

OFFSHORE AREAS – THE KEY TO SUCCESS IN THE FISCAL REGIME

Economist Engineer Florin Ovidiu HURJUI
 “ tefan cel Mare” University, Suceava, Romania
 ovidiuh@seap.usv.ro
 Professor PhD. Gheorghe SANDU
 “ tefan cel Mare” University, Suceava, Romania
 sandu@seap.usv.ro

Abstract:

The main advantages of fiscal paradises result from the fact that: some countries do not demand any income tax, on capital plus values, on wealth; other countries have established a tax demand on the related incomes of a territorial base: if the benefits do not have their source on the territory of the respective state, there is no income; other countries still have low taxing rates; certain countries offer specific advantages for specific types of companies. The fiscal policy in Romania has been revised repeatedly, having a sinuous and unsteady character and, because of the created uncertainties (the high number of exceptions and exemptions) it has been less propitious for the business environment – and although, ironically, a lot of the operated changes and the granted exempts were supposed to have been destined to the stimulation of businesses.

Keywords: fiscal paradises, offshore companies, harmonization, fiscal facilities, fiscal competition, fiscal policy

JEL Classification: G100, O420, F430

INTRODUCTION

The main feature of fiscal paradises consists of not paying any tax to the local authorities (besides the authorization taxes) or the payment of extremely low taxes. This feature is tempting for economic agents from some countries with high taxation, among which Romania occupies a top position.

The existence of fiscal paradises puts pressure on tax rates, even if many actions against them have been carried out. Because reducing the rates cannot go on forever, the extension of the area of taxation is a solution, but neither this can go on without end.

Therefore, the European Union proposed that the fiscal paradises should give up their facilities for foreigners, but three European countries refused.

HARMONIZATION AND FISCAL COMPETITION

The harmonization and the fiscal competition are two elements which are completely opposed. The harmonization involves reducing compliance costs, transparency for the tax payers, fiscal neutrality, while the fiscal competition refers to, firstly, diminishing the fiscal pressure.

The fiscal competition manifests itself through the reduction of tax rates.

The compensation is achieved by increasing the tax base, the passage of the fiscal pressure on to direct taxes, but also reducing budget expenditures.

A lot of facilities which are found in internal regulations are not actually created for fiscal competition purposes (attracting foreign investments), but wish to be supportive elements to some activity sectors (preferential amortization in the case of Small and Middle Enterprises).

From the point of view of income tax, physical persons with a high qualification and which are indispensable to the good functioning of an economy, benefit from preferential fiscal regimes, in Romania in such a situation being the IT people [1].

Nowadays, according to the statistics of the Organisation for Economic Co-operation and Development (OECD), there are thirty five fiscal paradises in the world. The businesses performed thorough these have reached unimaginable proportions.

Economic analysts state that almost 70% of the world money mass is run from the shadows of the fiscal paradises. If, in 1978, American corporations transferred to fiscal paradises, under the form of direct foreign investments, capitals numbered at 23 billion US dollars, and the corporations of Western Europe paid in advance financial resources estimated at 160 billion US dollars, nowadays, at the beginning of the XXI century, the volume of capital operations run in paradise-countries are evaluated at 1,600 billion US dollars, as representatives of the UN claim.

Some American economists state that the turnover of the fiscal paradises would represent 50% of the world economy, unlike 5%, 20 years ago [4].

Firstly, these juridical entities offer fiscal advantages, compared to other fiscal entities, companies that set their head office or physical persons which reside on their territory. The purpose consists in attracting expanding companies, attracting capital and the stimulating the appearance of activities necessary to assure the economic and social balance.

The fiscal facilities used in achieving the followed goal are multiple: tax relief of incomes/profits made or applying extremely low rates. Another essential feature consists in protecting through a law the financial or commercial operations made by physical or juridical persons [2].

The fiscal advantages linked to relocating operations and profits from onshore to offshore are easy to understand.

Taking advantage of the fiscal legislation which favours these special states, the offshore companies and implicitly their owners, can obtain substantial savings from paying taxes owed to the state/states (source of income). There are however other types of benefits which can be accessed in offshore areas: [3]

- the elimination of currency exchange – usually, offshore companies can run their financial transactions in any currency and can keep their financial reserves in any currency, without any special permission;
- the lack of obligation to keep accounting evidences – a lot of fiscal paradises do not ask off-shore companies to keep accounting evidences which means substantial savings;
- Considerations related to prestige – many times, especially in transition economies or developing ones, a foreign company may benefit from more advantageous terms and conditions than a national company, an autochthon one. Moreover, the presence of “foreign capital” in a national society leads to the obtaining a better image of this society, to a trust in the international perspectives of this society, being able to assure in some cases tax reliefs.

In the case of offshore centres, besides the stable legislation and favourable taxation, other possible advantages of using these areas are: [5]

- exploiting the possibilities offered by the evolution of the treaty systems and of international fiscal agreements (the so-called “treaty shopping”);
- using the facilities offered by some states concerning the non-taxation of the interests paid to non-residents and protecting the assets (especially in the USA);
- using the almost 1,500 areas of free trade in the world.

These entities permanently adapt their taxation legislation in order to assure a privileged taxation regime, according to its evolution on an international scale. Let us not forget that the fact that some fiscal paradises dispose of *fiscal agreements in order to avoid the double taxation* of incomes with the industrialised countries.

What is sought through this is assuring the reduction of the taxes normally applied to foreign investments as opposed to the one applied in the signatory countries.

Other features concern: *developing a banking system* lacking in restrictive regulations and constraints, which assures the rapidity of the operations inside and outside the borders, *the absence/limitation of a control of currency exchange*, excepting the operations linked to foreign currency, as well *assuring some means of communication* (phone, Internet connection, air services) at a highly functional level.[2]

To attract international businesses and in order to be competitive at an international scale, these jurisdictions must come forth with new financial instruments and products and lower costs of financial services.

The question which may arise is that if these lower costs aren't obtained on behalf of some gaps in the banking regulation and supervising system of the taken risks. What's more, the states from which the physical/juridical persons come from which act in the offshore are as are interested to quantify the danger formed by these permissive jurisdictions for the national and international financial system.

The fiscal paradises present certain predominant features:

- the location in the immediate vicinity of seas and oceans;
- most of fiscal paradises are small states, just recently independent, or autonomous territories with an exotic setting and a small population;
- offer fiscal advantages, comparable with other legal entities, to the companies which establish their head office or the physical persons which have their residence on the territory of these fiscal paradises, having the purpose to attract expanding societies, to attract capital and stimulate the appearance of activities necessary to assure the economic and social balance;
- the protection guaranteed by the law of the financial or commercial operations made by physical or juridical persons;
- the bank secret;
- the lack of control over the currency;
- they permanently adapt their fiscal legislation according with its evolution on the international stage. [5]

The main advantages of fiscal paradises result from the fact that: some countries do not demand any income tax, on capital plus values, on wealth; other countries have established a tax demand on the related incomes of a territorial base: if the benefits do not have their source on the territory of the respective state, there is no income; other countries still have low taxing rates; certain countries offer specific advantages for specific types of companies (for instance holdings, exempt companies, etc.)

The purpose of using the fiscal paradises is simple: „pay less and earn more” [1].

In the conditions of globalization and integration of the financial markets, the problems of an institution located on an offshore can have repercussions on certain elements of the financial system situated in any part of the world.

For instance, an onshore bank which establishes a subsidiary in an offshore must be capable to control the risks taken by the bank from the offshore.

The latter could take up too big risks, in the absence of the regulation and supervision of the banking system in the jurisdiction of registration, risks which wouldn't have been accepted in the onshore jurisdiction of the mother-bank. If a great part of the risk of a bank system is located in an offshore, then the viability of the entire system could be compromised, enhancing the risks of the mother bank.

All these mentioned features contribute to the creation of a setting just right for the development of economic operations with or without fiscal motivation, the only condition being the compatibility with the legislation of these territorial entities.[5]

Considering the profit taxation, Romania could also be viewed as a fiscal paradise. Because 16% is a low taxation margin. We can affirm that the Romanian state cannot decrease any more taxes, but on the contrary, it will increase them. The 16% regime is very advantageous for the type of economy Romania has. Still the 16% has been a good way to attract the underground economy to the surface, because it is easier to pay this percentage than tormenting one's self to find solutions.

Offshore companies are, generally, viewed as illegal fund hiding places. Still, if they are established and correctly managed, they can assure substantial fiscal savings, remaining, at the same time, at the edge of the law. On a developing market, but without too many specialists, it is predicted that the number of offshore companies established by Romanians will grow every year, as

the world will realise that the intelligent use of such a company can reduce, postpone or completely eliminate some taxes which would otherwise have been paid.

CONCLUSIONS

The fiscal policy in Romania has been revised repeatedly, having a sinuous and unsteady character and, because of the created uncertainties (the high number of exceptions and exemptions) it has been less propitious for the business environment – and although, ironically, a lot of the operated changes and the granted exempts were supposed to have been destined to the stimulation of businesses. The fiscal policy has also suffered from the impact of an economy marked by structural tenseness.

Romania has known a considerable decrease in budget revenues. In this sense, Romania seems to be a particular case, having fiscal revenues and non-fiscal revenues which vary around 30% of the GDP, whereas the countries in transition from Eastern Europe and the Baltic area have the same types of budget revenues at 40%. Generally it can be assumed that these countries (where the reform is much more advanced) have a better fiscal system and a superior tax collection. The reasons which lie at the basis of this situation have their roots in: the quality of the public administration, the capacity to implement rules and regulations, the transparency level, the inclination of the companies to avoid taxes and to act in the underground economy, the intensity of the battle against corruption (having the effect of reducing tax evasion) and last, but not least, the structure of the fiscal debts.

The rates of the taxes in Romania are generally comparable with the mid level from the other countries of Central and Eastern Europe. This state of things points out what should the fiscal policy achieve.

On one hand, the alignment of the fiscal structure must be continued with a firm grip; this would lead to the widening of the tax base and improvement of tax collection.

The fiscal policy will coherently follow the acceleration and deepening of the reform in this domain, which will materialise in the reduction of the taxation degree, both through the abolishment of the contributions to some special funds, and also through the resettling of the fiscal burden and the ratio between the direct and indirect taxes, to encourage work, saving, investments, exports through:

- the full exempt from paying customs taxes and VAT for the import of machines and equipments, raw materials and materials destined to modernise the SME.
- the revision of the instalments and tax rates of the population's money incomes both to stimulate the work process, in the purpose to grow and strengthen the middle class, and to increase the buying power of persons with low incomes;
- the strengthening of financial discipline, both through the stimulation of payment on time and in the legal quantum of the budgetary obligations of the economic agents, and through the firm punishment of bad tax payers.
- the increase of transparency and understanding of the fiscal administration towards the tax payers by simplifying the procedures and the taxation documentation.
- the full exempt from paying customs taxes and VAT for the import of machines and equipments, raw materials and materials

Also, it is compulsory that the source of inspiration for the new laws should be the present legislation of the European Union, a proposal justified by the fact that Romania is in the course of accession, as a member with complete rights to the European Union. This is why:

- the fiscal facilities, once granted, shouldn't be withdrawn; the unpredictable and unstable character of the taxation system should be eliminated.
- the mechanism which sets taxes, like the one which collects these must be optimised in order to eliminate arbitrary interpretations, prolonged procedures and frequent and aggressive audits;
- the elimination of the double checking of the companies; the Romanian legislation should foresee that once the authorities have carried out a tax audit of a company, the audited periods and aspects shouldn't be subjected to further investigation.

The official strategy in the taxation domain is like a nebulous and is contrary in many aspects to the programmatic promises made. On the other hand, the increase of the VAT rate is a measure that risks to encourage practices related to the underground economy , favouring tax evasion, corruption, precisely those phenomena which the authorities presently deal with.

The increase of the VAT will trouble the categories of the population with small incomes, which even so couldn't benefit from the introduction of the single tax rate and which will be forced to support new and unjustified price increases.

The governments are now trying to thaw the crediting, strengthen the financial institutions, reduce the interests rates, to toughen the safety nets and revive the consume and investments – all these to stimulate businesses which provide jobs for the people, but also to build the foundations for a future growth. These steps will be as effective as the respective states will act together, in a way that allows mutual support. Economic nationalisms, which seek to obtain profits from the misfortune of others, will generate even more risks. Global challenges demand global solutions.

As the world emerges from the present financial and economic emaciation, we must look forward. Today's crisis reflects the extraordinary speed as a feature of an interconnected world. The factors which produced globalization offer more opportunities of overcoming poverty, of increasing the chances and opening of societies.[3]

BIBLIOGRAPHY

1. Filip, Gh. (2007), *Finan e Publice II*, Suport de curs, anul II, semestrul II profil tiin e Administrative, specializarea Administra ie Public , anul universitar 2007 -2008.
2. Minea, M. t., Costa , C. F. (2006), *Fiscalitatea în Europa la începutul mileniului III*, Editura Rosetti, Bucure ti.
3. Mo teanu, T., Catarama, D., Tâtu, L., Câmpeanu, E. (2005), *Politici fiscale si bugetare europene*, Editura Universitaria.
4. <http://www.romanialibera.ro/a142880/modernizarea-multilateralismului.html> accesat decembrie 2008
5. Sandu, Gh. (2007), Buget i fiscalitate în rile Uniunii Europene, Note de curs, Universitatea „ Ștefan cel Mare” Suceava.