



## ***Haven of a Different God***



**Pallavi Dinodia**

***They say the two things that always come without warning are "Death and Taxes"***

Universally, most people are afraid or worried about their taxes. A portion of every person's hard earned money goes to the Government in the form of taxes, much to their dismay. To organize financial matters globally in a tax efficient way, people starting investing in different parts of the world including in places which are popularly know as Tax Havens.



**Anuj Tiwari**

A Tax haven is tax utopia. It is a place where taxes are levied at low rates or sometimes not at all. Some countries of the world, have policies enabling attraction of foreign capital. World wide there are over 70 tiny tax haven destinations. These countries are trying to attract Foreign Direct Investment (FDI) by minimizing taxes and through the reduction or elimination of other restrictions on business operations in order to achieve greater economic strength. Individuals and /or business entities find it attractive to move to areas with lower tax rates. Many companies also shift their headquarters from high tax jurisdictions to lower tax jurisdictions. This practice of the MNC's has led to the loss of billions of

dollars in revenue for many countries. Such practices tend to create a situation of tax competition among various governments and their countries. However, some leading economists believe that tax havens play a major role in capital fund mobility.

Tax havens can be usually be classified as, those which maintain full secrecy about the investors, ownership of fund and those which simply assume the status of tax haven because of being low tax jurisdictions. Mauritius and Cyprus are those which fall in the later category. Switzerland because of its banks and their secrecy norms was known to be a tax haven earlier, however in recent times it has lost that identity.

It is believed that, the US government losses as much as \$100 billion a year in unpaid taxes through the use of offshore banking by its citizens. In recent times, the US government has take stringent steps to curb the practice of its residents to park money outside the USA especially in Swiss banks. UBS (Swiss bank)

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caved in to mounting pressure from the US Government to give details of 19,000 US clients with \$17.9 billion (£8.9 billion) in undeclared Swiss bank accounts. An investigation, whose report was issued recently, found that only 1,000 of UBS's 20,000 American clients with Swiss bank accounts had declared their accounts to the IRS.

In order to settle the dispute with the US government the UBS officials announced plans to close the Swiss bank accounts of all its American customers and agreed to lift the veil of secrecy that protected its clients for centuries. UBS officials say that, "UBS is working with the US Government to identify the names of US clients who may have engaged in tax fraud. The client identity is generally protected from disclosure under Swiss law. Such privacy protections do not apply when disclosure of client names is requested in connection with an investigation of tax fraud and where the requests are presented to the Swiss government through established legal channels. UBS will fully support and assist that process."

In this article we have discussed some facts of the tax haven countries that are important to the understanding of tax havens.

### ***Evolution of tax havens***

From the 1920s to the 1950s, tax havens were usually used for the avoidance of personal taxation. However, from the 1950s onward there was significant growth in the use of tax havens by corporate groups to mitigate their global tax burden. The corporation, by structuring the group ownership through the smaller jurisdiction, could take advantage of the double taxation treaty, thereby paying taxes at a much lower rate.

### ***Development in ethnicity***

Tax haven countries have very low corporate and personal tax rate structures to attract corporates and others entities. These countries also provide considerable relief in terms of regulatory compliances. Previously MNC's used these countries to minimize their total group tax by effectively shifting profits from high tax jurisdictions to the tax haven countries. This practice has considerably reduced due to the new transfer pricing regime inform in most tax jurisdictions globally.

Tax haven countries in the world may fall in any one of the following categories, which could classify the jurisdiction as a tax haven. For Example: jurisdiction with, no income tax (i.e. Bermuda), low taxation (Switzerland), tax domestic income but not foreign income (Hong Kong) and countries that provide other privileges (i.e. Luxembourg)

Other smaller jurisdictions such as Cyprus, the Cayman Island, and the British Virgin Islands attract large corporates enabling them to effectively structure their global tax burden. With special regards to India, Mauritius has been considered a virtual tax haven for offshore investment after India and Mauritius executed the DTAA in 1982. Most investors from all around the world choose this paradise tropical island to invest in the Indian Equity market. However, India is trying to **renegotiate** its tax treaty with the island nation of **Mauritius**, it remains to be seen whatever leads to this route being less preferred by the MNCs.

India has entered into an agreement with Singapore in 2005 for comprehensive economic co-operation agreement (CECA). In view of the CECA, it seems Singapore will replace Mauritius gradually due to the numerous incentives given in doing business through it. The new Indo-Singapore treaty has turned the heat on to some extent on Mauritius and Cyprus and their tax effaciousness.

Tax haven countries also facilitate in round tripping investment back to India. Funds of Indian residents parked in banks located in tax haven countries' are routed back for investment to India.

India has recently also entered into a DTAA with Luxemburg and commenced talks with other European tax haven countries. We hope that if favorable bilateral treaties are entered with these countries, they may emerge as major foreign investors in India.

***Havens maybe categorized by the types of activities that are given preferential treatment by the tax authority;***

1. Production haven – where the tax attraction induces a significant change in real value added.
2. Headquarter haven – where lower corporate taxes provide tax advantages to entities incorporated therein irrespective of the location of the shareholders.
3. Sham haven – where it is not necessary to conduct any business in the entities and these are usually intermediaries that may be little more than address for investment activity directed from elsewhere.
4. Secrecy haven – those which allow personal income tax evasion by re-investing funds parked in such a country without knowledge of tax authorities in the original tax jurisdiction. Such countries have tight secrecy laws and do not exchange information.

### ***Advantage of tax haven can be viewed in four ways***

- a) **Personal residency:** Wealthy individuals from high tax jurisdictions have sought to relocate themselves to low-tax jurisdictions.
- b) **Asset holding:** The company or trust will be formed in a tax haven, to hold assets, which may consist of port-folio of investments under management, real estate valuable property.
- c) **Trading and other business activity:** Many businesses which do not require a specific geographical location or extensive labour are set up in tax havens, to minimize their tax exposure.
- d) **Financial intermediaries:** Financial intermediaries such as mutual funds, banks, life insurance and pension companies in tax havens deposit the fund there and then act as intermediaries which invest the fund in higher tax jurisdictions. Although such systems do not normally totally avoid tax, it enables companies to provide multi jurisdictional products without adding any additional layers of taxation.

### ***Key factors of tax haven jurisdiction***

A good tax haven should have stable political and economic environment. It should also have a strong infrastructure and one which has communication network, easily convertible currency or is directly linked to an easily convertible currency. It should have no or only nominal tax, allow protection of personal financial information and should have a general lack of transparency.

### ***Steps to curb the practice***

The OECD began a series of initiatives aimed at tax havens to curb the abuse of what the OECD referred to as "unfair tax practice" through the use of tax havens. The OECD initiative in this regard has led to most major tax havens repealing their laws which permitted tax efficient structures.

In order to discourage this practice of countries, the Organization for Economic Cooperation and Development (OECD) in its publication black lists certain countries whose tax practices are harmful for the world economy. Through such steps the OECD helps the process of building a healthier with best tax practices world.



### ***Suggested techniques to prevent the practice***

- i) Retaining the income in the original tax jurisdiction by prudent tax policy
- ii) Strict transfer pricing regulations
- iii) Restriction on imposition of withholding tax
- iv) Exit charges, taxing of unrealized capital gain when a company or trust emigrates.

The above may be achieved by entering into bilateral treaties with tax haven countries, which include Limitation of Benefit (LOB) provisions; these LOB provision generally restrict treaty benefits to entities with bonafide business operations other ways, may be like those of employing the blunter rule, For example, In the France Securities Regulation, it is not possible to have a public bond issue through a company incorporated in a tax haven.;or

The "Forced disclosure" Rule which is one of the popular ways of tax mitigation schemes. Broadly, these involve the revenue authorities compelling tax advisors to reveal details of the proposed scheme, so that the existing structure can be closely followed during the following year.

Extensive financial and Know Your Customer (KYC) Regulations in tax havens may make tax structuring more difficult.

### ***Conclusion***

Tax havens are as such not all bad, some of them facilitate faster mobility of capital through good governance and help strengthen the world economy. As the world, shrinks in the face of rapid globalisation the tax haven countries cannot remain havens for too long. Once the objectives of such a country are achieved, they need to move on to better and then finally to best tax practices as followed by the developed nations of the global world.

There are many countries of the world, which have low tax rates but are still not regarded as tax havens. This is largely due to the fact, that most tax havens are marked by the ease of regulatory compliances. It is suggested that other countries of the world should also ease their regulatory norms to enable businesses to business effectively and not be lost in the myriad compliance issues.



Tax haven are looked upon very suspiciously by most tax authorities of the world. Corporates with ambitious growth plans should try to establish good tax efficient structures to enable long term survival in the global world. For good corporate citizens of the global economy, who believe in best practices all tax jurisdictions are tax havens.

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