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TAX HAVENS IN THE GLOBAL FINANCIAL CENTERS INDEX

Case study

Keywords
Tax haven
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JEL Classification
H32, H25, G20

Abstract

Previously scrutinized for adopting harmful fiscal measures, tax havens have progressively adhered to the internationally agreed principles of transparency and exchange of information for tax purposes promoted by the Organization for Economic Cooperation and Development. In this respect, important amendments have been made to both their tax and commercial legislation. Their main competitive advantage remains the favorable fiscal systems characterized by 0% tax rates which have favored the development of well established financial services sectors. The aim of this paper is to analyze the fiscal framework offered by six former tax haven jurisdictions: Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands, which occupy high ranks in the Global Financial Centers Index. The results come to emphasize the importance of these jurisdictions` tax systems in the development of strong financial sectors.

Introduction

In September 2013, the Z/Yen Group published the 14th Global Financial Centers Index which brought six former tax haven jurisdictions in the top 50 of the world`s financial centers (GFCI 14, 2013). Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands had been for a long time on the black list of The Organization for Economic Cooperation and Development (OECD) which considered these states to have in place harmful tax measures and they were classified under the tax haven headline. Their initial commitment and further adherence to the internationally agreed standards of transparency and exchange of information for tax purposes, together with the numerous amendments made to their tax legislation made these territories compliant to the OECD`s requirements and therefore they had been erased from the black list of tax havens.

Since reputation is a key factor in attracting business, the adherence of the six territories to the OECD`s standards together with the promotion of a low tax business environment have promoted these jurisdictions on the global stage as top destinations for investment and capital allocation.

Tax rates represent an important aspect in the management decisions and a detailed analysis of the opportunities offered by some fiscal systems can be a competitive advantage for the company.

Therefore, this paper addresses two aspects: on one hand it is emphasized the importance of taxation in the development of the financial sectors of the states under consideration and on the other hand there are presented the tax incentives offered by these states to the companies that choose to establish operations in these territories. It is important for the companies to be informed in terms of the tax planning opportunities made available by these states in order to diminish costs and to be competitive, while conducting operations in the global market place. Managers should respond to these opportunities and analyze them in relation to the long term objectives of the company.

This paper supports the findings of the Z/Yen Group that taxation is a critical factor in determining the competitiveness of a financial center (GFCI 14,2013) andin this respect the former tax havens can be seen as strong competitors in the race of reaching higher rankings in the top.

The second part of this paper presents the evolution of the tax haven jurisdictions in terms of reputation and adherence to the international tax standards; the third part is an introduction to the favorable tax systems presented by the six jurisdictions: Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands andin the fourth part it is conducted an analysis of their position in the Global Financial Centers Indexreleased by the Z/Yen Group based on the development of their financial sectors with taxation as a key contributorto their success. Conclusions come to stress the importance of taxation in the development of the former tax haven jurisdictions` strong financial sectors.

Tax havens.In search for a widely accepteddefinition

Hines (2005) presented tax havens as locations with very low tax rates and numerous tax incentives meant to attract investors. Dharmapalaand Hines (2009)extended the research in tax haven jurisdictions presenting the following characteristics of these territories: Small countries, predominantly islands, with a population below one million; Good communication infrastructure; Few natural resources; British legal origins with English as an official language; Parliamentary systems; Proximity to the large capital-exporter countries; More affluent than other countries as they attract significant foreign investment due to the low tax rates and opportunities for tax avoidance; and High-quality governance institutions that can be translated in political stability,government effectiveness, rule of law and control of corruption. All these aspects provide the assurance of a stable business environment for the potential investors.

In the context of globalization, tax havenshad been analyzed from numerous perspectives. According to Hines (2005), the favorable fiscal systems of these territories had attracted massive foreign investment and they had registered important growing rates in the last 25 years.Krautheim and Schmidt-Eisenlohr (2011)sawtax havens as providing numerous tax planning opportunities for the multinationals through the profit shifting schemes. Contrary believes in respect of tax havens` effects over the other economies also arose.Tax havenswere considered to divert activity from the high tax jurisdictions and enhance tax competition between countries that would eventually lead to a race to the bottom (Slemrod, 2004). On the other hand Desai, Foley and Hines (2006) provided evidence that tax havens` operations enhanced activity in the nearby high-tax jurisdictions.

According to the OECD, a state is considered a tax haven as long as it presents the following characteristics:No or only nominal tax rates; Lack of effective exchange of information; Lack of transparency; and No substantial activities (OECD, 1998).

Therefore, the fact that a state was imposing no or very low tax rates was not the key aspect in classifying a state as a tax haven. The major concern raised by the OECD was the lack of transparency and the lack of exchange of information infrastructure for tax purposes. As a result, the OECD published in 2000 the list of the world`s tax havens which included: Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands (OECD, 2000). These territories committed to implement the standards of transparency and exchange of information for tax purposes set by the OECD. The key principles behind these standards were: the implementation of a mechanism for the exchange of information for tax purposes between countries upon request; the strict confidentiality of the information exchange; the access of the state to reliable bank, ownership identity and accounting information and the power to exchange such information upon request (OECD, 2009).

In order to prove that they implemented the standards, the nominated states were supposed to meet the minimum threshold of 12 tax treaties being signed with OECD countries.The Global Forum on transparency and exchange of information for tax purposes issued Peer Review Reports in order to monitor the level of implementation of the standards and recommendations were made in order to draw attention on the right course of action to be taken.

The latest OECD`s progress report from December 2012 reveals the fact that at the moment there are only two jurisdictions that meet the tax haven criteria: Nauru and Niue, as all the other states made progress in implementing the standards (OECD, 2012).

For the purpose of this paper, tax havens are referred as meeting the criteria set by the OECD.

Taxation as a key ingredient of the competitiveness of a financial center

The six jurisdictions chosen for the analysishad all been listed under the tax haven headline in the report released by the OECD in 2000. Yet, by 2009 Jersey, Guernsey and Isle of Man succeeded to substantially implement the internationally agreed tax standards, while the other three states continued to preserve their status on the black list until 2011.The implementation of the OECD`s standards, the amendments made to both their tax and commercial legislations, together with the partial elimination of the offshore sectors, while preserving a very fiscal-friendly environment, helped these statesdevelop strong financial services sectors. Their listing in the top 50 global financial centersstands as a proof of their performance in constructing and maintaining sustainable financial sectors.

In respect of tax legislation, the six jurisdictions present their particularities although the main feature of their fiscal system remains the 0% level of taxation.

Monaco distinguishes by a tax system that relies especially on indirect taxes; the British crown dependencies: Jersey, Guernsey and the Isle of Man have in place the 0/10 tax system; the Cayman Islands opted for a consumption based taxation system, while the British Virgin Islands adopted a uniform 0% tax rate.

Monaco`sfavorable individual taxation

Monaco`s tax system relies on indirect taxes. It has avalue added tax and the bases to which it applies as well as the rates are the same as in France: a reduced rate of 5.5%, an intermediary rate of 7% and the standard rate of 19.6%.

Monaco offers important tax incentives to individuals in that there is no personal income tax in the territory, no wealth tax or other local taxes.

In terms of corporate taxation, companies conducting industrial or commercial activities that derive more than 25% of their turnover outside Monaco are subject to a 33.33% tax. On the other handcompanies that derive more than75 % of their turnover from within the territory are tax exempt (OECD Monaco, 2013).

Therefore, Monaco`s tax system is constructed in order to present significant advantages for the wealthy individuals who can bring capital within the territory and invest it locally. Also, companies are invited to conduct their activities in Monaco and create jobs for its residents. Given the absence of individual taxation, Monaco is preferred by the companies that choose to locate their service centers within this jurisdiction. Headquarter offices, logistics, management, research departments and other costs centers are located here. The advantage is that the hired personnel of these departments is not imposed an income tax.On the other hand the profit centers of the companies conducting international business activities are not encouraged to be set in Monaco since they will be subject to a 33.33% tax rate.

The 0/10 tax system of the British crown dependencies

The three British crown dependencies adopted the 0/10 tax system at different time scales: Isle of Man introduced the system in 2006, followed by Guernsey in 2008 and Jersey in 2009. Before that date, both companies and individuals were charged a 20% tax rate on profits respectively, revenues. After that date, individuals` income continued to be charged a tax rate of 20%, while companies became subject to the following tax rates: a uniform 0% corporate income tax; a 10% tax for the financial services companies and a 20% tax applicable to the utility companies and income from the ownership of land and building (States of Guernsey, 2013).

The introduction of this system saw the end of the offshore sector characterized by the exempt companies and the international business companies which were producing ring-fencing tax effects:the profits generated by a resident company outside the territory were tax exempt while the companies which derived their profits from within the islands were subject to a 20% tax rate. The elimination of this offshore sector was mandatory as the three islands were required to adhere to the principles of the EU`s Code of Conduct for business taxation. Despite early scrutiny of the 0/10 tax system, the set of amendments that followed made the system Code compliant.

Other tax incentives offered by the three islands are: capital gains are tax exempted; no withholding tax on dividends, interest or royalties paid to nonresidents; a well developed network of tax treaties.

Cayman Islands`consumption based tax system

The Cayman Islands, a self-governed overseas territory of the United Kingdom, has in place a consumption based fiscal system. There are custom duties on imports, tourism related taxes and stamp duty on real property transfers. There is no income tax, corporate tax, capital gains tax and sales tax.

The Cayman Islands` commercial legislation presents two special types of companies: the ordinary non-resident company and the exempted company. These companies are incorporated in the island but they are required to conduct business activity outside it. Instead of being imposed a direct corporate tax, these entities have to pay an incorporation fee and an annual fee according to their share capital as presented in Table 1.

The lack of direct taxation on the profits realized outside the jurisdiction provide an important fiscal incentive for investors and trading companies that choose to conduct international operations.

British Virgin Islands` 0% tax regime

Having the status of an overseas territory of the United Kingdom, The British Virgin Islands had to amend its tax legislation in order to become compliant to the EU`s Code of Conduct for business taxation. Therefore, it abolished its offshore sector characterized by the existence of the International Business Company (IBC) which was conferred tax exempt status as long as all the operations of the company were conducted outside the island.

In 2005, it was introduced a 0% tax regime applicable to all the entities and individuals, yet the companies became subject to a fixed annual fee payable to the Government as presented in Table 2.Under the new legislation the IBC became known as the BVI Business Company. Also, in order to diminish the state`s budget deficit, a payroll tax was introduced.Therefore, every employer and self-employed person who carries on business in the British Virgin Islands is charged a payroll tax of up to 14%. In addition to the payroll tax there are property taxes, stamp duty and custom duties.

Adherence to the OECD`s tax standards

In order to be erased from the black list of tax havens, the six jurisdictions had to meet the objectives imposed by the OECD in terms of transparency and exchange of information for tax purposes.

In the case of the six jurisdictions: Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands, the levels of compliance are presented in Table 3 and in this respect there are differences between the six territories. The Isle of Man proved compliance in nine out of ten areas, whereas Guernsey and Cayman Islands meet eight objectives. Jersey scores seven, while Monaco and British Virgin Islands meet six of the OECD’s tax objectives.

Rankings in the Global Financial Centers Index

According to Xinhua - Dow Jones Index (2013), a financial center presents the following:

- A consistent number of financial institutions that are engaged in international businesses: international banks, insurance companies, financial services companies, investment funds, etc;
- A wide range of financial markets: stock market, bond market, etc;
- It conducts international finance trading activities: issuing and trading of stocks, borrowing and lending of capital, etc;
- It is located in a modern city with a good communication infrastructure, sound traffic conditions, a developed service industry and a high degree of openness;

The Global Financial Centers Indexpublished by the Z/Yen Group in September 2013 was the result of two separate sources of data which reflect on the competitiveness of the financial center:

- Instrumental factors:business environment, financial sector development, infrastructure, human capital, reputational factors, and
- Financial center assessment: responses to an online questionnaire completed by international financial services professionals.

The business environment and taxation were considered the most important factors in determining the competitiveness of a financial center.

The business environment had to be characterized bya low regulatory burden,efficiency and simplicity of regulationsandstability.

In terms of taxation, the jurisdiction had to offer a low and competitive tax regime, stability and transparency. Considering the fact that the former tax haven jurisdictions have in place attractive fiscal systems and their economies rely heavily on the financial sectors, in the first 50 positions out of 80 we can find Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands.

In terms of the financial centers` profiles, consideration had been given to:

- The level of their connectivity: the extent to which the center is well known around the world and how connected it is to the other financial centers;
-Diversity: development of the financial sector; and
-Specialty: investment, management, banking, insurance, professional services, government and regulatory.

In this respect, Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands are grouped under the transnational contenders` category (GFCI 14, 2013).

Monaco`s financial sector

In 2013 Monaco occupied the 23rd place in The Global Financial Centers Index as it knew a 12 position increase in the ranks compared to its position from 2012. In terms of the stability of the financial center, it is seen as an unpredictable center as there is a high sensitivity to changes in the instrumental factors and it presents a high variance of assessment (GFCI 14, 2013).

Monaco`s finance industry is dominated by the banking sector. Private banking and asset management are the main services offered by the Monegasque banks which aimed to service the growing number of wealthy individuals who settled in Monaco.

Investment advisory and wealth management services are also offered within the range of financial services offered by specialized companies. Oriented towards providing services to the high net worth individuals, company service providers are an important part of the Monegasque financial services sector, whose main activities are family inheritance planning rather than corporate advice or management (IMF Monaco, 2008).

From a taxation point of view, the financial services providers operating within Monaco and offering their services to the residents are tax exempt since every juridical entity conducting business locally is exempted from corporate tax. This was a key incentive in attracting a large number of financial institutions, so that at the end of June 2012 Monaco`s financial market comprised of 34 credit institutions and 47 financial services companies (Monaco Commission for the control of financial activities, 2013).

British crown dependencies` financial sectors

Jersey maintained its 28th place in the rank just as in 2012,while Guernsey fell 5 positions occupying the 36th place. The Isle of Man knew a two positions rank increase, from the 43rd rank in 2012 to the 41st rank in 2013. They are seen as dynamic centers as they present a lower sensitivity to changes in the instrumental factors but still a high variance of assessment (GFCI 14, 2013).

Jersey is considered to have grown to become one of the world`s leading offshore financial centers in the fields of wealth management, banking, funds and capital markets. Its economy relies on its financial sector which is dominated by the banking industry. Most major British banks are present on its market as well as a number of branches and subsidiaries from EU countries as well as North America. Banks` major activity is the collection of retail deposits from overseas as well as from companies and trusts that are managed from the island (IMF Jersey, 2009).

At the end of 2012 in Jersey there were: 42 banks; 466 fund services businesses; 97 investment businesses; 178 insurance companies; 189 trust companies businesses (Jersey Financial Services Commission, 2012).

Guernsey`s economy is sustained mainly by the financial services sector which comprises banking, insurance, as well as trust and company services related to collective investment schemes. Unlike, Jersey and the Isle of Man, banking does not account for the largest part of Guernsey`s financial sector. The sector is dominated by significant insurance operations and many licensed companies that provide administration, trustee and custodial services to collective investment funds. In terms of the banking sector, the trend is to move away from the retail business and to focus on private banking and other services to high net worth individuals and to institutional fund and securities services. The Channel Islands Stock Exchange based in Guernsey lists and trades mainly collective investment schemes (IMF Guernsey, 2010).

On the 31st of December 2012 in Guernsey there were registered: 32 banks, 185 fiduciary entities, 804 insurance companies, 1758 investment businesses, 162 non-regulated financial services businesses (Guernsey Financial Services Commission, 2012).

In the case of the Isle of Man, the banking sector remains the largest component of the financial sector, followed by the investment business, insurance, fund management and fiduciary services. The banking sector is smaller than that of the other two British crown dependencies but the collective investment schemes` sector is well developed in terms of number of funds and assets under management. Providers of fiduciary services also contribute essentially to the local economy (IMF Isle of Man, 2009).

Currently, in The Isle of Man operate: 29 banks, 53 investment businesses, 60 collective investment schemes,174 corporate service providers, 126 trust services, 9 management or administration services (Isle of Man Financial Supervision Commission, 2014).

In terms of taxation, the three British crown dependencies adopted the 0/10 tax system which imposed a 10% tax rate on the profits generated by the financial institutions.

Cayman Islands` financial sector

The Cayman Islands increased in The Global Financial Centers Indexin 2013 two positions as compared to 2012, reaching the 39th place. It is seen as a dynamic center as it presents a lower sensitivity to changes in the instrumental factors but still a high variance of assessment (GFCI 14, 2013).

The offshore financial industry is a key component of the Cayman Islands` economy. It is one of the world`s largest banking centers in terms of assets, one of the world`s largest offshore insurance center, and a leader in the offshore mutual funds industry (Moody`s Investors Service Cayman Islands, 2013).

Currently, there are 250 licensed banks in the Cayman Islands, including branches of the 40 of the world`s largest banks. They offer a wide range of products including letters of credit, foreign exchange, guarantees, safe custody, commercial loans and mortgages. With more than 8000 registered funds, the Cayman Islands is a leader in the fund market. In addition, the insurance sector comprises more than 700 captive insurance companies being registered in the island (Cayman Islands Financial Services, 2014).

The absence of direct taxation has contributed to the development of these sectors of the financial industry.

British Virgin Islands` financial sector

British Virgin Islandsdecreased one position in The Global Financial Centers Index, occupying the 48th place. Just like the Cayman Islands, it is seen as a dynamic center as it presents a lower sensitivity to changes in the instrumental factors but still a high variance of assessment (GFCI 14, 2013).

Its financial sector is a significant contributor to the government revenues along with the tourism industry.The core business activity is company registration rather than asset management and banking. Therefore, the British Virgin Islands is an important global financial service provider in terms of registration of companies and trusts. It also hosts a large number of investment funds (IMF British Virgin Islands, 2010).

At the end of 2012, in the British Virgin Islandsthere were registered 459.005 companies, out of which 64.099 companies had been registered in the course of 2012. There were six licenses provided for general banking (conducting banking business within or outside the British Virgin Islands); three for money services/ financial businesses and one for restricted class 1 banking (the banks are restricted to take deposits or make loans to the British Virgin Islands` residents, except in the case of corporations); 189 trusts;21 company management providers;526 investment businesses and a total of 2318 mutual funds. In terms of insurance, at the end of 2012 there were 191 insurance companies (BVI Financial Services Commission, 2014).

The tax neutrality of the island remains a key incentive for the companies operating in the financial sector as well as those conducting international business activities.

Conclusion

The favorable fiscalsystems presented by the six former tax havens: Monaco, Jersey, Guernsey, Cayman Islands, Isle of Man and British Virgin Islands remain an important factor of their success in creating well established financial sectors.At the same time their adherence to the OECD`s international standards of transparency and exchange of information for tax purposes contributed to the creation of a good reputation at the international level.Therefore, the latest Global Financial Centers Index of the Z/Yen Group nominates the six states among the leading 50 jurisdictions thatsucceeded in developing strong financial industries, their main competitive advantageremaining taxation.

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Table No.1

Cayman Islands - Annul Government fees for an exempted company.

Share capital (USD)	Annual Government fee (USD)
Less than USD 50,000	USD 732
Between USD 50,001 – USD 1,000,000	USD 1,098
Between USD 1,000,001 – USD 2,000,000	USD 2,298
Over USD 2,000,000	USD 3.010

Source: (Higgs & Johnson, 2013)

Table No.2

British Virgin Islands - Annual Government fees for a BVI Business company

Share capital (USD)	Annual Government fee (USD)
Less than USD 50,000	USD 350
More than USD 50,000	USD 1,100

Source:(Trident Trust, 2011)

Table No.3

Degree of Implementation of the Internationally Agreed Tax Standards

<table>
<tr><th></th><th>Monaco</th><th>Jersey</th><th>Guernsey</th><th>Cayman Islands</th><th>Isle of Man</th><th>British Virgin Islands</th></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to their competent authorities.</td></tr>
<tr><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Largely compliant</td><td>Compliant</td><td>Partially compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements.</td></tr>
<tr><td>Largely compliant</td><td>Partially compliant</td><td>Largely compliant</td><td>Largely compliant</td><td>Compliant</td><td>Non-Compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">Banking information should be available for all account-holders.</td></tr>
<tr><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information.</td></tr>
<tr><td>Compliant</td><td>Largely Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Non-Compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">The rights and safeguards that apply to persons in the requested jurisdiction should be compatible with effective exchange of information.</td></tr>
<tr><td>Partially compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">Exchange of information mechanisms should allow for effective exchange of information.</td></tr>
<tr><td>Compliant</td><td>Largely Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td></tr>
<tr><td rowspan="2">Objective</td><td colspan="6">The jurisdictions` network of information exchange mechanisms should cover all relevant partners.</td></tr>
<tr><td>Largely</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td><td>Compliant</td></tr>
</table>

	compliant					
Objective	The jurisdictions` mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received.					
	Compliant	*Compliant*	*Largely Compliant*	*Compliant*	*Largely Compliant*	*Compliant*
Objective	The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties.					
	Compliant	*Compliant*	*Compliant*	*Compliant*	*Compliant*	*Compliant*
Objective	The jurisdiction should provide information under its network of agreements in a timely manner.					
	Largely Compliant	*Compliant*	*Compliant*	*Compliant*	*Compliant*	*Non-Compliant*

Source:(OECD Monaco, 2013; OECD Jersey, 2013);(OECD Guernsey, 2013);(OECD Cayman Islands, 2013); (OECD Isle of Man, 2013);(OECD British Virgin Islands, 2013)