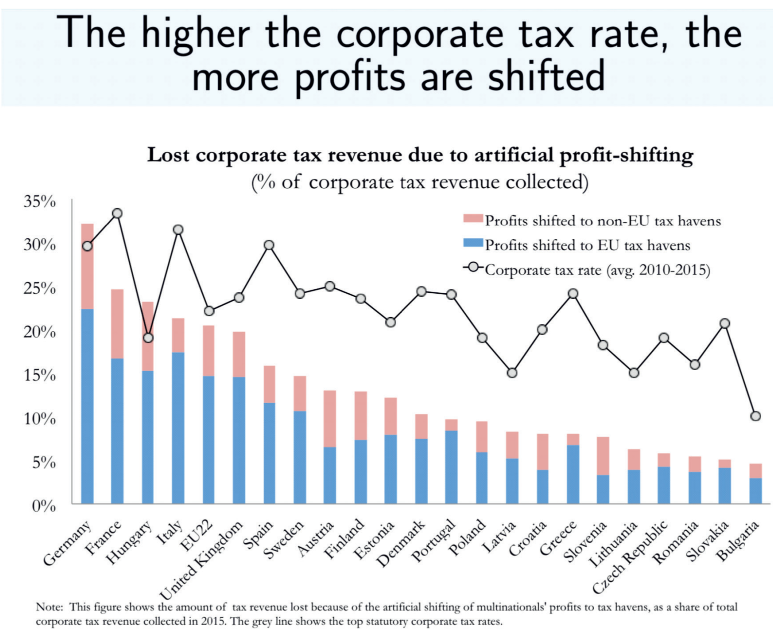


Figure 8: Comparison of corporate tax rates with shifting of profits to tax havens

Source: United Nations University World Institute for Development Economics Research

THE MODUS OPERANDI TAX HAVENS FOLLOW

Tax havens are utilized for miscellaneous functions. The primary goal of those businesses and individuals who patronize tax havens is to reduce the taxpayer's tax burden and subject the minimum portion of revenues or wealth to a decreased effective tax structure as compared to what would otherwise be applicable. Nonetheless, precautions should be carried out to differentiate between functions whose primary objective is that of decreasing a taxpayer's liability and those that have a bona fide trade goal. The latter illegal business activities are not considered tax haven operations, even if they originate in a tax haven nation.

Certain industries located in tax havens are employed to manufacture merchandise for both domestic and transnational markets. Some royalty fees are expended from tax havens for patents or know-how being utilized in the nation. Also, certain non-residents operate in tax haven nations. These professionals or businesses profit from the nation's lower tax structure and are required to do real business within its geographical boundaries. However, some of the tax haven businesses are fictitious, as little or none of the businesses are executed in the tax haven in the true sense. Merchandise that is purchased and traded by tax haven subsidiaries frequently does not pass through the tax haven's region and transit directly from the nation of origin to the nation of destination. The assets of trusts that are founded in tax haven nations are generally kept at a distance and neither the grantor nor the beneficiary is usually a resident in the tax haven nation.

Tax haven procedures comprise primarily founding within a tax haven nation one or more legal entities, namely - trusts, personal holding businesses, or business subsidiaries, and attribute to these entities revenue obtained elsewhere should be taxed at the nation's lower tax rates or maybe not taxed at all. This goal can be achieved for either of the following purposes:

(1) Accumulating revenue in the tax haven nation with a lower tax structure, to be taken away later and invested according to the investor's desires

(2) Artificially changing the direction of a company's gains and profits from high-tax structured nations to a tax haven nation

Refer to Figures 9, 10 and 11 for further details.

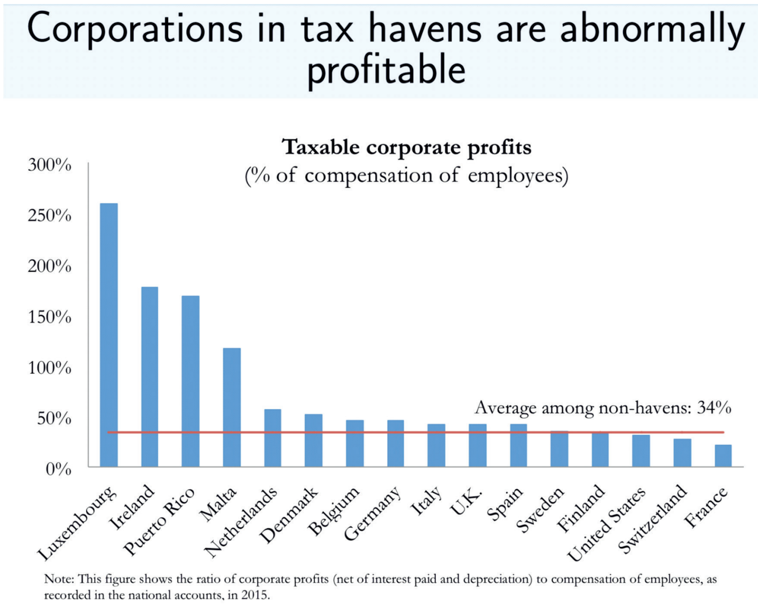


Figure 9: High profits in tax havens

Source: United Nations University World Institute for Development Economics Research

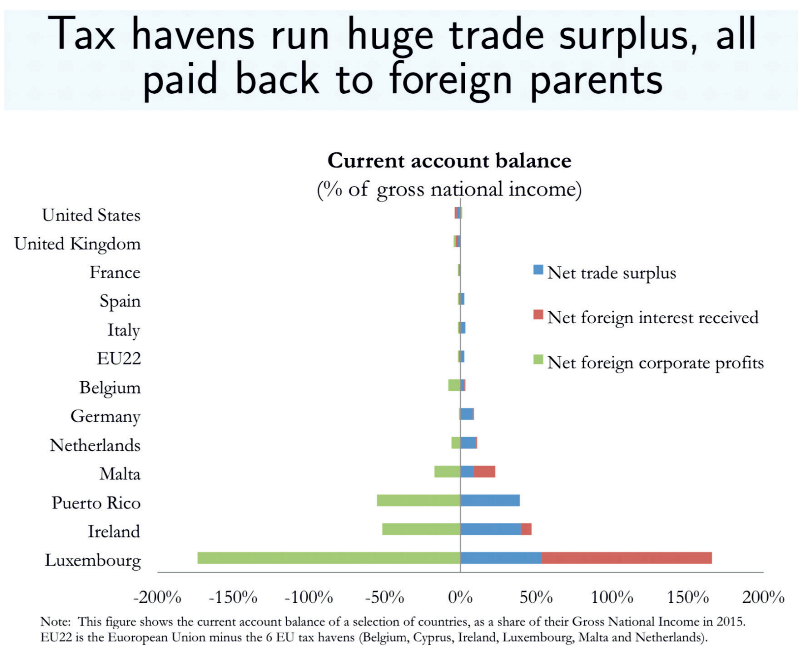


Figure 10: Trade surplus in tax havens transferred to foreign parent firms

Source: United Nations University World Institute for Development Economics Research

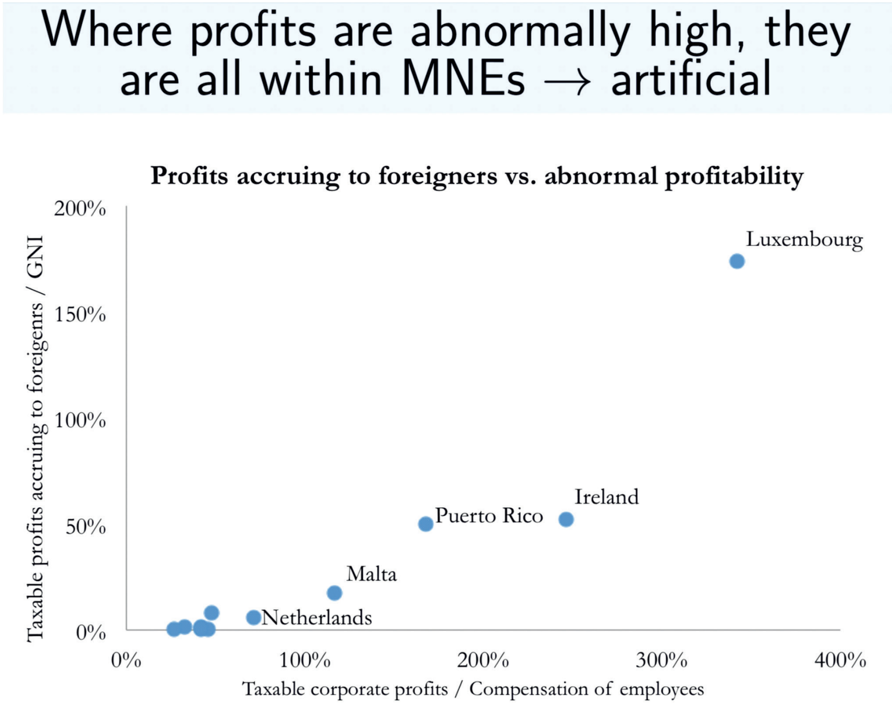


Figure 11: Revenue gains to foreign firms versus high abnormal profits

Source: United Nations University World Institute for Development Economics Research

For several years the invention of these lawful entities for the objective of receiving a tax benefit was amongst the vastly widespread usages of tax havens. In the case of passive investments, from which bonuses, interests, or royalties stem, trusts and personal holding firms are utilized as buffers or screens between the actual investor and his acquisitions. However, as a consequence of countermeasures laid down in recent times in specific capital-exporting nations, the usage of tax havens to harbor passive investment revenue has not expanded as quickly as compared with additional tax haven actions.

Currently, the quick thriving classification of tax haven procedures involves changing the direction of a company's profits from high-tax structured nations to tax haven nations. This changing direction of profit dealings is generally performed by big companies through tax haven subsidiaries, utilizing refined techniques that are planned to decrease the tax base artificially in high-tax structured nations while expanding it in the tax haven nation. Refer to Figures 12 and 13 to study the loss of corporate tax revenue in high-tax structured nations and offshore revenues.

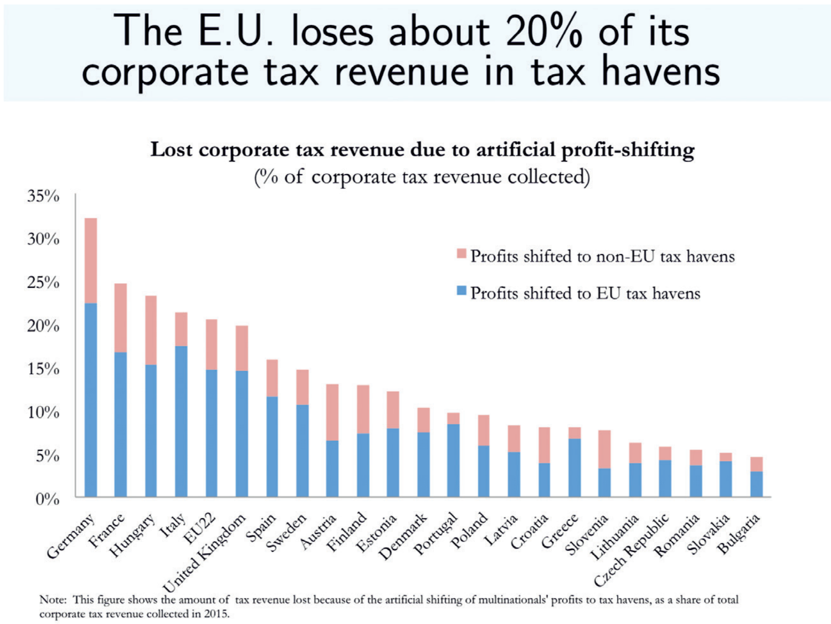


Figure 12: Loss of corporate tax revenue in the E.U. due to tax havens

Source: United Nations University World Institute for Development Economics Research

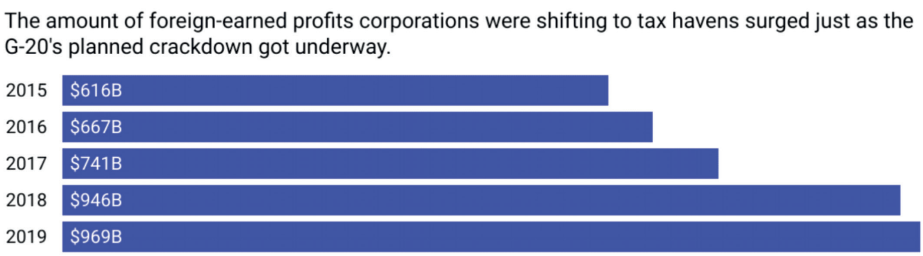


Figure 13: G-20's crackdown stimulating foreign-earned profits

Source: Scroll.in

The most significant of these strategies involves transfer pricing which means the setting of prices on goods and services that are purchased and traded between a parent firm and its foreign subsidiary. No "arm's length" bargaining arises between these groups and prices are not determined as per market influences, hence the prices that are established can be used to reduce a firm's total taxes. For instance, rather than a firm selling merchandise directly to a foreign customer and earning profits that are entirely taxable in its home nation, the firm can sell the merchandise at an artificially lower price to its subsidiary unit in a tax haven country. Hence, it demonstrates only a diminutive profit on which it has to pay lower taxes, or possibly even a loss and the subsidiary unit then resells the merchandise to the utmost consumer at the regular price, attaining a considerable profit which is taxed at a lower rate, or not at all taxed as the subsidiary unit is located in a tax haven nation.

Another classification of practices conducted in tax haven nations is by the financial sector. In tax havens, there exists a financial sector whose scope and significance are out of consonance with the extent of the nation and its resources. This financial sector generally constitutes a considerable number of banks and trust firms, the majority of which are subsidiaries of foreign-owned business organizations. The justifications for their existence in tax haven nations can be relatively varied. These business organizations oversee trusts and holding firms that have been appointed to harbor non-resident passive investment income. These financial institutions carry deposits for non-resident investors and deliver managerial services for a miscellany of corporate subsidiaries. Foreign banks also employ "shell" banks or subsidiaries located in tax haven nations to conduct international businesses.

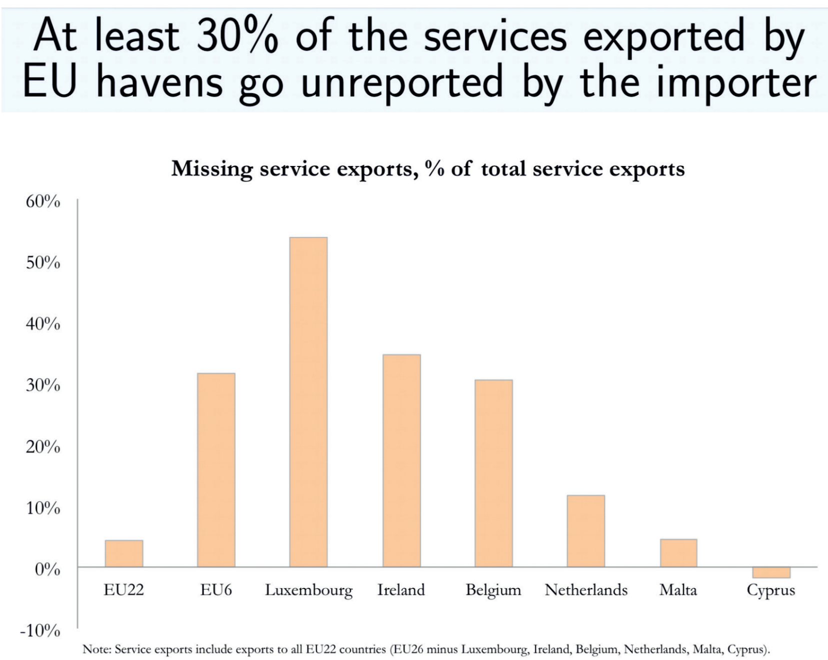


Figure 14: Services exported by the E.U. tax havens gone unreported

Source: United Nations University World Institute for Development Economics Research

These actions of the financial institutions are predominantly of an ancillary or dependent essence, as the primary objective of these banks and trust firms is to deliver services to additional tax haven exercises, namely assisting tax haven trusts and corporate subsidiaries and maintaining deposits for non-resident investors. They also perform a considerable quantity of technological, audit and legal jobs of administration of firms in the tax haven nations. However, in the case of the Euro-currency subsidiaries of foreign banks, the true activity is conducted elsewhere, except possibly for an insignificant existence in the tax haven nation. Figure 14 highlights the services exported by tax havens which have gone missing.

Tax haven nations also lure non-residents who come to operate in foreign banks, trust firms and retirees, who choose to establish their residence where there is a benefit of climatic conditions along with a low-tax structure. In these circumstances, there is true action in the tax haven nation, whether it is operating or simply residing in the nation, and the low tax aspect is simply one of the several reflections that influence these people to live in a tax haven nation. Figure 15 highlights the profit by MNCs in tax havens.

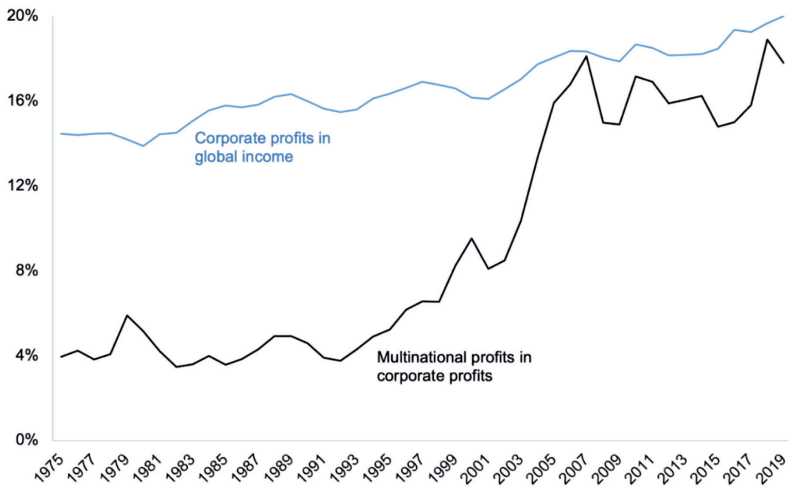
ELEMENTS RELATED TO TAX HAVENS

Lower tax structures are the chief attractions proposed by tax havens. Generally, these lower tax structures are associated with income taxation or the existence of an arrangement of income taxation that exempts non-resident investment. Even though it is true that the multiple advantages offered by tax haven nations are related to income tax benefits, these are not the only benefits that these nations propose to non-resident investors.

Within the tax domain, the absence of additional taxes such as estate, inheritance and gift taxes also is noteworthy attractions to specific investors in addition to the absence of an income tax. Bilateral tax treaties between a tax haven nation and developed nations are another characteristic that attracts foreign investors. The presence of a tax treaty allows third-nation investors to establish their holding firms in tax haven nations and receive a deduction in withholding taxes about the dividends and interests they obtain from developed nations with which the tax haven nation has a tax treaty.

Stringent and well-enforced regulations of banking secrecy and the likelihood of conducting businesses without tight government surveillance are some of the additional allures proposed by tax havens. Furthermore, aspects like lower expense of conducting business, the presence of liberal banking

Corporate profits (% of income) and multinational profits (% of all profits)



Multinational profits in tax havens and corporate tax lost

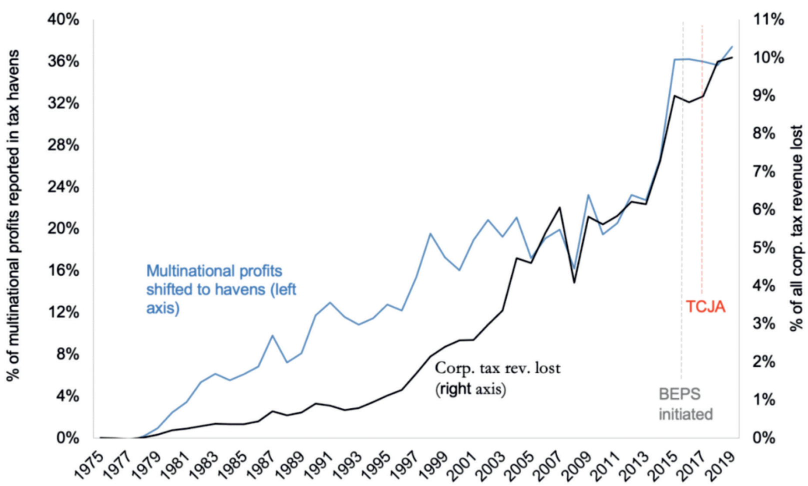


Figure 15: Global corporate profits as a percentage of income and multinational profits as a percentage of total profits versus multinational profits in tax havens and lost corporate tax

Source: CERP

laws and the absence of exchange controls are also crucial. These benefits were the predominant justifications why foreign banks established Euro-currency subsidiaries in the Bahamas; the nation's tempting tax environment was evidently of secondary significance. Eventually, a satisfactory communications service, an advanced law system with an abundance of legal and accounting expertise and an increased capacity of political and economic strength also support the making of a tax haven.

For developing nations, one of the primary benefits of being a tax haven is the likelihood of attaining greater employment levels. This is especially significant for nations with a limited resource base, which tend to have chronic unemployment concerns. However, there is a trend to magnify the number of employment opportunities developed by tax haven actions. The establishment of a large number of businesses and trusts and the large quantum of trades that technically transpire in tax haven nations are typically conducted by utilizing a minor workforce within tax havens. Figures 16, 17, 18 and 19 discusses such details.

Figure 16: Certain profits made by the U.S. M.N.E.s which are missing the E.U. tax havens accounts

Source: United Nations University World Institute for Development Economics Research

A growing amount of profits is artificially shifted to the EU havens

Figure 17: Percentage increase of corporate profits in Ireland

Source: United Nations University World Institute for Development Economics Research

By applying very low rates on a huge base, EU havens generate a lot of revenue

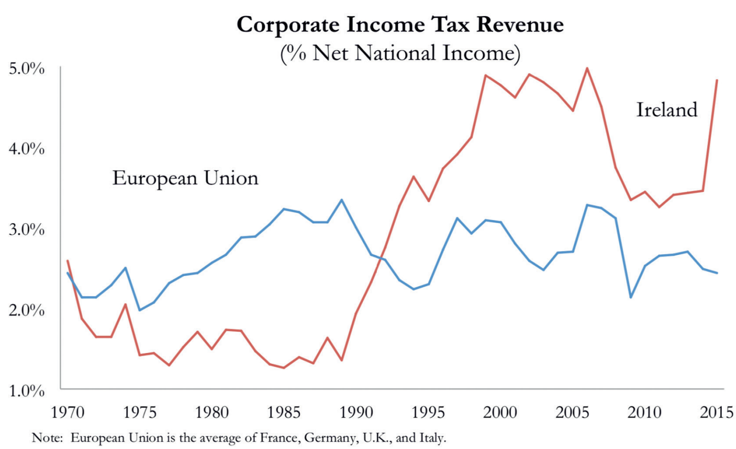


Figure 18: Corporate income tax revenue as a percentage of national income in Ireland and the E.U.

Source: United Nations University World Institute for Development Economics Research

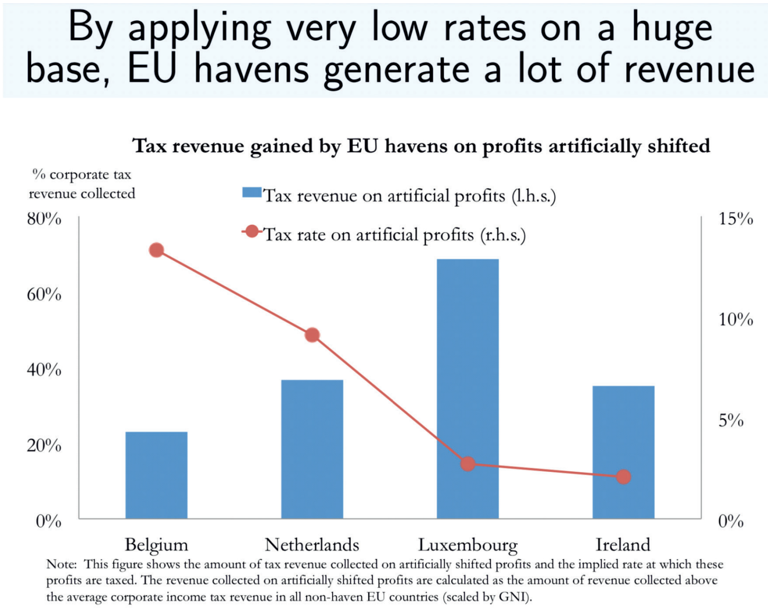


Figure 19: Accumulation of tax revenue by the E.U. tax havens

Source: United Nations University World Institute for Development Economics Research

The case of Norfolk Island, a possession of Australia and a former tax haven, exemplifies this issue. As per the survey cited in a manual on tax havens, in 1972 more than 1,450 firms were incorporated in Norfolk Island. Nonetheless, it looks like the tax haven sector was directly profiting only 25% of residents of the Island, as vastly the business was being executed by lawyers and accountants in Australia.[1]

The primary objective of tax haven activity is to evade taxes and that no business or trade is executed in the nation. The prominent exceptions are the organizations in the financial sector, which are the chief generators of job prospects and create more demand for services within the tax haven economy. Nonetheless, these institutions generally choose to staff their establishments with expatriates especially at elevated position levels, hence not all the employment opportunities constructed by this activity will be obtainable for residents of the host nation.

Additional economic actions are also facilitated by tax haven procedures. Construction activities are heightened chiefly for commercial structures, but holding corporations or other subsidiaries may need simply sufficient offices only to hang a nameplate. Only those companies that conduct business are corporations in the financial sector which mandate sizable office expanse to accomplish their businesses. Another economic activity that is likely to be promoted is tourism, especially if the nation enjoys friendly climatic conditions. A tax haven nation may also lure retired individuals as residents and their presence facilitates increased career prospects and assists in getting foreign exchange.

The presence of a significant financial sector has additional crucial influences as it would assist a nation in economizing unrestricted and easy foreign exchange and payment strategies. Furthermore, government bond issues may be underwritten or subscribed by foreign banks, thus creating funds obtainable for public investment and economic development.

Eventually, the tax haven is a source of earnings for the government. Regardless of how liberal the tax structure of a nation is, there will invariably be some form of tax or payment for which the non-resident investor is accountable. These contributions vary from a straightforward yearly payment payable by all firms established in the nation to income tax on gains assessed to be of domestic origin. For instance, in banks that do both domestic and foreign businesses, gains from domestic sources may be taxed while earnings from foreign sources are exempt. Moreover, in the majority of tax haven nations, indirect taxes like customs duty and sales tax are applicable.

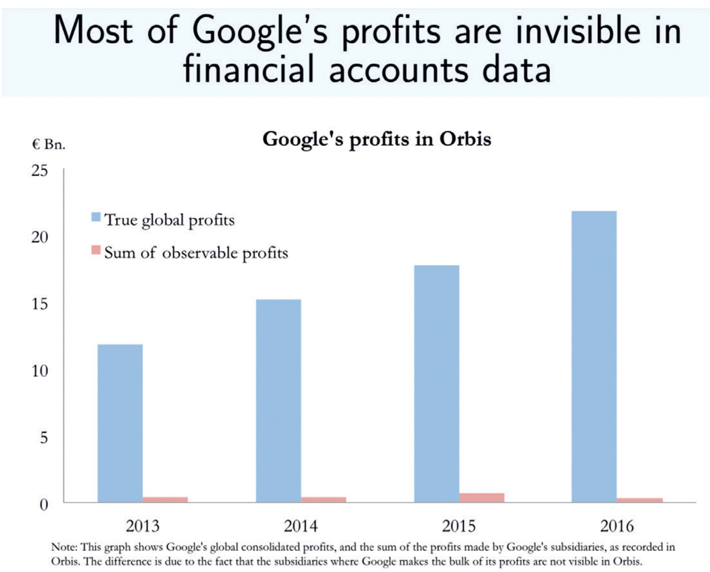


Figure 20: Hidden profits by Google

Source: United Nations University World Institute for Development Economics Research

Lists of some leading firms which benefit from tax havens are the following Apple, Nike, Facebook, Goldman Sachs and Google. Refer to Figures 20, 21, 22 and 23 which describe some of these details. In 2016 Google Alphabet earned US$19.2 billion in revenue in Bermuda, where it hardly engages any employees nor holds any tangible assets and where the corporate tax rate is 0%.

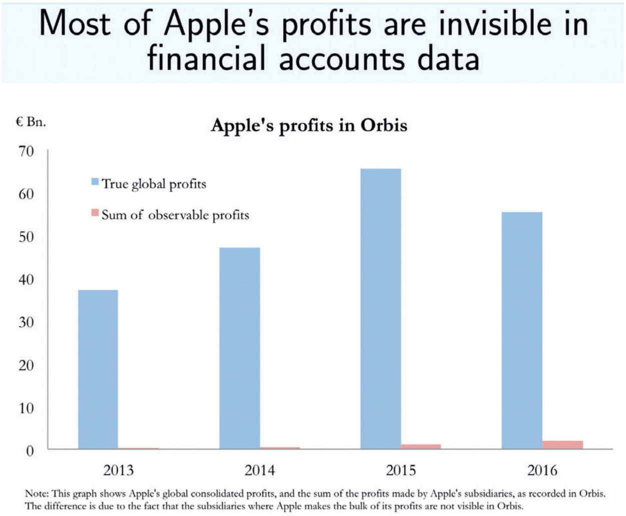


Figure 21: Hidden profits by Apple

Source: United Nations University World Institute for Development Economics Research

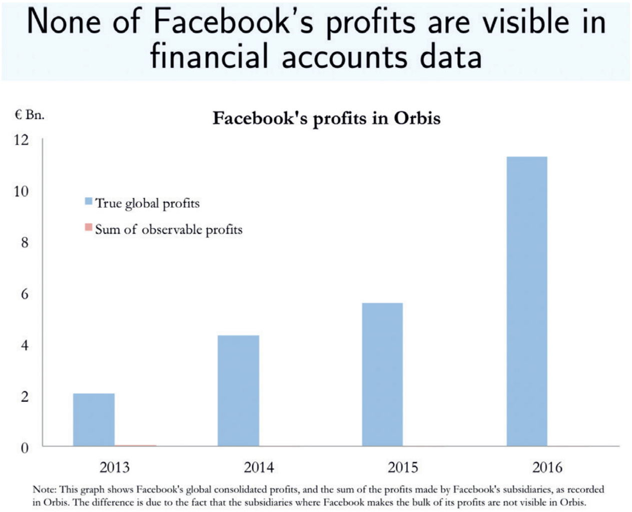


Figure 22: Hidden profits by Facebook

Source: United Nations University World Institute for Development Economics Research

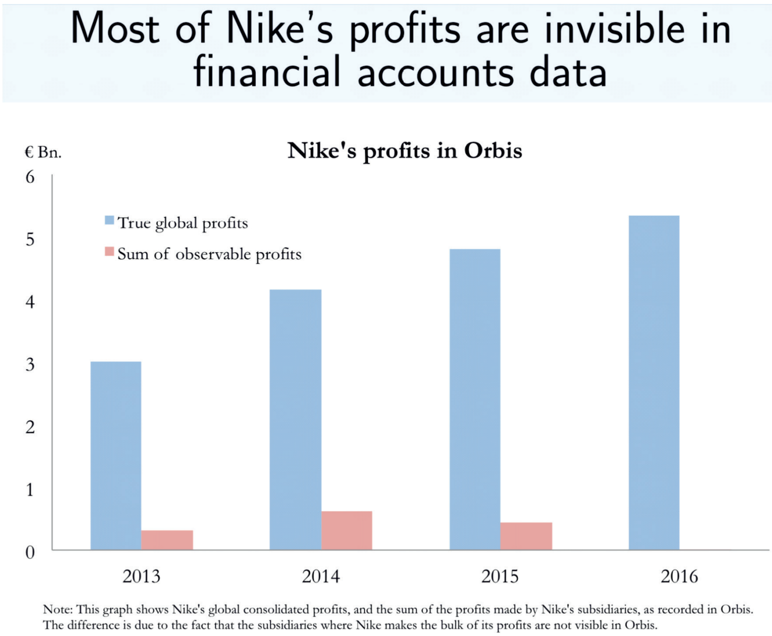


Figure 23: Hidden profits by Nike

Source: United Nations University World Institute for Development Economics Research

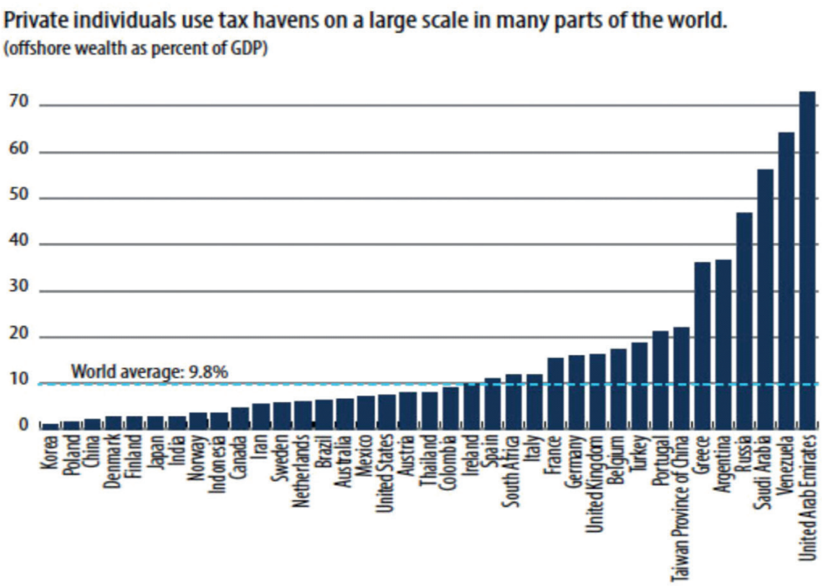


Figure 24: Offshore wealth in tax havens as a percentage of GDP in 2018 in several nations

Source: International Monetary Fund (IMF)

TAX LOOPHOLES

The presence of certain elements in the tax systems of developed nations permits taxpayers to make use of the advantages offered by tax havens. The more advantageous tax treatment consented to trusts located beyond geographical borders as compared to domestic trusts and the means of tax deferral that permits taxpayers of high-tax structured nations to defer income tax fees from foreign sources until it is repatriated. These means are associated with escape valves left in their tax strategies by high-tax structured nations to grant taxpayers ease from the stresses of high taxation. Also, as long as these conditions remain in effect, high-tax structured nations cannot put the entire blame on tax haven nations for the losses of income they suffer.

During the last twenty years, many nations have pushed to wipe out these safety valves. The United States of America has pioneered the path with other nations, following its example, namely Australia, Belgium, Canada, Germany and the United Kingdom. The legislation of measures against the usage of tax havens has not been manageable and in each of these nations this regulation has stimulated unrest among taxpayers in the high-income classification and there has been a disposition to overstate the number of employment opportunities developed by tax haven activities.

The ruling about the issue is geared towards the subsequent goals:

1. Discouraging the tax-free proliferation by tax haven nations of particular classification of income, namely - passive investment income and income derived from the appointment of service contracts to a foreign subsidiary unit.
2. Slamming the crisis of transfer pricing, by endeavoring to tax a parent firm on the earnings it would have acquired if the trade with its subsidiary unit had taken place at arm's length.

The tax systems of developed nations like Canada, Germany, the United Kingdom, and the United States, allow domestic firms to defer the fee of taxes on profits earned by foreign subsidiaries until those profits are repatriated. This has made the establishment of foreign personal holding businesses in tax haven nations which can amass revenue either free of tax or subject to an extremely low effective tax structure. The regulations enacted lately in certain developed nations to deter this proliferation normally mandate the earnings of these non-resident holding firms to be taxed on accrual grounds, hence putting an end to the tax deferral freedom that the proprietors formerly had.

However, these regulations are quite complicated. The primary aim of developed nations is to dampen their effect upon firms that are amassing earnings in low-tax nations for typical business justifications. Hence, anti-accumulation laws depend majorly on percentage measures, which contain the value of being objective but also leave an expansive margin for manipulation by taxpayers. Consequently, the anti-accumulation regulations generally apply only when the subsidiary unit founded in a tax haven is maintained by taxpayers in a high-tax structured nation. "Control" is defined as ownership of more than 50 per cent of the stock of the foreign subsidiary.

For example, the United States and Canada, just count firms or individuals, each of whom holds greater than 10% of the foreign firms, towards the 51% controlling stake of the corporation. This law tries to keep out portfolio investment from the anti-accumulation conditions. However, Germany does not operate this provision and these percentage measures can be effortlessly evaded. A case in point is the current growth in the number of subsidiary branches in tax haven nations whose parent firm lawfully holds only 50% of the stock but in reality exercises whole power without being subject to the anti-accumulation requirements.[2] Figure 25 depicts the worldwide cost of tax avoidance which is stimulating change.

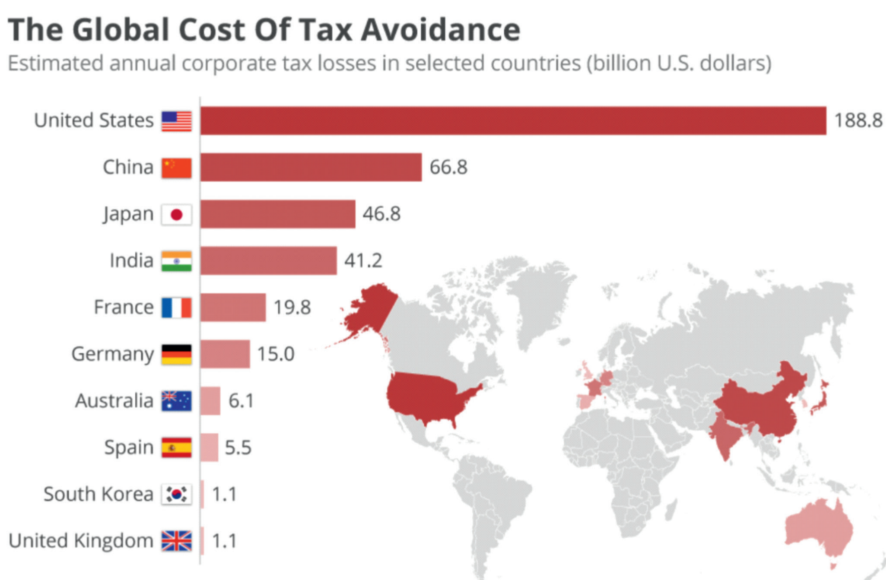


Figure 25: Annual loss of corporate tax in 2017 in selected nations in billion US$

Source: Statista

TRANSFER PRICING

Despite the drawbacks of these regulations that try to dissuade the proliferation of tax-free earnings in tax havens via holding firms, these regulations seem to have been more triumphant as compared to the provisions planned to restrain the usage of transfer pricing to change the course of income from high-tax structured nations to low-taxed nations. The tax regulations of many developed nations include provisions to assure that sales and additional processes executed between domestic firms and their foreign subsidiaries are transacted at arm's length prices. These provisions are hard to execute, as the actual judgment of the arm's length price is full of difficulties.

Consequently, the provisions against the usage of tax havens that developed nations have recently presented have particularly influenced the proliferation of passive investment revenue in tax haven nations, not by prohibiting accumulations out rightly, but by making them more expensive and complicated. Thus, the accumulation of revenue by holding firms and trusts is still feasible but is merely for extremely affluent investors or enormous businesses.

Also, the businesses that employ transfer pricing veer around earnings to tax haven nations; the use of transfer pricing techniques has not been largely affected by the provisions against the use of tax havens. It is possible that the shoppers of tax havens are regularly being pulled out from high-wealth

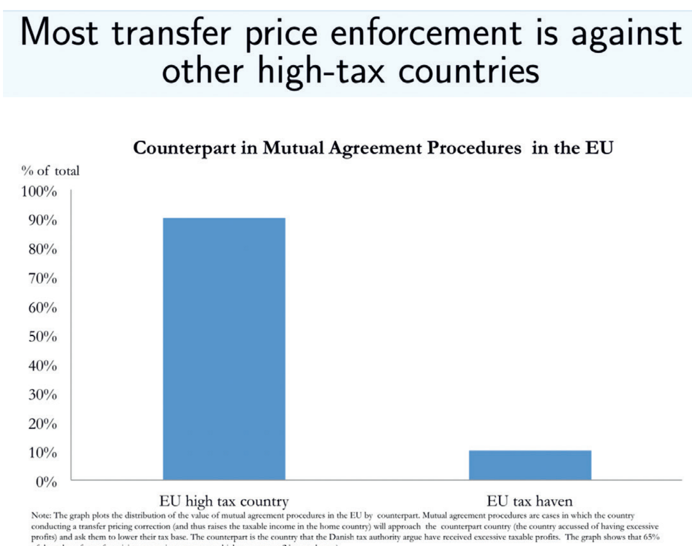


Figure 26: Partial transfer pricing scenario

Source: United Nations University World Institute for Development Economics Research

individuals. Nonetheless, some of the actions against tax haven nations in developed nations have originated from medium-sized or small businesses that assert that tax havens afford tax relief primarily to considerable-sized firms, making competition trickier for other businesses. Figures 26, 27, 28, 29 and 30 explain some details regarding transfer pricing.

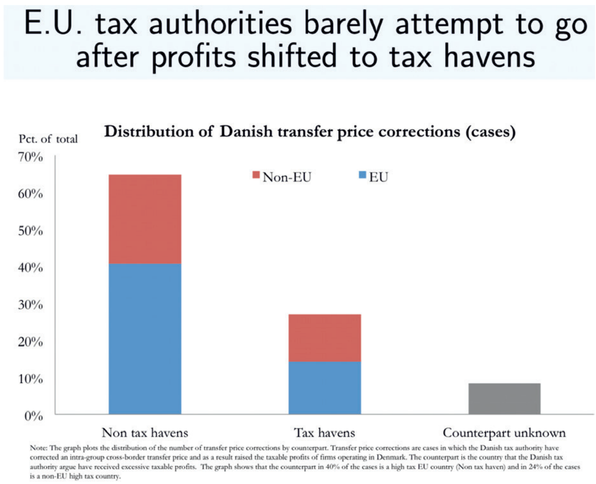


Figure 27: Example of distribution of transfer price correction in terms of cases in Denmark

Source: United Nations University World Institute for Development Economics Research

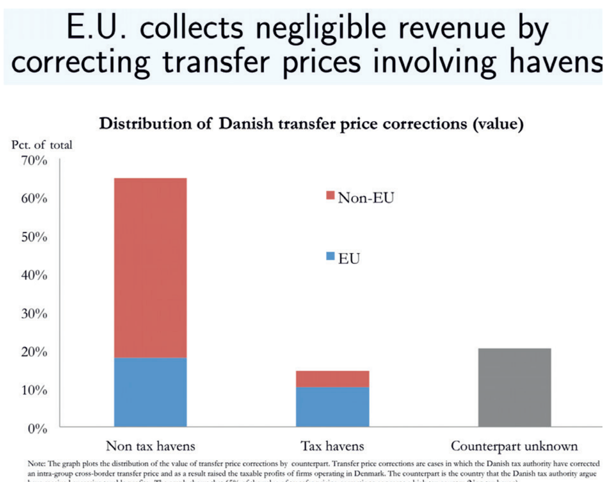


Figure 28: Example of distribution of transfer price correction in terms of value in Denmark

Source: United Nations University World Institute for Development Economics Research

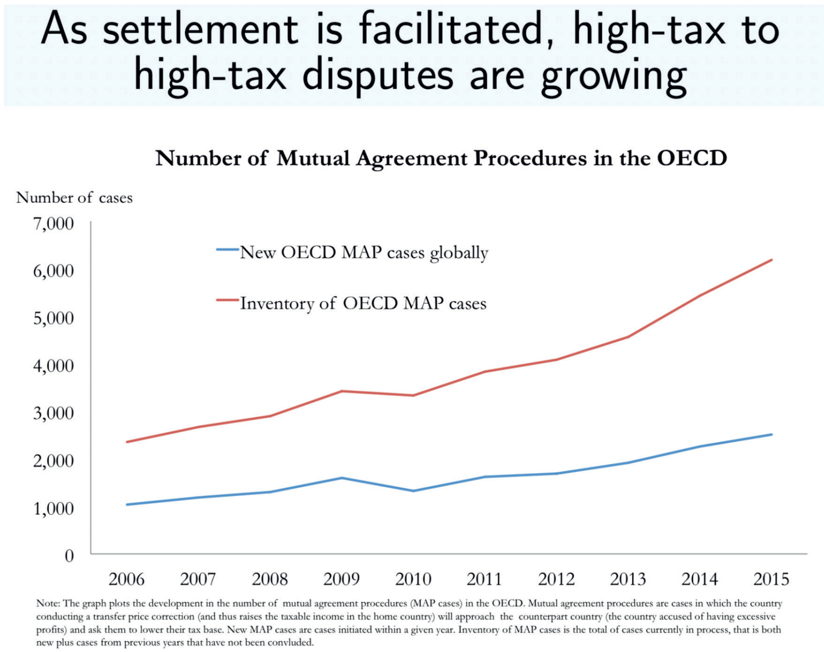


Figure 29: Quantum of OECD Mutually Agreement Procedures (MAP) cases

Source: United Nations University World Institute for Development Economics Research

Figure 30: The world's most destructive corporate tax havens in 2019

Source: Statista

TAX HAVENS CHALLENGES

The unfavorable consequences of tax havens are not merely on the economy in high-tax nations or on individuals/businesses situated there due to loss of tax revenue, but also in the nations in which the tax haven is being stimulated. Figures 31, 32 and 33 depict some of these challenges.

Decrease in public revenue: Tax havens accumulate lower tax revenue due to a no-to-low tax system, consequently decreasing the governments' reserves for general public services, infrastructure development and social agendas. For example, in 2016, the European Commission ordered Apple to pay back €13 billion in outstanding taxes due to Ireland, as the firm had taken undue advantage of the nation's lower corporate tax rate, although the judgment was still being challenged as of November 2023.[3]

Rising Inequality: Tax havens can aggravate income inequalities. Moneyed individuals and big businesses usually have the resources to study and take advantage of lower tax breaks. For example, the Panama Papers leak in 2016, disclosed that affluent individuals and firms from across the globe employed the Panamanian law company Mossack Fonseca to establish offshore accounts to evade taxes, accentuating how the transnational cream society was utilizing tax havens, which was not possible by regular residents.[4]

Regulatory Challenges: Tax havens usually have loose and non-transparent regulatory frameworks, which conceals the division between shrewd tax schemes and unlawful action. For example, Danske Bank was recently booked in a money laundering scandal, where huge unlawful funds from Russia and other nations streamed through the bank's Estonian branch. This scandal was due to the loose oversight in the Baltic region, and the bank manipulated the feeble regulations.[5]

Inconsistent Revenues: Dependency on tax earnings from offshore entities can prove to be perilous for tax havens, as it leads to erratic and unexpected earnings, as well as unstable inflows or outflows, creating difficulties in strategizing yearly budgets and hampering regulatory requirements. Also, in some cases, this inconsistency can lead to forced banking closures or unfavorably affect customers' secret monetary reserves.

The problems built and restrictions imposed by the tax haven status vary depending on the extent of evolution of a nation, the extent and composition of its tax haven and the type of advantages bestowed to this sector. Generally, considerable difficulties arise in developing nations where the tax haven sector contributes a fairly significant percentage to the nation's gross national product.

Figure 31: Growing share of offshore profits for MNCs in tax havens

Source: Scroll.in

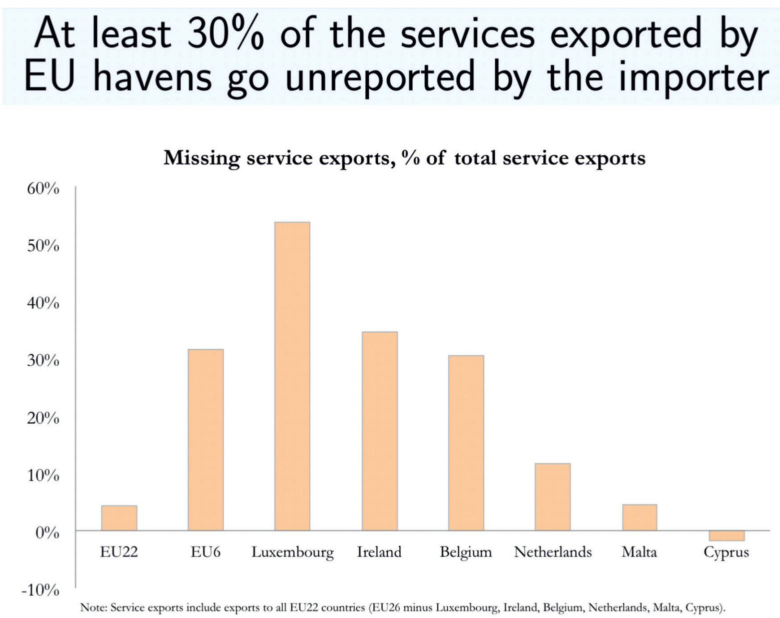


Figure 32: Unreported service exports as a percentage of total service exports by the E.U. tax havens

Source: United Nations University World Institute for Development Economics Research

This may seem paradoxical. The point that the tax haven sector is contributing significantly to the gross national product should imply that fresh economic action is taking place, which is welcome. However, the difficulty lies in the essence of tax haven activity, as its primary objective is that of tax avoidance and tax haven action yields extremely low investment in tangible assets; thus, tax haven businesses are incredibly volatile and unstable.

The only tax haven sector that accomplishes to engage in actual economic activity is the financial sector which is extremely conditional on what happens in the rest of the tax haven sector. If foreign businesses vanish, domestic economic action will not be adequate to maintain the immense banking and insurance corporations and supplementary institutions that create the financial sector of a tax haven nation.

Tax haven activity is extremely susceptible to nationwide and transnational consequences. The subtlest indication of a financial dishonor in a tax haven like a distinguished bank defaulting on its obligations is sufficient to scare investors and compel them to search for another tax haven that offers more security. Situations such as these are difficult to prevent, as one of the things investors look for in tax havens is absolute secrecy and as little prying as possible by government officials into their affairs. Secrecy and supervision do not go well together, and generally the latter suffers in tax haven countries; accordingly, it is not surprising when bank failures or other financial problems do occur.

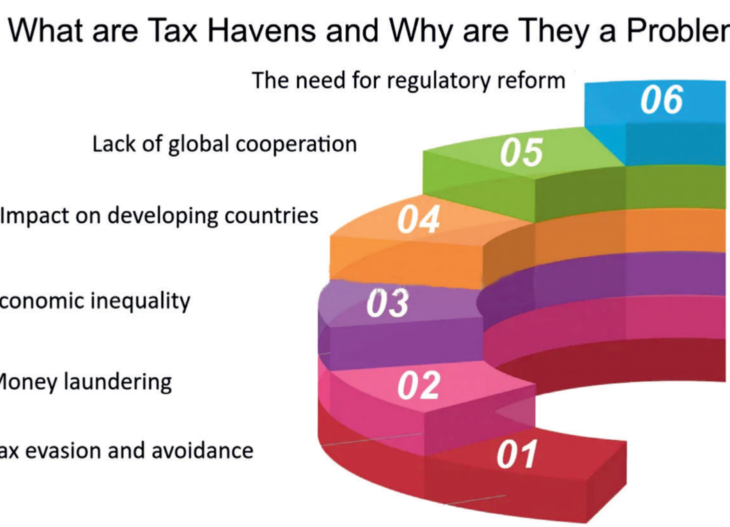


Figure 33: Adverse impacts of tax havens

Source: Faster Capital

MULTINATIONAL ASPECTS AFFECTING TAX HAVENS

One of the aspects that can impact tax haven investments is the mindset of developed nations toward this trend. The steps against the usage of tax havens already have had some consequences. Future criteria's are being researched by developed nations that will make the usage of tax havens more expensive and complicated. Instabilities in the global economy and disruptions in transnational monetary markets also impact tax haven actions. Also, competition among tax haven nations attempting to outperform one another by showing more stability, reduced tax structures and promising commercial facilities underlines the volatility of tax haven investments.

Tax havens tend to be susceptible to modifications in multinational merchandise prices and economic fluctuations and are also instantly influenced by the tax policies of advanced nations, which are beyond their power. The higher the dependence on tax haven activities, the more unstable is their economic condition. These deliberations jointly with the regulations that the tax haven status positions on the formulation of nationwide fiscal guidelines, imply that developing nations should think twice before desiring to evolve as tax havens. Meanwhile, those countries that are already tax havens should try to decrease their reliance on the activities related to this sector.

CONCLUSIONS

Tax havens are inherently legal sovereign jurisdictions having their own regulations, laws and ordinances. Nonetheless, the lawfulness depends on how people and business entities employ tax havens; based on their distinct actions and the regulations of both the home nation and the tax haven. Multinational corporations frequently manipulate tax havens for profit-shifting schemes and stretch their laws to their advantage by developing subsidiaries in low-tax jurisdictions and rerouting profits via these entities to reduce their transnational tax responsibilities. These firms apparently determine their entity structure and managerial activities to create gains.

Due to these reasons, governments and multinational institutions have embraced diverse techniques to regulate tax havens, which comprise executing tax data exchange pacts and facilitating clarity via regulated endeavors. The lesser tax structure or no taxes in one nation puts pressure on other nations to maintain their taxes at a lower level too. This is beneficial for taxpayers in the short run, but the secretiveness and ambiguity associated with some of the tax havens can facilitate money laundering or additional unlawful activities, that can impair the global economy in the long run.

The crackdown on tax evaders in certain nations demonstrates that taxpayers must tread with vigilance. With building force from multinational associations such as the Organisation for Economic Co-operation and Development (OECD) and the Group of 20 (G-20), tax havens find it tough to maintain their carefree presence. The increasing magnitude of Tax Information Exchange Agreements (TIEAs) and Mutual Legal Assistance Treaties (MLAT) between tax havens and other nations such as the U.S.A. would take away tax havens' competitive advantage. TIEA makes it mandatory to share tax data between signatories and MLAT insists on cooperation on issues of lawful enforcement and illegal case inquiries. Figure 34 depicts some of the recent developments in to fight against the misuse of tax havens.

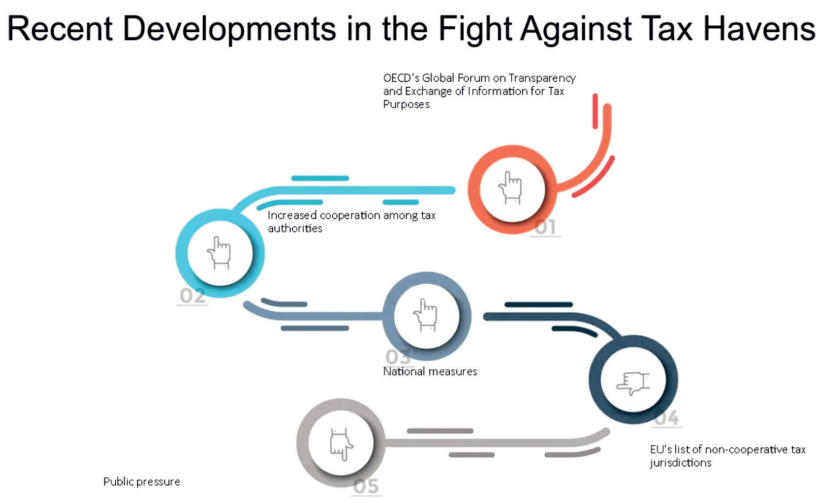


Figure 34: Current outcomes of the battles against tax havens

Source: Faster Capital

Investors utilizing tax havens and offshore banking locations should remember of the Liechtenstein banking scandal that quivered the entire globe in 2008. This scandal came to light when Germany initiated a series of tax investigations based on bank account information sold by a bank technician. Several Germans who took advantage of a Liechtenstein-based trust structure to avoid taxes in Germany found themselves in a loop. The leaked database also put tax evaders in several other countries like the U.S.A., U.K. and France at a threat for tax investigations. The Panama Papers leak in 2016 has revived interest and inquiries into offshore businesses. The article in a German newspaper exposed documents depicting the network of greater than 214,000 tax havens affecting individuals and entities from 200 diverse countries.[6]

Furthermore, by charging a low tax structure on the enormous amount of profits tax havens have been able to lure MNCs and tax havens have been able to yield greater tax revenue as a percentage of their national income, as compared to non-tax havens which have much higher rates. Also, nearly 40% of multinational profits were artificially steered to tax havens in 2015. Such huge tax evasions and the delinquency to restrain it are consequently directing more nations to give up on higher taxing of MNCs. As a result, between 1985 and 2018 the transnational mean statutory corporate tax rate decreased by more than half, from 49% to 24%. Refer to Figure 35 which depicts the decrease in global corporate tax from 2003 to 2018.

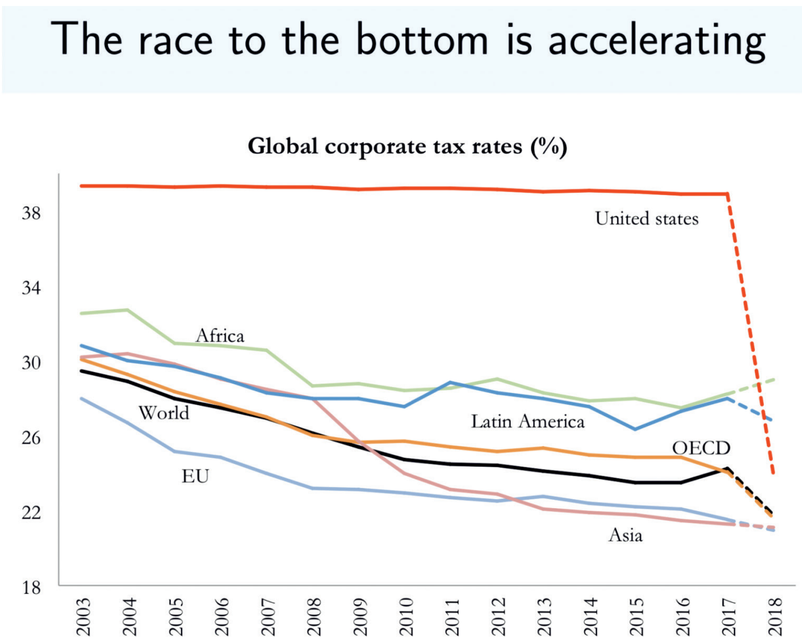


Figure 35: Reduction in global corporate taxes due to influence of tax havens

Source: United Nations University World Institute for Development Economics Research

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