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Determinants of tax havens

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Abstract

The purpose of this study is to identify the major determinants of tax havens in the actual economic context. The development of tax havens was favored by some factors at macroeconomic level, but also by tax noncompliance behavior of individuals who are seeking different ways to avoid taxation. Based on a logistic regression this study reveals the most important factors that favor a country's tax haven status. The main finding of this approach is that low taxation is not enough for a country to be a tax haven. Despite the fact that the corporate tax rate is indeed significant according to the model, the percentage of services in GDP proves to be the most prominent variable, and only the countries which have an important part of their GDP made up of services are likely to acquire tax haven status. Since offshore finance is one of the main pillars on which tax havens lie down, the importance of the services sector comes as no surprise. Using the logit model, each country's tax haven status is determined.

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1. Introduction

Tax haven status involves combining more favorable conditions in order to create that climate of great economic, fiscal, political and infrastructure necessary for the development of tax avoidance tasks using various tools and mechanisms such as offshore companies.

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According to classical definitions, a tax haven is a country which has a very low taxation or even no taxation at all. However, tax havens are not all about low or lack of taxation. They are also characterized by high levels of secrecy and the availability of a strong network of financial services that allows users sophisticated strategies for achieving their goals.

From a historical perspective tax havens have a continuously and complex evolution along the time. Gordon Report identifies one of the first "ancestors" of modern tax havens and implicitly tax evasion: Ancient Greece. In Athens, in order to avoid a custom duty in value of 2% applied by the city on imports and exports of goods, merchants were using nearby islands for storing their goods, which were then illegally introduced in the city (Gordon, 1981: 21).

Tax havens and money laundering have a long history behind, having as users pirates who acted in the Atlantic Ocean in the seventeenth century. They used to go in certain place, and even to moneylenders that represent for them a way of hiding wealth from plundering merchant ships (Nandra, 2008: 131).

A defining moment for the evolution of tax havens is when the legislation regarding limited liability companies was adopted in England and in its colonies in the nineteenth century. With the emergence of this type of company the two types of taxes that exist nowadays were differentiated: profit tax in the case of juridical persons and income tax for the physical persons (Mănăilă, 2004:5).

The European countries economies were in a bad state after the end of the First World War and funds were desperately needed in order to recover. In consequence, the vast majority of them choose to highly increase their level of taxes. Many of the investors were not at all pleased by this situation and therefore them chosen to move their money in Switzerland which was neutral and used to be a financial haven for investors even before this event. Furthermore, Switzerland significantly lowered its level of taxation.

One of the characteristics of tax haven legislation is the quick company registration technique that was used for the first time in New Jersey Delaware around 1880 by the governor of New Jersey. In that time, considering the fact that other U.S. states' legislation was quite restrictive in terms of recording companies, New Jersey attracted a large number of corporations who were interested in its permissive legislation regarding company registration. In addition, Delaware also started to make use of this technique. So it seems that one of the first techniques used by tax havens was established in these two states. The European states also began to follow their example. It is the case of some Swiss cantons that brought this technique in Europe and started using it (Palan, 2009).

The idea of the "virtual" residence was patented by the British Court when there were firms that were registered in Britain even if they didn't have any form of activity there and as a consequence of the non-residence they were not subject to taxation. This technique was later copied by Bermuda and Bahamas and improved by Cayman Islands (Palan, 2009).

The point when Switzerland highly increased its level of banking secrecy in 1934 by placing the obligation of keeping this secret under the protection of criminal law is another important moment for the historical evolution of tax havens. The punishment was the imprisonment for any act of disclosure of information to some authorities regarding customer bank accounts (Buzan, 2011:14-15).

So, as it can be widely observed the legal premises on which modern tax havens later developed are: laws in Delaware and New Jersey on quick registration companies, the UK laws related to tax residency and the Swiss law that establishes the banking secrecy (Buzan, 2011: 15).

States that began to enact a legislation that would favor the development of the necessary conditions of becoming a tax haven started doing this by being aware of all the advantages that would accompany it only after the Second World War (Buzan, 2011: 12).

Lately tax havens have been the cause of a great international concern while becoming the target of numerous attacks from various institutions and individuals. This is a normal reaction taking into account the history of economic crimes involving financial havens and the accusations of them eroding other countries' tax base. Some examples of financial crimes conducted through tax havens are the following: Panama has served as