AN OVERVIEW OF THE EUROPEAN TAX HAVENS

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Abstract: *In the actual context of economic globalization, tax havens represent a significant obstacle for global governments seeking to increase their fiscal incomes and a source of polarization of income and wealth. Statistics reports showed that tax havens hold at least $10 trillion in assets, money generally controlled and hidden by major players from the political and financial areas, as well as from criminal ones. The paper introduces the present situation of European tax havens, with the major poles of action. The conclusion finds the real efforts of international bodies such as OECD, to interdict opportunities to avoid taxation.*

Keywords: tax haven; offshore financial centres; globalization; illegal markets.
JEL Classification: H25; H26; H87; F21.

INTRODUCTION

The last decade was characterized by a considerable amount of attention devoted to offshore financial centres (OFCs) and tax havens around the world, that have evolved surprisingly in the context of economic globalization, dimension which has led to a significant increase in capital mobility and in demand for tax haven operations. For example, Kudrle (2008) reported a 154% growth in total liabilities from 1998 to 2006 for a sample of 20 tax havens (Blanco, 2012, p. 291).

Usually, the expression, "tax haven" is a truly modern term and a label for sunny images or beautiful islands. Despite this way of thinking which generally seduces the rich people and wealthy states of the world, tax havens offer not only beautiful islands but also safe shelter from most financial regulation and international agreements and a significant obstacle for governments in their activity to increase the fiscal incomes.

The aim of this paper is to describe the recent development of classical European tax havens. According to its history, the subject is quite controversial. Myths and legends have replaced tax havens reality. In fact, the phenomenon is very old. Tax havens existed even before the twentieth century, but it was around World War I when the wealthy increased use of their services, when the U.S. income tax, as well as increasing taxes in European countries, motivated capital to seek safety in low or no – tax locales. Switzerland became more popular as a place to park assets after it passed strong banking secrecy laws in 1934 (Larudee, 2009, p. 344). Ronen Palan (2009) suggested in a recent study, that the history of tax havens could be organized into four sections. First, he points out

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the historical emergence from the late nineteenth century to the 1930s of three distinct instruments of tax haven: low or zero taxation for non-residents, easy methods of incorporation, and legally-protected secrecy. The second section of Palan's study describes the phase of multiple tax havens from World War I to 1970, a phase characterized by the importance of Switzerland regarding the easy development of tax havens regimes and the first institution of protection assets secrecy. The third section brings into the light the period 1970-1990, the true explosion of tax havens around the globe. The last section follows the intensification of international concerns since 1998, regarding the impressive volume of financial assets through the tax havens hands, the beginning of several OECD`s publication and reports on harmful tax competition, and the real efforts of European Union to combat and to pressure the activity of such financial shields, along with the consequences of the 2007 crisis that intensified the global reaction to the huge expansion of OFC`s.

Several studies suggested that tax havens have an important role in the global economic system due to their activity profile, characterized by multiple factors such as tax evasion, lack of transparency, unconventional states strategy, hard traceability of assets, the code of agreements secrecy, a safe route for laundered money and a drain actor position which constitute most of the time, a security financial shield for developing countries' economies.

A tax haven, or OFC, is a jurisdiction that offers two things: (1) zero or near-zero taxes on business activities; and (2) secrecy regarding financial assets (Larudee, 2009, p. 344). Today, some researchers have classified the modern offshore financial centres, into three main groups: the United Kingdom tax havens with a strong pole linked to the City of London region; European havens and the last and probably the most popular are the havens of les developed economies in South America and Africa.

1. TAX HAVENS VERSUS OFFSHORE FINANCIAL CENTRES

Labeled as tax paradise in French or tax oasis in German, the term "tax haven" has been widely used since the 1950`s (Palan, 2009). Nevertheless, globalization aspects have made possible the flows of financial services industry which led at the end, to a sizeable expansion of an "offshore" financial sector.

Tax havens are low-tax jurisdictions that provide investors opportunities for tax avoidance (Desai, Foley and Hines, 2004, p. 1) or in other words a country that offers the possibility to reduce the volume of taxes that you usually pay. Between the concept of tax havens and OFC has always been some confusion. The literature itself is very vast. Some recent studies see no difference between these two terms, and very often are considered interchangeable, but on the other hand other studies argue that OFCs are not the same as tax havens. OFCs are commercial communities hosted by tax havens which exploit the structures that can be created using the tax havens legislation for the benefit of those residents elsewhere. In other words, OFC is made up of the accountants, lawyers, bankers, plus their associated trust companies and financial intermediaries who sell services to those who wish to exploit the mechanism the tax haven has created (House of Commons Treasury Committee, pp. 10-11).

Thus, the expression "offshore financial centre" (OFC) has become the modern phrase of tax havens and it has been accepted and used by experts, because it is less offensive than the old concept. OFC also suggests a very low or no tax jurisdiction facilitating a broad range of international financial activities, which operates in a less regulated environment than that experienced onshore (Donaghy and Clarke, 2003, p. 382). The term "offshore" itself suggest a nautical image of some entity (ship, rock, or island) located at a distance from the mainland (a larger island or continent) (Vlcek, 2004, p. 228). Moreover, Palan et al. (1996, p. 180) argue that tax havens are "*nothing less than the cornerstone of the process of globalization*".

•Other possible definition of offshore financial centres

"An offshore centre is a country which provides to the residents of other countries the opportunity to establish companies and to use its financial services for activities outside this centre, offering in most of the cases some advantages such as low taxation rates. In other words the aim of the users of the offshore centres is to take advantage of the lower tax rates offered by the offshore centre which is not synonymous to tax evasion as is the general perception. […] Certain jurisdictions establish themselves as offshore financial centres in order to attract funds, provide jobs and facilitate economic development" (Di Nicola, 2006, p. 3).

According to Mattias Levin, OFC`s normally combine some of the following characteristics: a high number of financial institutions that mainly serve non-residents, financial systems out of proportion with the domestic economy`s need, low or no taxes, light financial supervision and regulation, flexible use of different company structures, and high levels of bank secrecy and anonymity (Levin, 2002, p. 2).

2. LOCATION AND TYPES OF TAX HAVENS

Experts tend to organize the tax haven in order to make a clearly distinction between them. For example, Lee Hadnum (2012) suggests that are three main types of tax havens:

•*Nil-Tax Havens* associated with no corporate and income tax, no inheritance and capital tax, specifically to The Cayman Islands, Dubai, Monaco, The Bahamas, Anquilla and so on;

•*Foreign Source Exempt Havens* – these countries do levy taxes and sometimes they can be quite high. Maybe, what makes them tax havens is the fact they only tax you on locally derived income (Hadnum, 2012, p. 3). The best examples are given by Panama, Seychelles, Hong Kong or Singapore;

•*Low Tax Havens* - a different situation when the expression "tax advantage" is implied (for example the capital gains tax) or the situation when it is allowed to lower your tax bill. Some good examples are Cyprus, UK, Switzerland, The Netherlands, Denmark, Belgium and Austria.

There is a substantial theoretical literature on the importance of tax havens. Some studies pointed out that are roughly 40 major tax havens in the world today (Dharmapala and Hines, 2009, p. 1058) while other publications identified 70 countries, divided into islands and urban centres (London, Luxembourg). Despite the initial OECD report which showed a map of 47 countries as tax havens, the current list of tax havens seems to be much longer than OECD estimations (see Table 1).

Table 1 - Tax Justice Network's List of Tax Havens

The Caribbean & Americas	Africa	Middle East & Asia	Europe	India & Pacific Oceans
Anquilla*	Liberia*	Bahrain*	Alderney	The Cook Islands*
Antiqua and Barbuda*	Mauritius*	Dubai	Andorra*	The Maldives
Aruba*	Melilla	Hong Kong	Belgium	The Marianas
The Bahamas*	The Seychelles*	Labuan	Campione d`Italia	Marshall Islands*
Barbados*	Sao Tome e Principe	Lebanon	City of London	Nauru*
Belize*	Somalia	Macau	Cyprus*	Niue*
Bermuda*	South Africa	Singapore	Frankfurt	Samoa*
British Virgin Islands*		Tel Aviv	Gibraltar*	Tonga
Cayman Islands*		Taipei	Guernsey*	Vanuatu*
Costa Rica			Hungary	
Dominica*			Iceland	
Grenada*			Ireland (Dublin)	
Montserrat*			Ingushetia	
Netherlands Antilles*			Isle of Man*	

New York	Jersey*
Panama*	Liechtenstein*
St. Kitts &Nevis*	Luxembourg
St. Lucia*	Madeira
St. Vincent& The Grenadines*	Malta*
Turks and Caicos Islands*	Monaco*
Uruguay	Netherlands
US Virgin Islands*	Sark
	Switzerland
	Trieste
	Turkish Republic & Northern Cyprus

Source: TJN, "Tax Havens by Region" - http://www.taxjustice.net/cms/upload/pdf/mapamundi.pdf

Note: Asterisks mark those jurisdictions that were also on the OECD`s list of 39 tax havens in GAO. San Marino is on the OECD list of 39, but not on the TJN list of 72.

The last 10 years have concentrated a large amount of research in this field, given by several international bodies such as the International Monetary Fund, the OECD or the G-7. The OECD has given its view on tax evasion, the IMF on stock market speculation and insider trading, and the G-7 on drug trafficking and the financing of terrorism (Deneault, 2007, p. 261).

Based on the academic literature, the OECD estimated that in 2007 the capital placed through offshore companies in tax havens reached a value between 5.000 and 7.000 billion of dollars, also the international group, named Tax Justice Network, estimated great losses, up to 255 billion of dollars, as a result of the global system of taxation through tax havens (Radu, 2012, p. 398). The total amount of financial assets hidden in safe shelters is supposed to be equal with the USA and Japan economy, according with, "The Price of Offshore Revisited" study, realized by the economist, James Henry.

Nicholas Shaxson (in Kilkenny, 2011), the author of Treasure Islands, explained that ,,The biggest tax havens are big, rich countries, particularly the United States, the United Kingdom, Switzerland – of course, the Cayman Islands is very big too – but also countries like Ireland and Luxembourg, Luxembourg is absolutely huge".

3. THE EUROPEAN TAX HAVENS

Despite its culture and history, Europe has always been a strong player on the global financial market, taking into account its financial strength found in the heart of the United Kingdom, its confidence, neutrality and banking secrecy of Switzerland, its egocentrism as a result of a new born community (EU) but also to its tough financial system, found in different countries such as France, Germany and so on.

Regarding its very high taxes, Europe can be in the mind of its citizens, a "trouble hornet". A good example is given by the high cost of living in London. The British pound costs $2, up from $1.75 just a year ago. So, two round-trip bus tickets cost $8 and two movie tickets $36. And worst of all, if you import income of $200.000 to the U.K, taxes may eat up $90.000 of it. The high taxes combined with high cost of living generate very constraining living conditions (Fitch, 2007). Also, a considerable attention was devoted to France, because of its new politics of high wealth tax. Thus, it is not surprising at all, that the Old Continent can gather some important tax havens that simply can avoid the new European tax practices.

The most popular tax havens that you can find in Europe are illustrated in the Figure 1: Switzerland, Luxembourg, Lichtenstein, Monaco, Andorra, Dublin, Isle of Man, Cyprus, Jersey, Malta, Guernsey and Gibraltar.

Figure 1 - European Tax Havens

1.Isle of Man, 2.Dublin, 3. Guernsey, 4.Jersey, 5.Luxembourg, 6.Switzerland, 7.Lichenstein, 8. Monaco, 9.Andorra, 10.Gibraltar, 11.Malta, 12.Cyprus.

Source: Reszat (2005), at http://reszatonline.wordpress.com/2012/07/29/offshore-centres/.

Along with the events in the period 2008-2009, the peaceful activity of tax havens put an end to the relationship between OECD and these safe shelters. It must be emphasized that Europe has been in the middle of several tax scandals launched by the governments of France, Germany and the US and directed to the financial institutions in Switzerland, Liechtenstein or Austria, who helped a great number of citizens to invest and to hide millions of dollars in these countries banks without any concern to pay taxes required in their home country. Nevertheless, the G20 leaders have articulated at the London Summit in 2009, the imperative need to put an end to the era of banking secrecy.

In the heart of Europe there is Switzerland, an Alpine nation of the most well-established tax havens and one of the most popular in the world. But what does Switzerland offer? It is very well recognized for its long tradition exposed in political stability, neutrality and also for its bank discretion and secrecy of assets. For many years, this country hosted the wealth of many well-known political, economic and artistic figures.

The laws enacted by the Swiss banks have transformed this country into a favourite destination for the top elite who seek to avoid different high taxes.

Although Switzerland is considered the top Euro-tax haven, the truly Euro-haven is represented by Andorra, a very popular country due to is duty free politics. A small country like Andorra, surrounded by mountains, between Spanish and French border, is a wonderful attraction because it offers no income tax.

Another important tax haven of Europe is Monaco, a dream location for rich people around the world. This wonderful Mediterranean coast of France it is very well known due to its generous offer, 0% income tax for residents. Thus, the cost of live is very high; practically you have to be a very rich person to afford to live here.

CONCLUSIONS

Globalization became a catalyst in every section of global activity. It has contributed to an important increase in foreign investments, technology, business relations, and the speed of world transactions. The freedom launched by the globalization process has made possible the ease transfer of assets around the globe and the development of new way of taxation and the channelling of considerable amount of money on the underground financial markets.

The globalization process articulated an expansion of tax havens around the world, from the most famous and modern in the West, the Caribbean pole, to the more classical one placed in the Europe, such as Benelux, Switzerland or Cyprus. It must also be emphasized that tax havens can be described in a variety of ways, but today, the main concern of international bodies such as OECD, IMF and so on, is the lack of transparency of such jurisdictions. For example, OECD has maintained for many years several campaigns against tax havens.

Regarding the geographical location, tax havens are very well-represented on all the continents. From small states, recognized under the term, classical tax havens' such as *inland* *states:* Liechtenstein, Luxembourg, Belgium; *costal states*: Monaco, Hong Kong; or *island states* such as British Virgin Islands.

Roughly, Europe has been a shelter of many reputable countries, as Switzerland, Monaco, Luxembourg, Liechtenstein, and Andorra and so on, that have offered multiple financial services as, for example: banking and commercial secrecy, liberal currency control, lower standards regarding the regulation of banks and insurance activity. European governments continue to be affected by the activity of tax havens, especially concentrated in the Euromarkets sphere, the City of London, Switzerland, Monaco and Cyprus. Furthermore, the last decade was an extension of OECD efforts and initiative to combat harmful tax competition.

Presently, there are several initiatives targeting directly or indirectly tax haven jurisdictions. These include, inter alia, the 1998 OECD initiative against harmful tax competition, the FATF work directed at combating money laundering, the 1998 United Nations Office for Drug Control and Crime Prevention Report on Financial Havens, Banking Secrecy and Money Laundering and the work of the Financial Stability Forum concerning offshore centres (Orlov, 2004, p. 104).

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