THE PROBLEM OF TAX HAVENS AND THE ROMANIAN TAX AUTHORITIES' REACTION

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Abstract: *The opportunities to avoid paying taxes provided by tax havens have motivated numerous multinational companies to resort to offshore operations, generating a significant tax loss at a global level. Romania is facing the same problem and the Finance Minister estimates that offshore operations in tax havens are approximately between three and four billion Euros. The refusal to exchange information and the lack of transparency of many tax havens represent a barrier for tax authorities to control these transactions and facilitate the coverage of illegal activities. This has determined certain countries, among which Romania, to impose higher taxes on taxable income of non-residents who are residents in "uncooperative" jurisdictions. In this paper we have emphasized the issue of tax havens and we have presented their classification after the foreign contribution to the capital of Romanian companies. We have also listed the ones with which Romania has signed agreements for information exchange.*

Keywords: tax havens; offshore financial centres; transfer pricing; tax avoidance; tax evasion.
JEL Classification: F23; H21; H25; H26; M4; O16.

INTRODUCTION

Anthony Ginsberg compares financial transactions from tax havens to the water cycle. *Water, as well as money is used and reused, ending its cycle in the great reservoirs of oceans. Money stock, similar to water, circulates from one state to another. A part of it is visible to the authorities and another one, quite substantial, "drains" in the underground to the great reservoirs of tax havens* (Ginsberg, 1997 in Trandafir, 2012, p. 28).

In order to reduce tax liabilities or even to totally avoid them, companies have the opportunity of opening branches in tax havens and directing their income to them (Krautheim and Schmidt-Eisenlohr, 2011). A lot of the companies registered in these jurisdictions are of a "mailbox" type and appear as having the offices in those certain locations only in official documents, but in reality they do not actually carry out any activities and no one can be found there (ActionAid, 2009; Preuss, 2012). These transnational companies are registered only for the possibility of avoiding tax burdens in the countries of origin (Otusanya and Lauwo, 2012). This is the main goal of tax havens, respectively of attracting a significant part of cash flow at a global level (Preuss, 2010) from transactions made by non-residents (Otusanya and Lauwo, 2012).

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1. CHARACTERISTICS OF TAX HAVENS

Tax havens are countries or territories which have conceived a special legislation to attract capital flows from companies within countries with a high tax burden (Otusanya, 2011), offering them the opportunity of tax avoidance on a legal basis (Desai, Foley and Hines Jr., 2006).

The Organisation for Economic Co-operation and Development (1998) presents four main signs through which a jurisdiction can be identified as a tax heaven: (1) no or only nominal taxes; (2) lack of effective exchange of information; (3) lack of transparency and (4) no substantial activities.

Although they are often mistaken, a difference between the notions of offshore financial centre and tax haven must be made. An offshore financial centre is a commercial community established in a tax haven, consisting of accountants, bankers and lawyers who exploit the favourable tax legislation in the benefit of non-residents (Tax Justice Network UK, 2008). In addition, the International Monetary Fund defines an offshore financial centre as *a country or jurisdiction that provides financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy* (Zorome, 2007, p. 7).

An important feature of tax havens is that the population size is very low, the majority being under one million inhabitants (Dharmapala and Hines, 2009). Thus, a study of Slemrod and Wilson (2009) on a sample of 35 countries, named "uncooperative tax havens" by the Organisation for Economic Co-operation and Development in 2000, showed that the average of population of these countries or territories is of 284,000 inhabitants. Furthermore, if Liberia and Panama, which have a population of over one million inhabitants are excluded from the calculation, this average drops to less than a half, respectively 116,000 inhabitants. Donato Masciandaro (2008) developed an empirically tested model on a sample of 222 countries, through which he demonstrated that jurisdictions with a common law system, a stable political system, a low degree of influence in international bodies and which do not have crime or corruption problems have a bigger chance of being offshore financial centres than the others. Also, the quality of governance plays an important role (Dharmapala and Hines, 2009).

The term "offshore" is also used in association with "outsourcing". Offshore outsourcing has known a significant evolution at the end of the 1980s until the beginning of the 1990s and refers to the transfer of certain enterprise functions to a specialised provider or the establishment of own subsidiaries abroad with the purpose to benefit from a highly degree skilled personnel or with the simple purpose of cutting costs (Aman et al., 2012). Laura D'Andrea Tyson (2004) believes that *offshoring is a process of creative destruction*, because the economy stands to gain from it through growth of the market competitiveness and lower prices, but it strikes a sensitive issue regarding job losses.

2. TAX AVOIDANCE AND TAX EVASION

Generally, big companies are the ones which profit by the advantages offered by tax havens (Krautheim and Schmidt-Eisenlohr, 2011), while smaller companies continue to pay taxes and dues in the country of origin. The International Organisation ActionAid (2011), which militates for Human Rights, has identified the fact that 98 of the biggest 100 company groups listed on London Stock Exchange use tax havens.

Authors Dragoş Pătroi and Florin Cuciureanu (2010) consider that international tax evasion and money laundering operations are possible through the following tools: tax planning transactions, tax avoidance transactions, double trust transactions, holding companies, captive insurance companies, captive banks, trusts, readymade companies and international business companies.

The *tax avoidance* concept refers to business planning so as to ensure reduction of taxes to be paid, through accounting tools applied in the limit laws and is different from tax evasion (Loomer and Maffini, 2009). Thus, transactions may be established at an arbitrary price between affiliated entities through transfer pricing, which leads to distortion of accounting result and to artificial reduction of profits (Brock, 2011). Transfer pricing is the price at which economic transactions regarding buying and selling goods and services between affiliated entities of the same transnational company are concluded (Aid, 2008). According to legal rules, these prices should be established at market price, but multinational companies often resort to their manipulation (Henry, 2012) depending on the situation and on the intended purpose. Thus, for diminishing the taxable base in countries with a high tax, transnational companies over-evaluate acquisitions and under-evaluate sales so that the profit is directed to jurisdictions with a permissive tax (Gravelle, 2010; Henry, 2012). In this way, artificial growth of profit at the level of the entire group of companies is ensured.

Surely the most favourable investment opportunities can be found beyond own borders (Dauphin, 1999), but a significant part of the direct capital to tax havens, after being laundered, returns to the origin country as foreign direct investments. This is encouraged by the fact that certain governments offer numerous facilities to foreign investors, such as grants, low tax or favourable land use rights. In this way, competition is affected and the foreign investors are clearly advantaged, especially fiscally, while local business can be put in difficulty in a certain way (Christensen, 2011).

The South African Finance Minister, Pravin Gordhan, stated that a*ggressive tax avoidance is a serious cancer eating into the fiscal base of many countries* (Houlder, 2009), while the author Lutz Preuss (2012) came to the conclusion that a enterprise which uses tax havens cannot be considered under any circumstances of being socially responsible as long as it takes a deliberate decision of tax debts avoidance.

Over time, a series of national and international organizations were enrolled in the battle for combating tax evasion, money laundering and international movement of illicit funds, among which Organisation for Economic Co-operation and Development, International Monetary Fund, Tax Justice Network, Global Financial Integrity, Financial Integrity and Economic Development, United Nations Conference on Trade and Development, Organized Crime and Corruption Reporting Project and Tax Research LLP.

3. THE INFLUENCE OF TAX HAVENS IN ROMANIA

The Romanian Finance Minister, Daniel Chiţoiu, stated, at a television program, (Realitatea TV, 2013), in April 2013, that Romania is dealing with a major problem of directing income to tax havens and believes that the total level of these operations is about 3-4 billion Euros, which represents 2-3% of GDP.

Authors Johnson and Holub (2004, p. 186) begin their article with a famous quote by Benjamin Franklin who said at the middle of the eighteenth century that *in this world nothing is certain but death and taxes.* However, over time, offshore companies have seriously doubted this theory, having the opportunity of tax avoidance through tax havens. But now, Romanian tax authorities intend to approach Benjamin Franklin's words and the income obtained by non-residents from Romania (such as interest; royalties; commissions; income from sports and entertainment activities; incomes representing remuneration received by non-residents who have an administrator, founder or member of the board of a Romanian legal person; revenue from services rendered; income from independent professions; income from prizes; incomes obtained from gambling or income of non-residents from the liquidation of a Romanian legal entity) are subject of taxation (Fiscal Code of Romania, 2013; Ţinteanu, 2013), as shown in table 1. Also, one of the main objectives of the National Agency for Tax Administration (2012, p. 2) on a medium term (2013-

2016) is *multinational fraud combat, especially the Intra Community one*, and this requires intensifying checking actions of transfer prices.

Table 1 - Non-resident tax rates for income from Romania

Where a double taxation avoidance agreement between Romania and the country of origin is concluded		Where a double taxation avoidance agreement between Romania and the country of origin is not concluded
If the taxpayer offers proof of residence (tax residence certificate issued by the competent authority of its state), the most favourable tax shall apply, respectively between 16% and the tax rate in the other country.	If the tax payer doesn't offer proof of residence (tax residence certificate issued by the competent authority of its state), the 16% Romanian tax rate shall apply.	Income is taxed with 50% *if the income is not paid in a state with which Romania does not have a concluded legal instrument under which exchange of information can be made.*

Source: Own processing after Fiscal Code of Romania, Law no. 571/2003, art. 116 and art. 118

In the following part (table 2) we present a list made by Tax Justice Network UK (2008) of tax havens and offshore financial centres from around the world, nominated by the Organisation for Economic Co-operation and Development, International Monetary Fund and Tax Justice Network. From this list we have emphasized the countries and territories with which Romania has concluded a double taxation avoidance agreement in order to observe which of these are targeted by the new regulations in Romania.

Table 2 - The world's tax havens and offshore financial centres

No.	Jurisdiction	OECD	FSF-IMF 2000	TJN 2005	Double taxation avoidance agreement with Romania
1.	Andorra	■	■	■	✗
2.	Anguilla	■	■	■	✗
3.	Antigua & Barbuda	■	■	■	✗
4.	Aruba	■	■	■	✗
5.	Australia	□			✓
6.	Austria	□			✓
7.	Bahamas	■	■	■	✗
8.	Bahrain	■	■	■	✗
9.	Barbados	■	■	■	✗
10.	Belgium	□		■	✓
11.	Belize	■	■	■	✗
12.	Bermuda	■	■	■	✗
13.	British Virgin Islands	■	■	■	✗
14.	Canada	□			✓
15.	Cayman Islands	■	■	■	✗
16.	Cook Islands	■	■	■	✗
17.	Costa Rica		■	■	✗
18.	Cyprus	■	■	■	✓
19.	Dominica	■	■	■	✗
20.	Dubai			■	✗
21.	Finland (Åland)	□			✓

22.	France	□			✓
23.	Germany (Frankfurt)	□		■	✓
24.	Gibraltar	■	■	■	✗
25.	Greece	□			✓
26.	Grenada	■	■	■	✗
27.	Guernsey, Sark & Alderney	■	■	■	✗
28.	Hong Kong		■	■	✗
29.	Hungary	□		■	✓
30.	Iceland	□		■	✗
31.	Ireland	□	■	■	✓
32.	Isle of Man	■	■	■	✗
33.	Israel (Tel Aviv)			■	✓
34.	Italy (Campione d'Italia & Trieste)	□		■	✓
35.	Jersey	■	■	■	✗
36.	Korea	□			✓
37.	Latvia				✓
38.	Lebanon		■	■	✓
39.	Liberia	■		■	✗
40.	Liechtenstein	■	■	■	✗
41.	Luxembourg	□	■	■	✓
42.	Macao		■	■	✗
43.	Malaysia (Labuan)		■	■	✓
44.	Maldives	■		■	✗
45.	Malta	■	■	■	✓
46.	Marshall Islands	■	■	■	✗
47.	Mauritius	■	■	■	✗
48.	Monaco	■	■	■	✗
49.	Montserrat	■	■	■	✗
50.	Nauru	■	■	■	✗
51.	Netherlands	□		■	✓
52.	Netherlands Antilles	■	■	■	✗
53.	Niue	■	■	■	✗
54.	Northern Mariana Islands				✗
55.	Palau		■		✗
56.	Panama	■	■	■	✗
57.	Portugal (Madeira)	□		■	✓
58.	Russia (Ingushetia)			■	✓
59.	Saint Kitts & Nevis	■	■	■	✗
60.	Saint Lucia	■	■	■	✗
61.	Saint Vincent & the Grenadines	■	■	■	✗
62.	Samoa	■	■	■	✗
63.	San Marino	■			✓
64.	São Tomé e Principe			■	✗
65.	Seychelles	■	■	■	✗
66.	Singapore		■	■	✗
67.	Somalia			■	✗
68.	South Africa			■	✓
69.	Spain (Melilla)	□		■	✓
70.	Sweden	□			✓
71.	Switzerland	□	■	■	✓
72.	Taiwan (Taipei)			■	✗
73.	Tonga	■		■	✗
74.	Turkey (Istanbul)	□			✓
75.	Turkish Rep. of Northern Cyprus			■	✗
76.	Turks & Caicos Islands	■	■	■	✗
77.	United Kingdom (City of London)			■	✓

78.	Uruguay			■	✗
79.	US Virgin Islands	■		■	✗
80.	USA (New York)	□		■	✓
81.	Vanuatu	■	■	■	✗

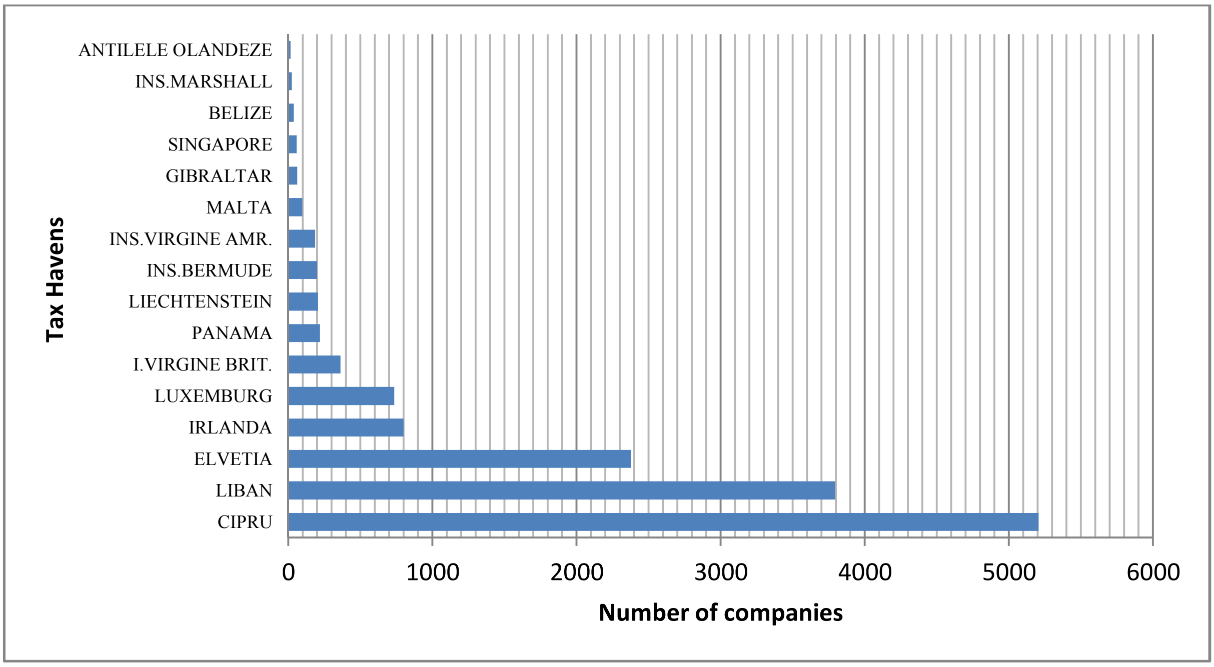
■	Tax Haven OECD, TJN 2007 /Offshore Financial Centre FSF/IMF 2000
□	OECD member country with potentially harmful preferential tax regime as distinguished by OECD 2000
■	No longer regarded a tax haven according to the OECD 2006
✓	There is a double taxation avoidance agreement with Romania
✗	There isn't a double taxation avoidance agreement with Romania

Source: Tax Justice Network (2007), *Identifying Tax Havens and Offshore Finance Centres* with our additions from Agenția Națională de Administrare Fiscală, *Lista convențiilor de evitare a dublei impuneri*

From this list of 81 tax havens and offshore financial centres we can see that currently, Romania has concluded agreements concerning exchange of information and double taxation avoidance with only 30 of them.

According to statistical data summary report from the Central Trade Register, in Romania there are 185,791 companies with foreign participation to the capital. Of these, a significant number of shareholders have residence in tax havens and offshore financial centres. In figure 1 we have presented the classification of tax heaven countries on the number of companies where the majority of foreign shareholders of Romanian companies come from.

Figure 1 - Tax havens top by foreign participation in the share capital of Romanian companies between 1991 and 2012



Source: Own processing based on data from Oficiul Național al Registrului Comerțului (2013), http://www.onrc.ro/statistici/is_ianuarie_2013.pdf

From this figure we can see that the majority of countries with foreign participation to the capital of Romanian companies are Cyprus (4362), Lebanon (3795), Switzerland (2380), Ireland (799), Luxembourg (735) and British Virgin Islands (363).

CONCLUSIONS

The problem of tax havens is by far a global priority, as long as *tax havens provide an important channel for tax evasion* (Brock, 2011, p.7).

The elimination of trade barriers created a multitude of benefits, but tax havens can be seen as a dark side of the global economy, as William Brittain-Catlin (2005) entitled a famous book.

As we have shown previously, in Romania tax regulations were introduced designed to stop capital flight to countries with a permissive tax regime with which there are no concluded double taxation avoidance agreement. In this way, taxable income obtained from Romania by non-residents who have residence in countries and territories such as Isle of Man, Singapore, Netherlands Antilles, Jersey, Cayman Islands, British Virgin Islands, Bermuda, Belize or Barbados will be taxed at 50%. In case of income obtained by non-residents from Romania, but who have residence in countries such as Cyprus, Switzerland, Ireland or Luxembourg a tax of 16% shall be paid (if there is no proof of residence), or the most favourable tax rate between the one in Romania and the one in the country of origin. There is no doubt about the fact that these regulations have a precise goal, respectively encouraging exchange of information between states by providing a legal instrument for tax controls.

Enterprises which use tax havens have an advantage over the ones that meet their burdens on a fair and responsible manner in the country of origin. Paying lower taxes or no taxes at all it is much easier to lead a market competitive fight and they will always be one step ahead.

Thus, in conformity with Quintard (2010), we consider the existence of a fiscal coordination and even a harmonization of corporate tax rates in the European Union in order to prevent and combat border tax evasion and to stop harmful tax competition to be absolutely necessary.

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