Forum: Economic and Financial Committee

Issue: Limiting the abuse of European tax havens through international jurisdiction

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Introduction

In the 21st century where the global economy takes its steps to a higher point each day, the amount of ongoing trade and taxation that comes within is constantly increasing. Taxation, which might increase proportionally to the income of individuals or corporations, may reach massive amounts if the individual has a correspondingly huge income. In order to avoid paying a certain amount of tax or paying lower than the amount of tax that is normally charged in a nation, businesses and individuals choose to exploit tax havens by using offshore companies, aggressive tax planning, profit shifting and transfer pricing. Considering that approximately one-third of the world's wealth, equivalent to $427 billion, resides in tax havens, it can be said that the money that governments lose each day isn’t a small amount - not at all - bearing in mind that the taxation system is for governments to develop themselves by providing crucial needs like infrastructure, a qualified healthcare system, and education. So, the money governments lose day by day has a direct impact on the welfare of the country. If less financially stable people are willing to pay the taxes they owe, then surely those with the most should at least do the bare minimum by paying taxes and cooperating with the society that made them rich rather than using legal loopholes. From Switzerland’s financial secrecy to offshore activities in The Netherlands and Cyprus, Europe has become a continent with a considerable amount of tax havens. Since such a global and multilateral issue can only be solved by global support, the role of international jurisdiction on the matter is crucial.

Definition of Key Terms

Tax Haven: Tax havens are places that offer little or no taxation to people and companies. Through these havens, individuals and businesses can avoid tax loans from their home countries. Today, there are approximately 55 tax havens worldwide, and 10 countries in Europe are used as tax havens (Investopedia).

Corporate Tax Havens: A technique which corporations use to decrease the tax loan by registering their headquarters in another country which has a lower rate of corporate tax compared to their native country.

Offshore Company: A company located outside of its home country. Also, registering the headquarters of a company or starting a new business outside of where the company is originally managed. This system is generally used by people who live abroad and have companies that want to stream the cash flow.

Profit Shifting: Used by multinational companies that want to reduce their tax burden by moving the location of their profits from high-tax companies to tax havens (Tax Foundation).

Transfer Pricing: A taxation and accounting principle which represents the transfer of profits between two companies that are under the same division. For example, there are two companies named Company A and Company B which are the businesses of the same person or group, transfer their profits between each other to maximise their profit by lowering tax amounts. In cases where one of these companies is located in a tax haven, the division might earn more money by using the advantage that comes with the tax haven usage (Seth).

Patent Box Regime: Also known as intellectual property (IP) regime. The act of taxing businesses with their income earned from intellectual property at a rate lower than the legal income tax rate to develop and encourage research in the country. ("*What is a Patent Box?"*).

Trust: An agreement upon allowing another individual, a third party called a trustee, to hold assets on behalf of another person (*"What Is a Trust?"*).

Asset Protection Trust (APT): A trust system that aims to hold one's assets to shield them from creditors. A domestic APT can provide a state income tax-saving when located in a tax haven (Investopedia).

General Overview

Background History

The development of tax havens started in the post-colonial era. As nations started to claim their independence, colonial officials and other businesspeople who needed to leave the land required more complex mechanisms for moving their assets with them. In some cases, they wanted to maintain their assets offshore and untaxed. With this idea, the use of tax havens started to become a trend and developed every day. The founding of the Swiss Confederation in 1848 marked the first country that was the most suitable to call a 'tax haven'. Even before the term tax haven was coined, bankers in Geneva and Zurich started to harbour the European elite's wealth in private. With the era of financial globalisation, offshore activity also changed its form into a more spreadable phase. At the same time, the tax haven system also started to develop in the Caribbean and Britain's nearby Crown Dependencies. Asian havens such as Hong Kong and Singapore, also started to become tax havens because of the country's illicit offshore financial activities.

In 1998, the Organization for Economic Cooperation and Development (OECD) identified some factors to determine tax havens. The factors identified were consisting of no taxation on relevant income, lack of effective exchange of information, lack of transparency and no substantial activities.

The Usage Of Tax Havens

Any country that levies minimum to no tax is currently used as a tax haven (a financial offshore) in order to maximise the individual's profit. However, tax havens are not always fully tax-free. They charge less enough to increase profit than other countries. Yet, low-tax jurisdictions generally charge high customs or import duties to cover the losses in tax revenues. Rather than taxing with increased rates, annual fees are charged to companies by tax havens since the country itself known as a tax haven doesn't have an income from taxes but still requires the government to provide for citizens'. The countries that don't have an income from taxes generally earn money from these charges and attract more individuals and businesses while taking enough money from other charges to fulfil its needs. Considering that some tax havens have a small population, taking annual and registration fees from numerous companies might be more beneficial for the country. In general, tax haven countries benefit by attracting capital to their banks or other financial institutions (Corporate Finance Institute).

Tax havens are generally used for legal tax avoidance and wealth secrecy. Because of suitable legal conditions and the convenient process of opening an offshore company the abuse of tax havens started to occur. As a result, currently, governments around the world lose 170 billion annually according to European Union (EU) Tax Observatory's Director Gabriel Zucman. From the abuse of tax havens, Europe pays the highest price with 2.5 trillion which is equal to 11% of its total wealth held offshore and a tax loss of 60$ billion. From the Greek Debt Crisis to the Enron Scandal, many things that pivoted world economics could have been prevented with the amount of money lost from the countries' revenue to individual wealth. The top 10 European tax havens are respectively, England, Germany, Ireland, Jersey, The Netherlands, Switzerland, Sweden, Denmark, Austria and Luxembourg.

For instance, assume that there is a company run in the United States with federal income tax rates such as 10%, 12%, 22%, 24%, 32%, 35% and 37%. To escape from this tax, with the help of legal loopholes caused by problems in redundancy, transparency and anonymity, the company hires a trustee and opens another place located in a tax haven which has a little to no tax rate. Since there is another headquarters located in a tax haven legally, the company turns into an offshore company. Depending on the requests, it can be shown as another person is working as a director for your offshore company while the person is just running it on paper. When the company is legally a company with no taxation, all the money is coming as revenue directly to the company’s budget. Also, along with offshore companies, tax havens might be abused with profit shifting or aggressive tax planning.

According to the United States Federal Reserve in 2014 global household financial wealth was $95.5 trillion dollars and in his book *Hidden Wealth of Nations*, Gabriel Zucman estimates that 7.6 trillion of that 2014 wealth was held offshore. Moreover, in the US, offshore evasion costs about $ 32 billion annually which is equal to the 1,8 times of the National Aeronautics and Space Administration’s (NASA) annual budget.

The amount was equal to 8% of the world’s general wealth. In 2017, the amount had risen to 8.7 trillion $. Gabriel Zuchman's estimate doesn't take into account nonfinancial wealth such as many yachts registered in the Cayman Islands, priceless art and gold hidden in Singapore and Luxembourg or real estate in London and NYC etc. If the nonfinancial wealth is considered this could easily drive that 8% figure up to 12% or even more.

The usage of tax havens increased rapidly in recent years. Currently, corporations like Apple, Google, Walmart, Nike and Microsoft are using offshore systems to use tax havens. Apple holds 246 billion $ offshore and uses Ireland as a tax haven. If Apple hadn’t used the tax havens, it would have owed the United States 76.7 billion.

Impact of tax haven usage on developing countries

The amount lost from the country’s revenue to tax havens directly affects the government. The governments are responsible for providing necessary services by the taxes they get. However, the increase in the usage of tax havens results in a decrease in the country’s revenue. This causes the quality of services to decrease. For instance, infrastructure, education, healthcare, sanitation and other public services are dependent on countries' revenues. That's why the evasion only benefits the wealthiest. Also, it can be claimed that tackling tax evasion would reduce the burden on the vast majority of taxpayers who are not rich enough to hide their wealth. For instance, Greene wouldn't have to impose as much austerity, if the ultra-rich there had not abused the tax havens and paid their taxes.

Also, the everyday problems caused by financial instability and inability can be solved by taking the taxes lost by tax havens. The reason why tax havens mostly affect developing countries is because developing countries need money to develop themselves in governmental areas such as healthcare, education and infrastructure. If the developing country doesn't have enough money to develop such things which governments provide, the development level of the country can even decrease.

Major Parties Involved and Their Views

United States Of America (USA): Having one of the largest economies in the world, American companies effectively use tax havens. The 50 biggest American companies which earn over 4 trillion a year approximately $1.6 including companies like Microsoft and Walmart, use tax havens. In 2015, $15.5 billion in profits made their way to Google Ireland Holdings in Bermuda, a place where the corporate tax rate is 0%.

Switzerland: Being the first tax haven ever, Switzerland is still an active destination as a tax haven. The country adheres to privacy in banking practices, which makes the country a popular tax haven since some individuals don't want to reveal their identities in general because of their criminal records. The Financial Secrecy Index ranked Switzerland as the second tax haven in the world based on its banking secrecy procedures and the number of offshore businesses. Also, efforts of American tax evasion investigators haven't bumped Switzerland from the European tax havens list. Moreover, Russia has also identified Switzerland as an offshore jurisdiction that refuses to share banking information on account holders (Parietti).

Ireland: Ireland's attractive tax environment has a corporate tax rate of 12.5, which aims to encourage foreign businesses to relocate on paper rather than physically. Also, Dublin is the home to the International Financial Services Centre, which has attracted the presence of 20 of the world's top 25 financial service companies and 17 of 20 global banking institutions (*"Tax for companies"*).

The Netherlands: In terms of corporate headquarters and subsidiaries (which are important factors of being a tax haven and the usage of offshore companies) the Netherlands became popular. Also, in 2019, The Netherlands attracted $84 billion in foreign investment, making it the largest foreign direct investment recipient in Europe (Sánchez-Muñoz et al.).

United Kingdom: Being the epicentre of global tax havens, the country is famous for foreign billionaires' interests by being shown as one of the top tax havens located in Europe. The well-established banking systems are why foreigners are interested in using their trusts or offshore in England. Companies benefited from a 19% percent corporate tax rate up to 2022 which is considered to be relatively low. However, the rate increased to 25% in 2023. Most importantly, the British territories overseas are one of the most popular tax havens in the world. Jersey, which is a small island also levies a minimum amount of tax and is considered an important part of Especially, the British Virgin Islands and the Cayman Islands are popular tax havens in the world. The British Virgin Islands does not charge any tax unless they are employed in the territory. Also, the Cayman Islands do not charge any income taxes as well (Parietti).

Germany: The corporate tax rate is 15% which is lower than many European tax havens. In Germany, other capital gains have taxes in another category. With its low corporate taxation rate, Germany is one of the top 10 European tax havens (“Germany — orbitax corporate tax rates”).

Timeline of Events

1848	The first tax haven, the Swiss Confederation was founded.
1998-2000	The OECD launched a project called Harmful Tax Practices to evaluate taxes.
2009	The Global Forum on Transparency and Exchange of Information for Tax Purposes established by OECD.
2014	Common Reporting Standard (CRS) was introduced by the OECD which aimed to sustain the transparency of the financial

	account information between countries.
2016	The Panama Papers got leaked. The EU introduced the Anti-Tax Avoidance Directive (ATAD I).
2017	The Paradise Papers were leaked. The EU published the blacklist and grey list of tax havens.
2019	The EU introduced reporting requirements for certain companies.

UN Involvement

The UN's Tax Committee and The Committee of Experts on International Cooperation in Tax Matters; played an important role in providing countries to discuss tax-related matters, exchange information and observations and develop better guidelines about important aspects such as developing transparency. International tax cooperation is crucial since it is an important step toward achieving the 2030 Agenda for Sustainable Development.

Relevant UN Documents

United Nations Model Double Taxation Convention, 2017 - This is the updated version of a taxation convention template. Considering the importance of international jurisdiction, a general understanding of this convention is valuable. (*"OECD Model Tax Convention on Income and on Capital*")

Promotion of inclusive and effective international tax cooperation at the United Nations, 22 November 2023 (A/C.2/78/L.18/Rev.1) - This is one of the 9 resolutions approved by the GA2 on the mentioned date. The importance of international tax cooperation and the particular conditions of developing countries were evaluated. The Spain delegate, also the representative of the EU, mentioned that *"Developing global tax standards is imperative for a cohesive and prosperous international community, and the European Union supports actions that aim to ensure a fair and effective international tax system."*

Treaties and Events

Common Reporting Standard (CRS): Developed as a response to the G20 request and approved by the OECD on 15th of July 2014. CRS calls for jurisdictions to gather information from financial institutions and exchange information annually.

Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent BEPS (MLI): In November 2016, more than 100 jurisdictions concluded negotiations on BEPS MLI which swiftly implemented some of the tax treaty measures to update international tax rules and lessen the opportunity for tax avoidance by multinational enterprises.

EU Anti Tax Avoidance Directives (ATAD I and II): The EU adopted two Anti Tax Avoidance Directives ATAD I and ATAD II. These directives are not the same as the OECD's BEPS plans, but the developed versions with the same aims.

Panama Papers Leak:

The Panama Papers are the name of 'history's biggest data leak' (*"What are the Panama Papers? A guide to history's biggest data leak"*). The leak of 11.5 million files from the database of a company of Mossack Fonseca in Panama, which constructs offshore companies for its clients.

Evaluation of Previous Attempts to Resolve the Issue

Global cooperation is a must since the only solution to a worldwide problem will only be maintained by international jurisdiction. However, the conventions and agreements are in order to increase transparency, which is the right way to go, but the problem continues: the steps taken are not big enough. For example, the blacklist of the EU consists of crucial information but without tackling its own members which are huge tax havens, it might not be the most productive thing to evaluate other relatively small tax havens. Furthermore, the OECD's Common Reporting Standards in 2014, which is an automatic exchange of information between bank accounts and tax authorities, requires banks to report accurate information on foreign accounts. So far 97 countries signed up for the convention but even so, that convention was reported to have many loopholes that can be abused. The steps are right, but they should be conducted with the full support of everyone. This is only possible in the case of international jurisdiction. The conventions are open to be developed in order to make them more effective.

Possible Solutions

Gabriel Zuchman suggests penalising tax havens and creating a global financial register. The register mentioned would record all the financial investments circulating the world. So that the tax authorities could check with banks and correctly tax their citizens and businesses. With such a global register and countries full transparency between each other is a new way of fairly taxing the ultra rich. Full transparency is pivotal since the anonymity of offshore companies is risky and transparency is important to tackle legal loopholes. Moreover, taxation conventions might continue globally, but with emphasis on different economies of the countries. Even though it is nearly impossible to evaluate the same tax rate, international jurisdiction might determine specific guidelines.

Notes from the Chair

The understanding of the topic in general is the most important thing for this agenda item. The complexity of the topic and the terminology used to explain the whole taxation system might be confusing at first, but after understanding the big picture it should make sense. If you are still having a problem understanding how the system works, I highly encourage you to watch the video named *What Are Tax Havens and How Do They Work?*. After understanding how companies and individuals take advantage of these legal loopholes and tax havens, it is easier to think of a solution. Also, please focus on Gabriel Zuchman's recommendations. If you want to further research his works about the topic you can research his book *The Hidden Wealth of Nations*.

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