Academic Journal of Economic Studies
Vol. 1, No.1, March 2015, pp. 130–136
ISSN 2393-4913

Fighting Harmful Tax Competition Generated by Offshore Jurisdictions

Dan Drosu Şaguna[1]
Daniela Iuliana Radu[2]

[1]*Faculty of Law, University of Bucharest*
[2]*Dimitrie Cantemir Christian University, Faculty of Finance, Banking and Accountancy, E-mail: danielaavocat@yahoo.com*

Abstract *Harmful tax competition is not just tax system, but can also undermine the interests of local communities and the environment. Tax havens are a huge drain of resources from other countries (basic non tax haven) to offshore areas. To operate, tax havens are supported economically, politically, and socially by high tax states. Also, by encouraging savings, it boosts investment and capital formation. Because they are low tax jurisdictions, they exert a higher tax on tax rates worldwide.*

Key words Tax haven, tax competition, offshore jurisdiction, taxation, tax

JEL Codes: E62, H39

1. Introduction

In the tax competition literature is defined as reducing the tax burden to improve the economic performance of a country by improving the domestic business environment competitiveness and/or attracting foreign investment. [1]

A classic example of tax competition is the fiscal incentives offered by various countries to attract investment. Increasing globalization of capital flows declining importance as other economic competition, fiscal factor increased in importance. Also encouraging national economic agents to invest abroad lead, finally, to the amount increased profits repatriated from international specialization and efficiency improvement. [2]

Fiscal Policy states end up being dictated by narrow partisan interests of some multinational advantage of capital mobility. Under cover general trend of globalization, international tax environment knows, so a series of mutations, the transition from one economic system within which financial intermediaries were the main circuit financing to a system in which market financing is accomplished increasingly through direct contract between fund holders and applicants. [3]

Financial Market Tax contemporary world must be analyzed by highlighting the stages and different levels of integration and directions this process. Fiscal policies promoted by governments have influenced the evolution of tax structure and size but the tax levy.

The extent of tax incentives, the level and nature of tax rates, with sensitivity of taxable, tax competition has influenced a whole manifestation. [4]

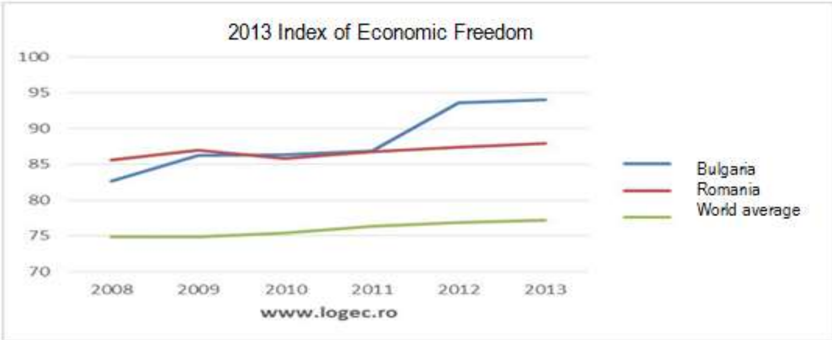


Figure 1. 2013 Index of Economic Freedom

Following a report in 1998 ("Harmful Tax Competition: An Emerging Global problem") the OECD (Organisation for Economic Co-operation and Development) has created a special forum, "Forum on harmful tax practices". To end harmful tax practices the work of the Forum focused on three areas: harmful tax practices in member countries; Tax havens; Involvement of non-OECD economies. Forum produced three progress reports. Furthermore, together with cooperative tax havens the Forum has produced a "Tax Margin Model Agreement on Exchange of Information on Tax Matters".

2. Tax competition in the EU

Member States' tax systems must also comply with EU state aid rules. According to Article 87, paragraph 1 of the EC Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market. State aid rules apply irrespective of the form is given, i.e. any kind of tax relief can constitute State aid if the other criteria are met. However, even if a measure qualifies as state aid, there are a number of situations in which aid can be considered compatible State aid (see Article 87, paragraphs 2 and 3 of the EC Treaty).

In addition, the Commission issued a number of regulations, notices, guidelines, frameworks and communications in the field of state aid. In particular, in the field of direct taxation, the Commission issued an opinion on the application of State aid rules to measures relating to direct business taxation in 1998 and a 2004 report on the implementation of that notice (see link CPC below the site Directorate General for Competition). The thought of losing tax revenue resources compel government officials to worry about the economically developed countries, condemning noisy tax competition (especially the so-called tax havens held) and would like to see reduced or eliminated.

Thus, through competent international authorities such as the European Commission (EC), the United Nations (UN) and Organization for Economic Cooperation and Development (OECD) governments promoting various tax harmonization schemes in order to inhibit flow High pressure capital tax jurisdictions to low-tax jurisdictions. Protecting and preserving the right to engage in tax competition should be a key goal for economic policymakers and to the states, especially those interested in promoting the economic development of poorer countries. The absence of tax competition would undermine opportunities for states to promote economic reform and reduce the same time creative and individual economic freedom.

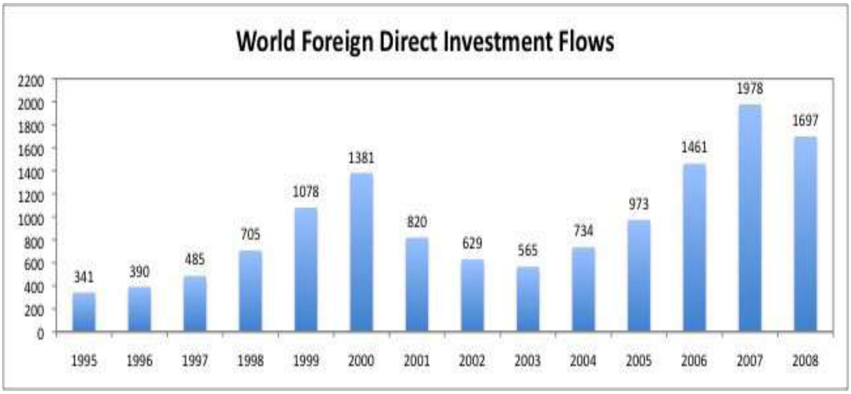


Figure 2. World Foreign Direct Investment Flows

The European Commission is a major supporter of fiscal harmonization and the United Nations created an "Office for Finance and Development," which calls for an international tax organization, and that would allow passage over sovereign nations and fiscal policy could lead to restriction tax competition. U.N proposes taxation of emigrants, who would have particular impact in countries such as Britain and the United States, which attract a large number of skilled immigrants. The battle between tax competition and tax harmonization is really a fight between the ways in which states can govern control inputs.

Historically, fiscal policies were developed primarily to address the internal economic and social concerns. Forms and tax levels were set based on the desired level of goods and transfers provided to the public, in terms also taken to allocative, stabilizing and redistributive goals were considered appropriate for a country.

While domestic tax systems of closed economies, in essence, had also an international dimension in that affected potential amount of tax imposed on foreign source income and domestic residents usually included in the taxable income of domestic non-residents, interaction of domestic tax systems was relatively unimportant, given the limited mobility of capital. The decision to have a high rate of taxation and a high level of government spending or lower taxes and limited public expenditure, the mixture of direct and indirect taxes, and the use of fiscal incentives, were all issues that were decided first based on domestic concerns and the impact has been mainly on the domestic market.

Although there have been some spillover effects on other international economies, these effects were generally limited.

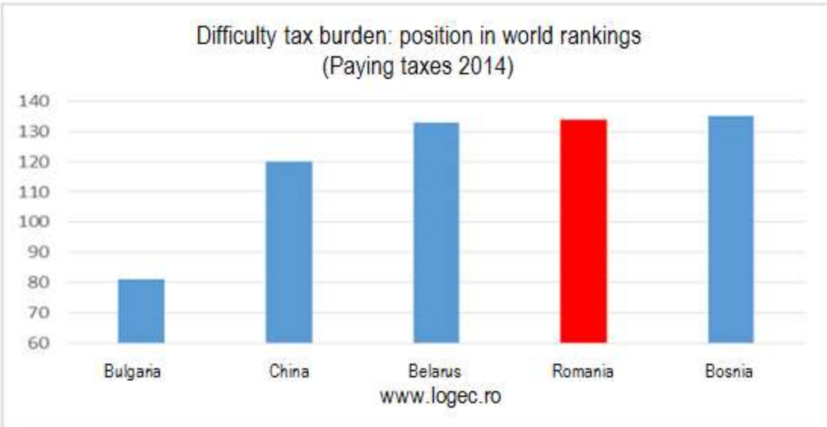


Figure 3. Paying taxes 2014

Globalization has also been one of the driving forces tax reform, which focused on base broadening and rate reductions, thus minimizing tax distortions induced. Globalization has also encouraged countries to continuously assess the tax and public spending in order to make adjustments, as necessary, to improve the "tax climate" for investment. [5, 6]

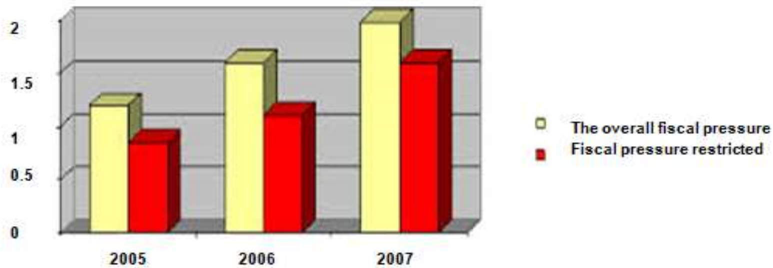
3. Tax Competition - Pillar in Operation Offshore Jurisdictions

Tax competition and interaction of tax systems can have effects that some countries may view negative or harmful, but others cannot. For example, a country may view investment incentives as a policy tool to stimulate new investment, while another may view investment incentives as a real estate investment diversion from one country to another.

In the context of this last effect, countries with specific structural disadvantages such as poor geographical location, lack of natural resources, etc., often considered as special tax incentives or tax regimes are needed to offset non-tax disadvantages, including any additional costs to locating in these areas.

Similarly, in countries outlying regions often experience difficulties in promoting their development and can, in some stages in this development, to benefit from attractive tax regimes and tax incentives for certain activities.

This result in itself recognizes that many factors affect a country's global competitive position. Although the international community may have concerns about potential spillover effects, these decisions can be justified in terms of the country concerned.



Source: *MEF and INS*

Figure 4. The fiscal pressure

Tax havens and harmful preferential tax regimes that drive effective tax rate applied to income from mobile well below rates in other countries have the potential to cause injury:

- financial reflux and, indirectly, real investment flows;
- undermining the integrity and fairness of tax structures;
- tax law compliance by all taxpayers;
- low level and mix of taxes and public spending desired;
- unwanted shifts the tax burden;
- increasing administrative costs and compliance burdens on the tax authorities and taxpayers.

Globalization and intensified competition among businesses in the global market has had and continues to have many positive effects. However, that tax competition may lead to the proliferation of harmful tax practices and the resulting negative consequences, as discussed here, it shows that governments need to take measures, including intensifying their international cooperation, to protect their tax bases and avoid global reduction in welfare caused by tax-induced distortions in capital and financial flows.

Tax havens are generally based on the existing global financial infrastructure and have traditionally facilitated capital flows and improving financial market liquidity. Now that non-haven countries have liberalized and regulated financial markets, any potential benefit of tax havens in this respect is more than offset by adverse fiscal effects. [7]

Many OECD countries and non-States have already established or are considering establishing preferential tax regimes to attract highly mobile activities and other financial services. These arrangements generally provide a favorable location for holding passive investment or for booking paper profits. In many cases, the arrangements were specifically designed to act as a channel for routing cross-border capital flows. These regimes can be found in CGI or administrative practices, or may have been determined by special charges and non-tax legislation outside the general tax system. [8]

Preferential tax regimes discussed in this part of the Report are usually targeted specifically to attract those economic activities which can be most easily moved in response to differences in taxes, in general, financial activities and other services. Such tax regimes may be particularly successful if targeted to attract income from activities and Investment Company based passive rather than active investment income. The existence of these preferential tax regimes can encourage relocation activities for which there is little or no demand or supply on the domestic market of the host country. In many cases, the scheme is only a pipe and no flow of investment regime would be unlikely to pass through the country providing the regime.

4. Conclusions

Economic evaluation of tax competition appears to be in line with general trends in economic thought from different countries. Most European governments have over the years developed a specific approach to international tax competition and position merits that country.

Questions complicated Taxation private savings and go to a more complicated issue that must be addressed in all areas I have mentioned on tax competition in Europe - the relationship between Europe (or even narrower: European Union) and third countries, especially in big industrialized regions (USA, East Asia), developing countries or tax havens simple. Progress towards fiscal harmonization in Europe will not change the competitive attitude of third countries which will use the inventory tax incentive to attract investments from European investors.

Therefore, it was said that as long as tax harmonization is limited to the Member States of the European Union will lose their competitive edge compared with third countries can exploit the tax burden between the "high" harmonized in Europe and the level of taxation " low "offer their competence. From this perspective, tax harmonization will not achieve the objectives of neutrality and fairness or off "tax degradation" in Europe, but simply put the Member States of the European Union in a straitjacket preventing them defend the competitive situation in the economy globalized.

In order to improve the competitive strength of Europe as a whole to these large economies in Europe must align its legal position limits, establish fairness and neutrality of taxation and to reduce transaction costs and burdens of compliance.

From this standpoint, the positive effects of tax competition, i.e. downward pressure on tax rates, will not disappear when tax harmonization is happening in Europe, because there will still be sufficient competitive pressure from the European Union to exercise control the fiscal and budgetary policies within the European Union.

Tax havens are a threat on capital flight from countries with high tax burdens.

Currently, there are two ways to combat this problem: by applying the principle of determining the market value of the tax payable by multinationals in a particular jurisdiction or by using a formula to allocate taxes paid by multinational companies between countries. Based on various studies conducted so far, is trying a presentation of the advantages and disadvantages of these methods in solving the issue of profit-shifting by multinationals.

References:

[1] Pinto C. (2003), Tax Competition and EU Law, Kluwer Law International, în Cristian George Buzan, Paradisurile Fiscale ;i Centrele Financiare Offshore în contextual economiei mondiale, Ed. C.H. Beck, 2011.

[2] Benassi Q. A., Fontagne L., Lahreche-Revil A. (2003), Tax Competition and Foreign Investment, Centre d'Etudes Prospectives et d'Informations Internationales, pp. 11-12.

[3] Gaftoniuc S. (2000). Finanţe Internaţionale, Ed. Economică, Bucureşti, p. 100.

[4] Buziernescu R. (2009), Fiscalitate, Ed. Universitari[, Craiova, p.74.

[5] Vording A. (1999), A level playing field for Business Taxation in Europe: Why Country Sizematters, European Taxation, p.410;

[6] Klaver/Timmermans (1999), EU Taxation: Policy Competition or Policy Coordination?, EC Tax Review 1999, p.185 et seq., 189.

[7] Harris A. (2001), The Notion of Abus de Droit and its Potential Application in Fiscal Matters Within the EU Legal Order, EC Tax Journa, p.187.

[8] Rivier I. (1996), The Formation of a Common Tax Law in the European Union and in Switzerland, EC Tax Review, p.81.