# TAX HAVEN: A BOON OR A BANE?

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## TABLE OF CONTENTS

## ABSTRACT

*Economists coined the word "capital curse" in the early 1990s to explain a phenomenon that they found in countries where valuable natural resources were discovered: they frequently crumbled, economically and politically, rather than flourishing. Instead of raising living standards for everyone, the newfound wealth created crime, and intensified the growth of inequality and corruption. In recent years, a similarly insidious trend has emerged among the countries that serve as offshore financial centres. Some, like the countries afflicted by the capital curse, are former colonial states struggling to remain fiscally viable; the "power" they discover is human capital, in the form of a population that is literate and numerate enough to provide financial services, such as filing and enforcement tasks linked to offshore companies, trusts, and foundations. For these economically and politically unstable nations, the cash inflow from participation in international finance seems like an unmitigated blessing, providing jobs and revenues for comparatively limited infrastructure spending, such as high-speed internet connectivity. But as others consider, there are unforeseen costs of being a tax haven. In these nations, precipitous cultural, political, and social declines have occurred so frequently that the analysts have coined a new word for it: "financial curse." In other words, to the detriment of those who do, these countries slowly become structured around the interests of people who don't even live there. As demonstrated by a rise in crime and violence, this has resulted in growing economic fragility for offshore financial centers, along with political corruption and social degradation. In this paper, the authors will discuss the meaning of tax havens and why such tax avoidance strategies are adopted by any corporation. Moreover, the main reason as to why preferential tax regimes exists at all. This raises the main question: Is it good at all? Are tax haven a boon or a bane?*

*Keywords: capital curse, financial curse, political corruption, BEPS, boon, bane.*

# 1. INTRODUCTION

Tax havens are those regions or nations that impose little or no tax on overseas players ' income in a comparatively stable economic and political setting, operating in a "financial secrecy" scheme. To prevent tax liability, nations either plan their investment in tax havens or sign a Double Tax Avoidance Treaties with nations that allow businesses to pay little or no taxes in one nation while avoiding paying greater taxes in another. Mauritius is renowned for its income tax zero, and India has signed a treaty with this nation.[1] The government on this note has decided to take actions via amendments in the taxing regimes in order to limit illicit transactions and corruption.

Quite significantly, presence of tax haven or tax avoidance activities have been prevailing since 1930's but have become a matter of concern with the liberalization and globalisation economy in the early 90's in which there was a tendency created by taxpayers in which they use to structure their activities in such a way by geographically choosing the appropriate location and plan their tax bases accordingly. Economic digitalization has made it even more tenuous to establish the link between jurisdiction and money flow.[2]

Sustainability in the company can only be accomplished if the company has the appropriate development climate that provides the company sufficient strength and energy to carry out its operations.[3] Since poorly developed countries with serious battling issues of sanitation, food and shelter; the main aim of the government of such countries to pool the investments made by various multi-nationals and individuals in their country and use that capital so raised in the development of the nation. Therefore, there are many proponents of tax haven who are inclined more in defending the concept of tax haven altogether because if understood in a broad spectrum, then often it accounts into some fruitful activities. This has also been the reason why tax havens are not considered illegal comprehensively. It is like "beauty, which lies in the eyes of the beholder." But on the other hand if we see, many countries are not able to evolve because of the presence of Tax Havens, which are deemed the heavenly bodies and act as a refuge for those who want to avoid / evade their tax liability. Through the use of tax

[1]Barkha Jamwal, *A study on the secret world of tax haven*, International Journal of Applied Research 3(5): 719-722(2017).
[2] Cécile Remeur, Listing of tax havens by EU (European Parliamentary Research Service (May 2018).
[3] Ibid.

havens, such organizations strip the developing and poor countries of the income that might have arisen from corporate tax and people had the tax havens not existed.

Tax haven in its very existence can be understood as manipulations made in the laws of the country by taking advantage of the loopholes of such taxing policies. This practice is greatly practiced by Multi-national Corporation who by forming a shell company or a sham company in poorly developed nations and set up a productive business there, which offers them land, labour, and enormous raw materials at low cost.[4] However they are not willing to pay higher taxes imposed by such nations thereby they manipulate their business operations through their already set-up shell companies. This is because the tax levied by developing nations will quite naturally be lower than that of the developed nations.

The issue with the present situation is that not only it is misunderstood in terms of its meaning but also the efforts been put to combat such activities have gone into vain. Because any legal matter requires precision and clarity in terms of strategy and tactical use otherwise, it can be easily interpreted by judiciary and legislation in very wide connotations or may lead to arbitrariness.[5]

### 1.1.INDIAN TREATMENT OF TAX HAVEN

In order to identify non-cooperative jurisdictions, the Indian government has highlighted transparency and data provisions exchange over the low / nil tax rate criterion.[6] They are not formally even referred to as tax havens, the legal provision that refers to them as "notified jurisdictional region" (section 94A[7] of the Income Tax Act introduced in 2011-12 by amendment). Having started early in the matter of exchanging tax data through bilateral TIEAs, mostly with secrecy jurisdictions / tax havens, India confronted the danger of blacklisting in June 2013 against Switzerland, the United Arab Emirates (UAE), Hong Kong, Singapore, Samoa and Seychelles for failing to efficiently share data. The blacklist published

[4] Ibid at 1.

[5] 1998 OECD Report On Harmful Tax Competition (1998 OECD Report); Klwer Law International, Volume 32, Issue 2 (2004).

[6] Jahanzeb Akhtar and Verónica Grondona, Tax Haven Listing In Multiple Hues: Blind, Winking Or Conniving? South Centre (2019)

[7]Section 94A of Income Tax Act allows the Indian Government to notify any of the applicable countries that fail to provide assistance with the exchange of tax information. Its areas of coverage include declared or located Notified Jurisdictional Area (NJA).

in November 2013, however, was only about Cyprus that was not listed in the initial threats, prompting some surprise responses.[8]

Section 94A has only been used once to date, including against Cyprus (Notification No 86/2013).[9] Blacklisting a tiny nation was used simply to send out a signal, rather than imperiling relationships with big trading partners such as the UAE (9.4% of India's trade) or Switzerland threatened with sanctions. Ultimately, the lack of ingredient in such exercises is political will.[10]

[8] Ibid at 6.
[9] Ibid.
[10] Ibid at 6 & 8.

## 2. HISTORICAL DEVELOPMENTS IN TAX HAVENS

The development of the concept of tax havens can be seen from the times of ancient Greece, the city of Athens imposed 2% tax on the merchants so to avoid tax the merchants used to take a detour of 20 miles. So the small neighbouring islands became safe havens to hide the goods and to export them to different countries on a later date[11]. Until , the 20th century, there was mass introduction of taxation system and so tax havens mainly focused on granting relief from the taxes and the excise duty. In the later stage there were several factors which contributed to the growth of the significance of the tax havens in the world economy. In the first place globalization in the world economy was accompanied by the improvements of infrastructure, telecommunications and also lower the transaction cost of the different tax planning schemes. Both individuals and the big companies started to use foreign jurisdiction to shelter from the tax and so the tax havens were considerably accessible to the potential users[12]. Classical Tax havens arose as a massive shift when the developed nations to income taxations as a primary of the tax revenue and post war the income tax rates and introduction of rigorous taxation regulations. Such policies led to increase in the demand of the tax havens for tax avoidance. Tax havens were formed in different times in the 20th century Leichtenstein made its debut as a tax haven with Anstalt in 1926. From[13] 1960s to 1980s many tax havens were made such the Cayman Islands, Bahamas, Bermuda, Israel, Hong Kong etc . this development slowed down in the 1990s with the liberalization of the national tax regimes and regulations practices which made the tax havens less appealing to the tax payers[14].

[11] Tax havens and their use by the United States Taxpayers- An Overview, A Report to the Commissioner of Internal Revenue Submitted by Richard A. Gordon, Special Counsel for International Taxation (Gordon Report) , 12th January 1981,p.26, cited from Marshal J . Langer , International Tax planning (Practicing Law institute , New York,1987)

[12] Ibid

[13] George E. Glos, Israel as a Tax Haven, International Lawyer 1970,Vol. 4,no. 5.

[14] Thus , according to Micheal Giles , Chairman of International Private Banking at Merrill Lynch: " *In market after market, the whole structure of the foreign exchange controls, the whole fear of having your saving and yoir capital confiscated or eroded by runaway inflation is decreasing*". George Graham and Robert Wright "Winds of Change on Treasury Islands", Financial Times, 24 january 1988, p.9. *See* Also the United Nations Office for Drug Control and Crime Prevention 1998 Report "Fanancial Havens, Banking secrecy and Money Laundering " (the UNReport), p.33.

## 3. WHAT ARE TAX HAVENS?

Tax Havens are small and well-governed states which impose low or zero tax on the foreign investors. Tax haven means tax shelter in *Spanish*. Mostly the multinational companies use tax havens to avoid taxation and the countries does not usually disclose data that is they provide high level of banking and financial secrecy and tax avoidance treaties. According to the *Black's Law Dictionary* "Tax havens is a country which imposes low or no tax on the Profits from the transactions carried on in that country"[15]. Countries in tax haven receive substantial foreign investment and have experienced very fast economic growth over the previous 25 years, mainly as a consequence. Over the past 20 years, shocking technological developments and the telecommunications revolution have made access to offshore facilities easier. And the OECD report defines tax haven as 'a jurisdiction actively making itself available for avoidance of tax which would otherwise be paid in relatively high tax countries'[16]. The OECD also relates factors for considering a country to be a Tax haven such as:

- No or only nominal taxes are imposed by the jurisdiction.
- If there is lack of transparency
- Whether the administrative laws and practice prevents the exchange of information with the other governments on the tax payers benefitting fron the low or no taxation.

### 3.1.CHARACTERISTICS OF TAX HAVENS

As noted in the Gordon Report, some factors are generally considered as tax havens characteristics. These are the following factors:

- Relatively low tax Rates[17] : Most tax havens do not collect taxes or collect taxes that are less than the tax haven resident in his nation of origin would have paid. It may be done to attract Foreign banking activities, multinational companies. It may also be said that there is impossibility of a taxation system on the basis of income

[15]Bryen A. Garner(ed), Black's Law Dictionary '7th edition, west group , 2001, p. 1474

[16] OECD : tax Havens, April/May 1987, available at http://www.kluwerlawonline.com (last visited on September 8th ,2019)

[17]SeÂbastienMoerman, The Main Characteristics of Tax Havens, Nigel Harris & Company, Available at http://www.kluwerlawonline.com ( lasted visited on September 8th,2019)

as the country are very poor and the people there lives on the edge of poverty so it is impossible to apply a tax system.

- Forms of Tax Havens
    a. The Zero Havens : the country which not have income tax , wealth tax, corporation tax and capital gains tax , for example, the Caymen Islands, Bahamas, Bermuda etc
    b. The countries in which these taxes are applied on a territorial basis: In this exemption is provided on the profits by operations outside the territory of the country, the major example in this case are , Costa Rica, HongKong, Panama, Malaysia etc
    c. The countries in which the rates of taxation are low : This is done either because it is fixed like that or the rates of taxation is low because of the application of the treaties. This is case for the example, The Netherlands Antilles , the Bristish Virgin Islands.
    d. The countries offering special advantages to holding companies or offshore companies, for example, the Caribbean, Luxembourg and Singapore .
    e. The countries offering tax exemptions to the companies created eith the aim to develop exports, for example in Ireland.

- Banking and Commercial Secrecy[18]: Each tax haven provides people making economic transactions a guarantee of discretion or confidentiality. Most tax havens consumers find banking secrecy protection to be a basic component in choosing a tax haven. Protection and scope of banking confidentiality may differ depending on the tax haven. Basically, in order to preserve their place in competition with other tax havens, most tax havens have enhanced and established their banking secrecy laws. For example, in the Bahamas, the Bank and Trust Company Regulatory Act 1965 stipulated that disclosure of information relating to the operations of a bank or trust company is prohibited for all the individual who knew this data in the course of his professional duties, unless the court ordered this disclosure.

[18] Ibid at 3

- An Important and Disproportionate Financial Sector[19]: In the economy of a tax haven, the banking region is usually more advanced and privileged than in a country's economy with a classic taxation scheme. In most cases, the activities of non-residents will be subject to a special advantageous regime. The importance of the banking sector with regard to the economy of a country may be determined by the ratio of the Foreign assets held by a country's bank for that country's foreign trade. For instance, as early as 1978, the Bahamas banks 'total overseas assets were USD 95.2 billion. Considering the ratio's global average, USD 1.2 billion was needed to finance the Bahamas ' overseas trade. The distinction (USD 93.4 billion) is an indication of the Bahamas ' attractiveness as a tax haven, representing the global excess assets.

- Modern Communications Systems[20]: This is also a major factor in the tax haven selection. He also wants to communicate with the rest of the world easily from this territory. The Tax havens must have communications system such as fast flight to the developed country and must also have telecommunications systems such as telephones , emails etc The Cayman Islands, for instance, have a contemporary telephone system and an outstanding telex service ; telephone numbers can be dialled straight from the U.S. and Canada.

- A stable currency and a flexible exchange control[21]: Most tax havens have a dual currency control system. Indeed, this dual scheme distinguishes inhabitants from non-residents and foreign currencies from national currency. Residents are basically subject to currency checks and non-residents are not. These laws were enacted with the objective of facilitating a individual wishing to build a company here to begin business with other nations to use the nation as a tax haven.

[19] Ibid at 3
[20] Ibid at 3
[21] Ibid at 3

## 4. IMPACT OF TAX HAVEN ON POOR AND DEVELOPING COUNTRIES

Most tax haven countries are being created and attracting investment from developing countries. These offshore countries deprive developing countries of spending the fiscal budget on offering fundamental amenities and welfare services such as clean water, food, shelter, education, hygiene, health care facilities and fundamental infrastructure for the benefit of the general public, as these countries are losing millions of tax revenue to tax havens. Thus, these tax havens / offshore centres hamper one of the primary goals of poverty reduction in developing countries, creating a worldwide issue of poverty.

MNC's being reluctant to pay high taxes, create a way of tax evasion through developing countries by parking their funds into tax havens and thereby avoiding any tax so levied in the home country. Revenue loss to growing economies is enormous and cannot be quantified.[22] Because of low tax collection, developing nation people lack high-quality vital facilities as the MNCs seek investment in tax havens to dodge taxes in the home nation where actual financial activity takes place. Tax evasion and tax avoidance through tax havens is one of the main obstacles to such emerging nations ' growth.

The Oxfam study shows the tax costs of tax havens and also that such income loss to non-tax havens implies underdevelopment and problems of high poverty. Furthermore, tax havens play no significant part in the world economy beyond minimizing taxes paid by the MNCs and as such no productive activity occurs either in the tax haven country or in the non-tax haven region. The impact of the developed countries of ripping out the the developed countries is not limited to the law-rate collection of tax, thereby leading to insufficient economical growth but it also effects the life of people living in such countries because then their governments levy greater tax on their income or other ways of tax collection in order to keep the nation in a healthy state of affairs.

[22] Ibid at 1.

## 5. NEED FOR BASE EROSION AND PROFIT SHIFTING (BEPS) PROJECT

A cursory look at the BEPS methods will show readily that the main reason for such aggressive tax planning is the very existence of preferential tax systems. This fact raises important questions: Are tax haven a boon or a bane? Is such type of preferential tax regime does any good at all?

"A tax haven is a country which offers foreign individuals and businesses a minimum tax liability in a politically and economically stable environment, with little or no financial information shared with foreign tax authorities."[23]. Most of the Tax Haven countries do not require the business persons and MNC's to physically reside in their country. Investments in these countries are done in a sham manner with minimum physical activity in the target country. Corporations such as Alphabet, Microsoft and Apple operate on their business activities in tax haven country by funding into an offshore account, thereby hiding behind the veil of liberalization and privatisation of businesses worldwide.

Across the globe there are almost 30-40 tax haven countries. Research shows that those countries are more prone to become tax haven countries where they have a more sound and a safe environment of corporate governance. Reports also show that with less population of a country, chance of becoming a tax haven country increases more to approx 65% from 25%. This is because MNC's and investors are protected in such a sound mechanism of corporate governance, thereby reducing any chances of scam and mismanagement within the system.

Some economists on this aspect argue that tax haven leads to tax competition beneficial for the society however, some believe that tax haven do not actually serve any economical purpose and it is just a medium for tax avoidance by big companies who intend to shift their profit in a nation where taxes are low and in their favour and exploit them of their resources. On the positive side, if one may look, we find that this tax competition provide such niche class of people privacy of information and low taxes which boosts the competition and effects the economy in a fruitful way. But at the same time the fact that MNC's exploit such developing nations off their available resources without compensating them with the lost taxes cannot be ignored.[24] This date pretty much answers some of the questions posed above

[23] Chandra Kant Parma and Arpit Vashishtha, Need and Impact of Base Erosion and Profit Shifting (BEPS) Project: An Indian Perspective (Pacific Business Review International) Volume 10 Issue 8, February 2018.
[24] Ibid.

as to why tax haven exists at all? There can be many reasons of its presence in a nation. Some nations compensate their losses from other sources like indirect taxes and do not need much FDI or capital investments in the country through MNC's. While some nations feel that there is a need to invite offshore investments into their country by allowing MNC's because through opening of subsidiaries and with industrialization, they generate employment by employing locals in their business, hence facilitating economic growth. Also it becomes way in which big conglomerates from industrialized countries transfer needed skills and upgraded technology in the tax haven country which is enjoyed by the locals of such nation.

Apart from the negative impact tax haven imposes and if we ignore the situation of Switzerland then we can see that most of the tax havens are poor, developing and in a vulnerable state. These countries in an attempt to join the mainstream of the economies, through pressure from large and big corporations dwell into making their privacy provisions intact with very limited scope of invasion hence, promotes transparency. This is important because there are powerful and influential people whose primary focus is to maintain their *status quo* by ensuring their financial information is kept private.

## 6. IMPACT OF BEPS PROJECT IN INDIA

India among other developing countries also faces the issue of tax haven and to avoid the situation where developed countries and big corporations, exploit India of its resources, it became imperative for India to take stringent actions in this regard. India in this attempt, besides the directives given by OECD, few years ago, the nation has decided to revise it tax treaty of Mauritius due which the country incurred major tax loss owing to the fact that residents using this route to evade taxes. Moreover, India strongly suggests the source based taxation and not residence based taxation as International tax regime. Through Finance Act of 2012, the General Anti Avoidance Rule (GAAR) have been introduced in the domestic statute of 1961 with certain rules notified on September 23, 2013.[25]

Attempts such as The "Equalization Levy on online payments to non-residents" for specific purposes has also been recently implemented by the then Finance Minister, Late Shri Arun Jaitley to bring big corporations and influential powers in the same spectrum of indirect taxation especially for their revenues from advertisement services.

[25] Ibid.

India in order to avoid becoming one of the developing countries being caught by the power of developed countries and MNC's have induced a very stringent and strict procedure of investment by MNC's into the country. These companies have to go through a highly comprehensive and detailed documentation process as which includes transfer pricing which is Action 13 plan of BEPS. Along with this a three-tier transfer pricing documentation. From the aspect of Permanent Establishment (PE), India has always been a strong taxation principle country but with the many service sectors and e-commerce activities, it became imperative for the government to introduce laws for the better facilitation of the existing provisions.

## 7. MISUSE OF TAX HAVEN

Tax havens are used to conceal the business activities performed in these areas, thereby promoting the activities related to criminals and terrorists. These offshore entities, by providing secrecy standards, encourage global financial crimes. It may even lead to ' Money Laundering ' as the money earned or transferred is not accounted for. A new report finds that at least $21 trillion in secretive offshore accounts has been accumulated by the extremely wealthy around the world. Now that is the sum equal to the gross domestic product of Japan and United States added together.[26]

i. Panama Case:

This case relates to leakage of information from one of the most secretive companies, a law firm known as Mossack Fonseca, located in Panama. The company kept hiding documents and records of some genuine and some illegal operations such as money laundering, false documents of property to avoid people and firms ' tax liabilities. It includes illegal and uncounted cash from wealthy, wealthy, and noble individuals ranging from big leaders around the globe to actors, sports individuals, and corporate giants. ED officials told The Indian Express that they have sent 137 "advisories" to the Indians named in the Panama Papers under Section 37 of the FEMA over the past two months. Some of the disclosures in this case include:

- The 11.5 m papers were collected by the Sueddeutsche Zeitung journal and shared with the International Consortium of Investigative Journalists (ICIJ).
- 2.6 TB data leaked by anonymous hacking of server of the law firm, from abroad.
- Almost 40 years of data revealed from 1977.

[26] Ibid at 6,8.

- Over 14,000 middlemen involved (such as banks, law firms, etc.) in incorporating these companies for clients.
- The list also includes actors like Amitabh Bachchan and Jackie Chan. The leak has also disclosed that more than 500 banks have recorded nearly 15,600 shell companies with Mossack Fonseca, including their subsidiaries and branches.

The information leak from Panama Paper includes a broad variety of entities and individuals many of whom may have parked their cash in such tax haven for lawful purposes such as: First, entrepreneurs may store cash offshore so it is not subject to theft by local criminals. Second, some nations have constraints on the quantity of difficult cash that local people / companies can take in order to store it.

ii. Enron Case:

The crash of the Energy, Commodities and Services Company based in Texas-ENRON in 2001 was one of the largest corporate governance mistakes that shook the world. In tax havens, this corporate giant used around 881 subsidiaries, including 692 in the Cayman Islands, 119 in the Turks and Caicos, 43 in Mauritius and 8 in Bermuda, to prevent paying taxes for 4-5 years.[27] Enron shares at their peak in August 2000 were worth $90.75 and fell in January 2002 to $0.67. His CEO, CFO, and auditor were at the core of the crime, charged by SEC with heavy investigation orders. Sarbanes Oxley Act, 2002 went into force after this significant corporate and accounting scandal. With the application of SOX, the role of boards of directors in supervising and the role of independent auditors reviewing the precision of corporate financial statements has been improved to avoid any other significant failure in corporate governance.

[27]BarkhaJamwal, *See also at* 1.

## 8. Conclusion And Suggestions

Tax havens are the tiny areas / nations that have well-developed infrastructure and attract corporations to provide the banking and financial secrecy standards with low / no tax advantage. The tax havens could have been used in a positive manner, but the evidence shows that they are used to exploit the poor nations by not paying taxes where income is earned and used for terrorist and money laundering. It has become a hub of global financial crimes where there are hidden and unreported trillions of dollars of money. The existence of Tax Havens clearly deteriorates the development process of poor and developing nations, as multinationals in developing nations avoid paying higher taxes in these areas and end up landing their profits in Tax Havens. Cases such as Panama Leaks and Corporate Governance failures such as Enron and Satyam are also evident from the fact that corporations consider tax havens as areas for which they can do anything and for which they will not be accounted. Tax havens on the tax bases of non-tax haven nations are regarded as the parasites. The non-tax havens and government fiscal policy is largely affected, which is mainly used for public welfare and nation development. These tax havens hamper the emerging nations developmental activities that charge taxes to fund government revenue.

### 8.1. What Can Be Done To Reduce Negative Impact of Tax Havens

- A public initiative that guarantees that transfer pricing takes place at an arms-length cost; can curb the practice of transfer pricing. Australian government adopts this.
- In addition, corporate revenue should be taxed based on the proportion of productive activityperformed in the nations concerned. Because for the sake of the name, most corporations in tax havens just appear on the paper and are not engaged in any physical / productive activity.Consequently, taxing company's earnings or revenues according to the amount of activity theyengage in could save countries from tax shortages owing to excessive investment in Tax Havens.
- Non-tax haven countries government should amend the Double Tax Avoidance Agreements withthe tax havens in order to check on the round tripping of cash.
- Non-tax haven countries government should not levy exorbitantly elevated income tax rates onmultinationals as it discourages multinationals from paying the elevated taxes and ultimately dodges the tax.