THE USE OF TAX HAVENS BY CZECH COMPANIES IN CONDITIONS OF GLOBALIZATION

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Abstract. Nowadays, in the context of the ever-changing globalization of the world, the question of international tax relations becomes important. It is absolutely natural that business entities want to optimize their tax liability and seek ways to achieve this. In today's globalized world, with an easy way of remote communication, more and more business entities are considering optimizing their tax obligations using tax havens that are more tax-friendly and more accommodating than their home countries. Tax havens are carried away by movable subjects from domestic tax jurisdictions, and the state is therefore losing considerable sums that would otherwise become revenue to the state budget. In view of the increasing indebtedness of states, they are trying, together with international organizations, to fight against tax havens and to attract leaking entrepreneurs back or to increase their ability to remain through different tax advantages on the one hand or different legal constraints on the other. The article deals with an overview of measures that are acquired worldwide and also in the Czech Republic to combat the growing phenomenon of tax havens. An analysis of the development of the number and characteristics of Czech companies controlled from tax havens has been made. It further analyses the motives of companies for relocation into tax havens.

Keywords: tax havens, fight against tax havens, corporate income tax

JEL Classification: H87, H25, K10

1. Introduction

The elimination of trade barriers and almost uncontrolled capital movements are consequence of the process of globalization and market integration and capital placement is affected by tax burden besides other things. Businesses are trying to move their tax bases to countries with a more favourable tax policy. In general, this behaviour can be considered beneficial as it puts pressure on government expenditure cuts and greater efficiency in the state administration. But on the other hand, if this behaviour of economic subjects starts to prevail, it can endanger the tax revenues of states and their economic growth. Especially with the move of mobile factors, most states deal the question of how to eliminate their placements mostly in tax havens and advantageous tax preferential regimes.

1.1 Tax havens

Despite the frequency of occurrence of the notion of tax havens in various articles, scientific texts and publications, its official and uniform interpretation cannot be found. According to (Slemrod, 1998), the tax haven is all areas in which certain activities or assets or certain entities are not taxed. According to (Hines 2010), tax havens are countries or territories with very low or no tax burdens, a favourable legal environment, and a lower level of administrative and financial burdens during company formation and management. Dharmapala & Hines (2009) provide empirical support to the widespread opinion that tax havens are, above all, small, rich island countries with a population of less than 1 million and quality protection of property rights.

It views as predominantly negative in literature analysing the impact of tax havens on the world economic or national economics of individual states.

Hines (2010) emphasizes that tax havens provide an opportunity for international tax planning and promote tax evasion by multinational corporations which seek the reduction of the tax base in high tax jurisdictions. By attracting these activities, tax havens are involved in the erosion of the tax base and the loss of tax revenues of countries with high tax rates (Dharmapala, 2008).

Several authors have attempted to quantify the amount of tax revenue loss due to the existence of tax havens. *K*linger et al. (2010) reports that banks and multinational corporations pay $ 37 billion less for corporate income tax. Zucman (2014) states that tax revenue losses are primarily due to the transfer of profits and tax base. He estimates that transferred profit to low-tax states reduce corporate income tax by almost 20%. Janský & Prats (2015) report that multinational corporations with links to tax havens reported 1.5% lower earnings, paid 17.4% less on tax per unit of property and 30.3% less per unit of profit versus corporations unrelated on tax havens. Tax havens also allocate a high share of foreign direct investment (Dharmapala, 2008). According to Palan et al. (2010), approximately 30% of world foreign direct investment goes into tax havens. The negative effects of investments are pointed out by Myšková et al. (2013) as well.

Tax havens also contribute to rising income inequality in the world. Empirical studies show that the profits that multinational corporations move to tax havens are significantly higher in developing countries than in developed ones. Loss of tax revenue consequently limits the economic growth of these countries (Johannesen et al., 2016). Rose & Spiegel (2007) report that tax havens support tax evasion, money laundering or increased incentives to corruption in their countries of origin. With specific suggestions of how to combat tax havens deals e.g. Johannesen (2014), Novotný (2015), Konrad (2016).

Despite the fact, that individual countries fear tax havens, there are also opposing views that point out the benefits for countries with a high tax rate. Hines (2010) emphasizes that tax havens are small, but rapidly evolving economies with the potential to influence the economic activity of nearby countries through positive impulses. He states that countries that are close to tax havens are showing faster growth than the more distant countries. Desai et al. (2006) report that corporations that are using tax havens are expanding their activities near countries with high tax rates. Blanco (2009) notes that foreign direct investments in developing countries are positively correlated with the inflow of foreign direct investment in the nearest tax haven.

2. Use of tax havens by Czech companies and legislative measures

Table 1 shows that the number of Czech companies, which are often only formally controlled from tax havens, has been continuously decreasing since 2016. In the first half of 2018, the number of Czech companies in the tax haven reached 12,970. Compared to 2015, there was a decrease of 449 companies, which represents a decrease of 3.35 %. At present, 2,7 % of Czech companies are audited in tax havens.

In the monitored period most of the Czech companies were in Hong Kong (105 companies), Malta (78 companies), the United States of America (74 companies), great interest was in Cyprus with 69 new companies or Marshall Islands with 69 companies. We can only deduce the motives of a significant increase in the number of companies in Hong Kong and the United States of America. One of the reasons may be that some companies may not be able to withstand international competition in the Czech Republic and therefore their move abroad gives them the opportunity to expand to the international market, branding, prestige and thus profit. Interest in the United States can be expected mainly from companies dealing with information technologies and their applications. Another motive may be lower logistical and other transaction costs, provided the use of benefits of free trade zones, customs warehouses and areas. Hong Kong is primarily used for trading with China.

The most common motives for using tax havens will include tax motives. In his empirical study, Gumpert et al. (2011) confirms that higher tax rates mean higher tax probability in tax havens.

In 2016 there was a change and the number of Czech companies in tax havens began to decline. The largest outflow of firms occurred in the Netherlands, where 508 firms dropped in the first half of 2018 compared to 2015, and in Luxembourg, where there was a decline of 154 companies. The Netherlands is primarily known for its excellent law enforcement. In the past, the Czech Republic has often been criticized for poor law enforcement. If the reason for companies exit from the Netherlands is related to improving the legal environment, especially the protection of property and assets in the Czech Republic, it would be a positive trend.

Among other motives for leaving companies for tax havens can be classified anonymity and privacy. The Czech legal system requires companies to disclose certain information such as financial statements, owners and their business share. Revealing these data to the public may be misused by certain groups. Contrarily, the non-disclosure of the real owner of a company may be undesirable in certain cases due to the increased risk of corruption, money laundering and tax evasion.

Political instability can also lead to the uncertainty of business entities in future developments. It is not just about uncertainty about taxation but also about legislative changes that have a negative impact on society.

Table: 1: Number of Czech companies with owner of tax havens.

Country	2. Q 2018	Change 2018-2015	Change (%) 2018-2015	2017	2016	2015	2014
Bahamas	39	-2	4.88%	37	39	41	42
Belize	203	9	4.64%	196	203	194	161
Bermuda	5	0	0.00%	4	5	5	5
British Virgin Islands	367	-66	15.24%	384	414	433	452
Gibraltar	66	-6	8.33%	69	72	72	75
Guernsey (Great Britain)	19	-12	38.71%	23	25	31	28
Hongkong	202	105	108.25%	191	137	97	102
Jersey (Great Britain)	37	-6	13.95%	38	39	43	43
Cayman Islands	11	-9	45.00%	14	18	20	30
Cyprus	2220	69	3.21%	2205	2175	2151	2097
Liechtenstein	198	-27	12.00%	210	216	225	226
Luxembourg	914	-154	14.42%	929	968	1068	1120
Malta	301	78	34.98%	302	259	223	177
Monaco	70	9	14.75%	67	63	61	72
Marshall Islands	158	68	75.56%	150	133	90	55
Netherlands Antilles	9	-8	47.06%	9	13	17	15
Netherlands	3685	-509	12.14%	3755	3912	4194	4208
Panama	235	-12	4.86%	224	239	247	243
Man Island	33	-6	15.38%	32	34	39	40
Seychelles	779	-107	12.08%	803	873	886	827
United Arab Emirates	355	63	21.58%	342	313	292	270
United States of America	3064	74	2.47%	3047	3035	2990	2959
Total:	12970	-449	3.35%	13031	13185	13419	13247

Source: Bismad

Since tax havens represent a problem for a number of countries, which deprives them of tax revenues, this issue is dealt not only by individual states themselves, but it is primarily dealt transnationally. One of the most significant organization that acts against the profit transfer to preferential regimes and tax evasion is the OECD. The OECD has created a new standard in the form of automatic exchange of information between countries. This standard has been undertaken to apply by less than 100 jurisdictions by 2018 at the latest. The OECD also presented an action plan to combat base erosion and profit shifting (BASE – Base Erosion and Profit Shifting). This document contains 15 specific actions to be taken to ensure that states have the instruments and the ability to combat tax evasion. In the context of globalization, the European Union offers effective instruments for solving cross-border tax issues, consisting primarily of individual directives that are gradually applied by individual member states. The EU allows co-operation between tax authorities of individual countries in various ways and several expert groups have been established.

The Czech Republic has incorporated the following legislative measures in relation to cross-border taxation. It is council directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (2011/96/EU), on a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares in the assets of companies of member states (2009/133/ES), on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states (2003/49/ES) a directive on taxation of savings income in the form of interest payments (2015/2060/EU).

Other measures against tax evasion which seek how to prevent or at least limit the use of low-tax jurisdictions include (1) transfer pricing rules, (2) low capitalization rules, and (3) tax residence rules based on the concept of a true place of management. Transfer pricing demands that specific rules, defined as the principles of market distance are followed among all related parties of transactions. This principle requires prices in related party transactions to correspond to prices that would be agreed between independent persons in comparable business relationships. In cases where the transfer price is not defined as a market price and the accounting unit cannot substantiate any relevant economic reason, the tax administrator will adjust the tax base to the difference in prices.

Low capitalization rules are related to financial costs (interest and associated costs) on loans from associated parties. Costs are not tax allowable if the amount of debt to equity exceeds four or six times for banks and insurance companies.

International exchange of information (TIEA – Tax Information Exchange Agreement) is another very important instrument in the fight against international tax evasion. The international exchange of information is based on three forms of information exchange: exchange of information on request, provision of information on its own initiative and regular exchange of information. At present, the Czech Republic has concluded agreements on the exchange of information in tax matters with the following countries: Jersey, Bermuda, Man Island, Guernsey, San Marino, British Virgin Islands, Cayman Islands, Andorra, Bahamas, Monaco, Aruba, Belize and Cook Islands.

Other measures that can be included in the anti-tax evasion instruments are double taxation avoidance agreements. These contracts deal with collisions between domestic and foreign tax legislation. The Treaties lay down clear rules that allow only one taxation in the case of international investment and there is no double or multiple taxation in both the country of the owner and the country of investment. However, it is not at the discretion of a taxpayer to choose a country where his income or property will be taxed more favourably. At present, the

Czech Republic has concluded double taxation avoidance agreements with 88 states. There are also contracts that are concluded with states that are considered tax havens.

At present, tax changes related to cross-border taxation are being discussed in the Czech Republic, which should be reflected in the income tax act and the tax code. Tax laws will now include these rules: (1) rule for limiting the deductibility of borrowing costs, (2) rule for taxation at leaving, (3) rule for controlled foreign companies (CFC rule), (4) hybrid mismatches and (5) general rule against abuse of the tax regime.

The authors (Markle & Robinson, 2012) have empirically tested the CFC rules and confirmed that these rules prevent the outflow of tax revenue into tax havens, and it can therefore be expected to have a positive impact since its implementation into Czech tax law.

2.1 Discussion

Individual countries tackle the fight against tax havens, above all through the various international conventions and rules they have committed themselves to. The Czech Republic also gradually applies the relevant EU directives on cross-border taxation into its legislation. We see great potential in the form of signed agreements on the exchange of information in tax matters between the Czech Republic and the states that are considered tax havens. By observing set rules, transparency and co-operation of individual countries, the practice of tax havens will be prevented.

It is positive that there has been a turnaround in the number of Czech companies whose owner is based in tax haven. We can only deduce the factors behind this decline. In 2016, electronic revenue records and control reports were introduced. These instruments are restricting fraudulent practices that generate untaxed profits, which is later transferred into tax havens. In the Czech Republic there are many loopholes in which untaxed profit arises. Measures such as the implementation of property declarations, prohibition of anonymous shares or inheritance taxation is for much of the political spectrum unacceptable. Positive can be seen a change in the public procurement act, where companies based in tax havens have restricted access to public procurement. Among other instruments which would limit the resettlement of Czech companies in tax havens is primarily legislation. The Czech Republic is famous for its heavy administrative burden. It takes a leading position in the world in statistics measuring the administrative burden associated with tax obligations. Tax can be considered as another aspect. Any reduction in the already low corporate tax rates would seem to have led to anger from other European countries.

3. Conclusion

The existence of international capital in the global world contributes to the activity of tax havens. Tax havens are characterized by a low tax rate, discretion and unwillingness to work with the authorities of advanced states to combat tax evasion. The impact of tax havens on the global economy is difficult to assess. There is a negative attitude towards tax havens, but according to some authors tax havens have positive effect as they force national governments to become more effective. Individual countries tackle the fight against tax havens especially through the conventions and rules they have committed to. In the fight against tax havens, however, there is a need for a uniform definition that does not exist globally. For the definition of tax havens plays a role criteria, to which each state gives a different level of importance. Switzerland, Luxembourg are countries that are considered tax havens and at the same time members of the OECD, an organization that stands out against tax havens. The number of Czech companies registered in tax havens peaked in 2015 and has been steadily declining ever since. Time will show whether this trend is only temporary, or whether the measures taken by the Czech Republic will be effective and tax havens will be the past.

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