

## OFFSHORE JURISDICTIONS, CONTROVERSIAL TOPIC OF THE MODERN BUSINESS WORLD

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### **Abstract**

*This article aims to present synthetically the off-shore jurisdiction issues in the context of the globalisation of our lives and automatically of the business world facing new issues and challenges regarding the business in the international area, starting from defining elements and approaching some of the practical challenges offered by the widespread use of such offshore jurisdictions known as “tax havens”.*

**Key-words:** *jurisdiction offshore, offshore companies, trusts, tax haven*

**JEL Classification:** Z<sub>11</sub>

### **Introduction**

Strictly speaking, each country can be considered a tax haven, because one way or another, companies or individuals are given incentives to encourage investment and to promote their growth. The United States as well can be considered a tax haven for people who invest in the American economy.

Confusion may arise in using the term by combining the financial and banking secrecy and commercial operations, carried on state territory, which may be associated as a “tax haven”, although all states require some level of protection for banking and commercial information.

Tax haven is an area with a privileged tax correspondent to English words: “tax heaven”, the German phrase “tax oasis”. In a 1987 OECD report on international taxation it is still stated in the introductory part: “that no single criteria, clear and permanent objective to identify a country as a tax haven.”

Tax haven business is defined in the dictionary: ([http://www.rubinian.com/dictionary\\_details](http://www.rubinian.com/dictionary_details).) the country practice of low taxes, including foreign income, respectively, country tax policy that encourages the exercise of its territory called the specific economic activities. The term originally appeared in the island tax havens, remote and exotic, and then was extended to “tiny” European countries, such as the Principality of Andorra, Cyprus, Gibraltar, Principality Leichtenstein, Monaco, so on.

### *Features*

The main features of tax haven can be summarized as: low taxes, the secret of the operations in the territory and jurisdiction of that State, the banking activity with separate legal regime for national citizens and foreigners, encouraging of the foreign banking systems, excellent communication telephone cable, telex, Internet, direct air service lines, non-stop, between various countries and some of these tax paradises (i.e.: direct flights Miami-Cayman Islands), promotional advertising, through aggressive advertising, in which the advantages offered by the state, considered a tax haven, the use of English as the main language in the Caribbean jurisdictions, America's proximity make these tax paradises be very attractive for U.S. and Canadian residents.

The term offshore\* (According to The Economist magazine's annual dictionary, offshore companies are businesses registered in certain countries or jurisdictions that are either tax-free or the taxes are very low as long as the companies do not operate in the countries where registered.) The British specialist language designates the territory located beyond the shore. In U.S. economic jargon, "offshore" means businesses and companies operating outside the national territory of the State where they reside.

In other words it is not companies doing business in the country where registered and which, in terms of trade acts committed, are regarded as foreign companies. An offshore company does not have income in the country that has been registered.

Theoretically, offshore companies may be set in any country in the world, but not everywhere and can get tax benefits. Tax Haven (English) – in free translation means the port finance, fiscal refugee, tax heaven. With this term were designated those political units that provide very favourable conditions for capital development and operation of offshore companies.

The offshore company, a firm registered in a country or a territory called "tax haven", because it is tax free or the taxes are very low. These lands offer foreign investors, in addition to exemption/reduction of taxes on income firm and the person, the inheritance and gift tax, etc., and a well-developed monetary sector (banking, insurance, stock exchange transactions), liberalization of foreign exchange transactions, etc.

Typically, a requirement for tax exemption is that the applicant company does not conduct business in that territory (condition imposed by the defence economy off the external influence).

Depending on operating conditions, the territories where they can register offshore companies are divided into three groups:

- Group 1 – Bahamas, Jersey, Isle of Man, Delaware (USA) (not registered capital base, balance should not be applied to any authority, annual profit company is charged only with a flat tax).
- Group 2 – Ireland, Hong Kong (companies have a duty to balance the authorities legalized by a certified accountant).

- Group 3 – Madeira, Cyprus, Switzerland, Liechtenstein, Hungary (1994) (the foundation of the company's capital base must be noted, deposit balance is required, but business profits are taxed rates – a rate from 0 to 4.25%).

It happens frequently that the purpose of setting up an offshore company is not only tax exemption, but also the start out on behalf of a company registered in a recognized country (as a means of enhancing the credibility of the business).

*Advantages of offshore companies established* (<http://companiioffshore.trade-romania.biz/htm>):

These advantages are:

- anonymity and confidentiality;
- supports low taxes and help better the international tax planning;
- lack of currency controls;
- operating in a stable political and economic system;
- operating in a well organized and developed system;
- the possibility of diversification of the field without restriction;
- lax regulations; possibility of better expansion;
- the concealment of the origin of goods processed in free zones adjacent to other offshore financial centres;

### **Theoretical background**

#### *Anonymity and confidentiality*

Anonymity and confidentiality are cited as the main advantages of offshore companies, where taxes are low or even lack thereof. Among the reasons for such a choice are:

- In most cases the offshore company is used as a third party carrying out transactions on the local market. In this case, the two companies should not have the same director (s) as the same person cannot sign an agreement between two companies as a director of both.
- In many countries the obligation to pay administration charges is linked to the company location. If it is clear that directors and shareholders of foreign companies are registered on the local market, foreign business income will be treated as income for local owners and are therefore taxable.
- The business people want to maintain anonymity regarding activities, accumulated profits, investment.
- Anonymity can be achieved once the company was registered under her real owners, and the documents where shareholders and directors are recorded are filed. By contrast, when the company is registered as a liability, and the owners, at a time, do not wish this anymore, the structure can be changed anytime.
- The public has access to files containing shareholder certificates, a company's articles of incorporation, etc.

Worldwide over 95% of owners use an offshore structure of anonymity, the rest preferring an open structure.

Employees are bound by oath to keep secret the name of non-beneficiaries. Only general data are presented from time to time to inform the government and the public about developments in this field. Depending on the willingness of the beneficiary company, its identity can be known only to those directly employed, such as general manager and deputy.

*Supports lower taxes and helps better international tax planning*

The existing tax jurisdictions in the world are divided into two categories:

- those characterized by a high level of taxes (income tax, VAT, payroll tax, dividend tax, municipal tax, road tax, property taxes, etc.) and
- those who do not charge at all or they are very small. In jurisdictions that do not levy taxes, such as the Bahamas, Gibraltar, none of the above fees is charged. A company registered in such jurisdiction does not pay any such tax.

If we consider a low-tax jurisdiction, we talk about company profit tax. The jurisdiction of such taxes is Cyprus, which applies a 4.25% tax on gross income. Gross profit is calculated by subtracting the income of all expenditures made by a company for doing business. This includes the cost of goods sold, salaries, travel expenses, accommodation and protocol, professional fees, commissions and so forth.

There are no limits in respect of these charges than common sense. Moreover, wages are not taxable. However, other jurisdictions, such as the Isle of Man, impose a flat fee (750 pounds, or \$ 1,200 for the Isle of Man) to any company, regardless of its profits or losses.

As for international tax planning, international companies are using offshore entities to direct profits to them and to operate so as to pay less tax. No wonder that thousands of businessmen and companies are using offshore companies for international tax planning, among them the renowned companies worldwide such as Pepsi Cola, Tetra Pak, Barclays RJR Nabisco and others. The existence of double taxation treaties with international low taxes provides huge opportunities for tax planning.

*Lack of foreign exchange controls*

Many business people are trying to avoid setting a base where there are foreign exchange controls or where formalities relating to such operations are intentionally complicated. Offshore companies are not subject to any currency controls. They can receive funds either in cash or otherwise, in any currency and may also make payments to any person in any country, or make withdrawals of funds without any explanation or documentation required by the bank. Thus, the company operates in an unrestricted banking system.

Offshore companies can maintain accounts in any currency in the form of current accounts, accounts with notice or fixed term deposits and interest payments are similar to those prevailing internationally. Funds from these accounts may be

transferred abroad without any restriction and without the demand for documents or permits.

*Operating in a stable political and economic system*

Every businessman, every investor wants to operate in a country that has these characteristics. Nobody wants to see money lost due to changing governments, government system or because of economic instability that can bring inflation, economic regression and many other issues. The emergence of new independent states of former Soviet bloc economic restructuring process has inevitably led to financial crises (bank failures, pyramid schemes, etc.) that caused people to lose their savings.

One of the biggest advantages of Cyprus as offshore centre is the economic and political stability in a region vulnerable in this regard. The Civil war in Lebanon gave the first advantage to Cyprus in 1970, followed by the 1990 Gulf War and the collapse of Yugoslavia. Many companies came to a temporary shelter remained when they saw that this country offers more than that.

*Operating in a well organized and developed banking system*

This is one of the priorities that all offshore financial centres have to fulfil. The world's big banks that have established centres operating in these areas and have raised the standard of conduct of this activity. Given how business is conducted today, it is inconceivable that an offshore financial centre does not have a well-developed banking system. This is one more reason to use these tax havens for business conduct in the context of the globalised world in which we live.

*The possibility of diversifying the objects without any restriction*

Offshore financial centres often allow diversification of the objects of a company, operation that is not possible in the investor's home country. Companies with taxation and restrictions in their origin countries can find countless business solutions in offshore centres, thus escaping many of the problems.

For example, Japanese or U.S. banks cannot engage in certain securities issues prohibited by law in their countries, they enter this delicate area with offshore entities. And it should be noted that formalities for business diversification of a company are met without too much bureaucracy.

*Lax regulations*

Fear of excessive regulations is a major attraction to this area and is why the registration of banks, insurance companies or shipping companies has become an important pillar of the offshore industry. A new wave of financial tools is moving to the offshore area for the same reason. This wave includes closed funds, payment instruments, Euro trade.

*Possibilities for expansion are much better*

Offshore centres see large corporations as something indispensable for their expansion into new markets at competitive costs. For example, offshore financial centres dominate several international activities such as shipping, air transport, financial and captive insurance companies. Lately, there were about one million

worldwide offshore companies and many of the famous corporations in the world market operate through them. I noted here Dublin IBM and Microsoft, the Orient Express and American Airlines in Bermuda, the Isle of Man Scholarship, GE and CNN in Cyprus.

Thus a company can more easily enter a market or it could open a subsidiary or branch in another country as it would be perceived as a foreign company and will be eligible for incentives granted by the government of that country. We give here an example of country– Romania, providing facilities to foreign investors who place their money in our country.

*The concealment of the origin of goods processed in free zones adjacent to other offshore financial centres* (<http://companiioffshore.trade-romania.biz/htm>)

Business people can hide the origin of the goods they sell through free zones. So they can bring the goods in free zones where they can change the packaging, process them and hide the origin as the goods will have the free zone and the country that has organised it as source, and therefore the goods can be chosen easier by the consumers

### **Conclusions**

The fiscal policy of a State may encourage or not the Finance, Business and Banking. A recent example was Bulgaria, that by the fiscal measures adopted at the end of 2006, just before accession, became, in the opinion of the experts, the “tax haven of Europe”, along with Cyprus. Bulgarian Parliament adopted the income tax reduction from 15% to 10%, starting with the date of accession. The Bulgarian law makes it a so-called “tax heaven” of the European Union. Taxes in Bulgaria and Cyprus are the lowest in the EU. This change in taxation was made to stimulate investment seeks to spur further growth in Bulgaria, which came on the first three quarters of 2007 to 6.3%.

It is expected that Bulgarian action will attract more companies from countries like Germany and Italy, where income tax is almost four times higher, as expected. Business people from developed countries have every reason to expand or relocate in Eastern Europe, even in the current global economic crisis.

In 2002 and 2003, Bulgaria has managed to attract foreign investment volume comparable to that of our country, in the circumstances in which the country has a population almost three times lower. In the last three years, results of economic reforms in our country have attracted increasingly larger investments. In the past 16 years, Romania has attracted foreign investment worth 26 billion euros, while Bulgaria has attracted only 16 billion.

Business representatives believe that foreign investors will continue to come to Romania, even if the tax is higher, since they are interested in the large size of the domestic market and high growth rate.

These estimates were valid until the outbreak of the global financial crisis and its expansion throughout the European single market.

Romania has attracted investors because of its large market and the six percent profit tax will not produce significant diversion of foreign investments to Bulgaria.

In the current context of the interface, unfortunately many of the foreign companies who did business primarily in Romania and other Eastern European countries and businesses have moved to countries where labour is cheaper and the business environment more stable, even in crisis conditions, with a stable legislative and predictability possibility of a business plan into a more stable economy.

Until the outbreak of the crisis, the hypothesis was confirmed by the particular foreign investment in Eastern Europe. Thus, the largest amounts have been brought so far, both in Romania and Bulgaria, to corner resources or consumers, not to use cheap labour. The areas that have shown a great interest for investments were the financial services, telecommunications, real estate and oil. The Bulgarian strategy is probably to convince investors interested in particular to produce cheaper, especially companies that prefer to work in loan.

The level of 10% corporate tax gives Cyprus and Bulgaria the tax haven status of the European Union. Highest taxes in the community are recorded in developed countries. Compared with countries of Central Europe, Romania is the lowest. The figures speak for themselves: 47.5% is the level of taxation on employment in Romania and in Bulgaria social contributions represent only 36.4% of gross salary, while the EU average is 34.5%.

Although the global economic crisis has disrupted all mankind and its effects are insurmountable especially on developing economies, the global financial and economic world is seeking solutions to the crisis and taking measures to redress the economies of all affected States.

Tax havens remain a concrete solution if economic, financial and banking policies of the states fail to find concrete solutions to attract investment performance in their countries, through tax incentives and the same advantages of tax havens.

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