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TAX AVOIDANCE FOR RESIDENT BUSINESS BY ESTABLISHING OFFSHORE COMPANIES

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Rezumat

Pana in prezent au fost dezvoltate o multitudine de servicii offshore pentru a acoperi diversele nevoi ale afacerilor. Industria offshore a ajuns sa fie o afacere la nivel global raspandita in toate colturile lumii acoperind mai mult de aproape jumatate din tranzactiile financiare globale. Companiile offshore sunt o solutie pentru toti cei care planifica dezvoltarea afacerii si reducerea impozitarii.

In ultimii 20 de ani, cererea crescuta a clientilor pentru facilitati offshore de cele mai multe ori a generat instabilitate politica si economica, globalizarea pietelor, regimuri cu taxe crescute si o mai eficienta recuperare a taxelor. Clientii deseori intreaba care zona offshore este cea mai buna pentru infiintarea unei companii. Raspunsul depinde in cea mai mare masura de modul cum intentioneaza a fi folosita aceasta companie offshore si de motivatia personala sau de afaceri a clientului.

Cuvinte cheie: paradisuri fiscale, profit, taxa, venituri, globalizare

Abstract

Until nowadays, a wide spectrum of offshore services satisfying various business needs has been developed. The offshore industry has turned into a global business, and reached all corners of the world, covering about a half of the world's financial transactions. The offshore companies are a solution for everyone who is planning new activity and are interested in business development and tax reduction.

Over the last twenty years, increasing client demand for offshore facilities has mostly resulted in political and economical instability, market globalization, high tax regimes and more effective tax recovery. Clients often ask which offshore area is the best for company incorporation. The answer really depends on the intended use of the offshore entity and the client's own personal or business reasons.

KEYWORDS: offshore (tax heaven), profit, tax, revenues, globalization

JEL Classification: H32 – Firm

1. INTRODUCTION

Offshore¹ companies are those companies who operate outside the economic territory of the state in which they reside, and do not achieve income in the country where they have been registered. Theoretically speaking, offshore companies can be set up in any country in the world, but they can't obtain everywhere tax advantages. Locations are usually represented by small countries, geographically speaking, with low population density, and where tourism and various services play the main role in the economies of these countries providing substantial revenues to these countries. On the one hand, jobs are created, because they require the existence of law firms, registration state institutions, registered banks in those territories, and on the other hand, as a result of payment obligations toward the State (taxes and registration and re -registration) and duties the population obtains a considerably income. (E.g. British Virgin Islands have 17,000 inhabitants, and currently in this country approximately 460,000 offshore companies are registered. If all this registered companies from this area pay an annual duty of 300 USD, then only the fees paid by offshore companies are 8000 USD per capita. (9_Motives_for_setting_up_an_off-shore, (n.d))

2. WHY GO OFFSHORE?

There are several reasons to set up an offshore company (Bisa, 2006), of which we are mentioning the most important, reasons to which we can look at as benefits, namely:

- **low fees or even lack thereof** – the location of the company's administration generates or not the obligation to pay taxes. If it is clear that directors and shareholders of a foreign company are registered on the local market, the foreign company's revenues will be considered as income of some national owners and, consequently, will be taxable;
- **confidentiality and anonymity** - the offshore company is used as a third party engaging transactions within the local market. In this case, the 2 companies should not have the same

¹ According to the yearly dictionary of the "The Economist" magazine, the offshore companies are companies registered in certain countries or jurisdictions which have a fiscal law either without taxes, or with very low taxes as long as the company doesn't operate within the country where it is registered; according to the British specialized language the term designates the territory located beyond shore. Tax heaven (engl.) - in free translation means fiscal paradise and represents those administrative-territorial units which provide very favorable conditions for capital development and for .

director (s) whereas the same person cannot sign an agreement between 2 companies as a director of both. Anonymity cannot be obtained once the company has been registered with its real owners, and the documents in which the shareholders and directors are recorded are filed in. If a company is registered as anonymous, and the owners, at a given time, chose not to be anonymous anymore, the structure cannot be changed at anytime;

- **lack of currency control**- the company operates in a nonrestrictive banking system, may receive funds either in cash or in another form, 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. **diversifying the object of activity without restrictions** – formalities for diversification of a company's activities are carried out without too much bureaucracy, big corporations seeing the offshore centers as something essential for their expansion on the new markets at competitive costs.
- **hiding the origin of goods** - businessmen hide the origin of goods by changing the packs in the free zones, later having the origin in the country which organized the free zone, becoming more easily selected by consumers.

3. TAXATION AND FEES

Traditional tax havens are located on islands (e.g. Isle of Man, UK), in archipelagos (eg British Virgin Islands, Nauru), small countries (eg Panama), and principedoms (San Marino, Liechtenstein and Andorra) or within large countries, usually near water crossings, near airports etc. All these areas, territories or regions encourage foreign investors in setting up offshore companies, based on an independent legislation, valid only in those areas.

International companies use offshore entities to manage their profits toward them and to conduct their business so as to pay less tax. Many companies choose to register their companies in countries with privileged tax regime, where they either don't pay tax on income, or they pay less than in the country of origin (Dobrescu, 2009). It may be that in certain business situations a foreign company could offer more favorable terms and conditions. Participation of a "foreign investor" in a normal business sometimes creates a considerably greater confidence in the potential business partner, or, in some cases, even exemption from import duty. Substantial savings are achieved by offshore companies because they are not required to prepare accounting records, common companies of similar size (non-offshore) spending annually hundreds or even thousands of dollars on accounting fees. The offshore companies can carry out financial transactions in any currency and can maintain financial reserves in

any currency without special permission.

Depending on the prevailing tax system, tax heaven can be classified into three categories: countries in which the income made abroad are totally exempt from tax, paying a fixed annual fee (e.g. Virgin Islands, Belize, etc.), countries where the standard base rate is not the achieved profit, but the value of social capital (e.g. Stiftung in Liechtenstein due to a tax equal to 0.1% of the capital, but not less than 1,000 Swiss francs) and in countries where a fixed income is established (e.g. in Cyprus, offshore companies pay a tax of 4.25% from the profit made, accounting and preparation of annual reports being mandatory) (Offshore companies enter too easily in Romania (n.d.) Journal of Curierul National, Year 14, nr. 5375,(2009, March 09)).

It is important to understand correlations between causes and effects of tax laws. One of the important issues regarding offshore companies is represented by location of the company's administration. Most offshore companies should possess some sort of board of directors which is usually the Board. Directors must have residence in a country, which means they are residents of the country. In some states tax law assumes that an offshore company is conducted from the country in which directors are residents and consequently, the company has permanent address in this country and any revenue related to it are taxable. In general, a more favorable situation concerning the tax laws related to whether the company is officially administered by a person residing in a territory where an exemption of the tax is applied, or where there are tax benefits (Sark, Cyprus, etc.) (Manaila, 2007)..

The simplest lesson of avoiding tax payment is brokering the export or import of goods. Companies can use the advantages of agreements to avoid double taxation or benefits arising from EU directives. The profit of a company can increase by approximately 10-14% if they register an off-shore. If an import is made at a price with 30-40% less, the bill is passed through the offshore company, then regenerated and the revenue of 30-40% is added and finally the bill is issued to the parent company in Romania. This way the profit of 30-40% will be taxed in off-shore companies and the duty can vary from a fixed fee up to 10% fee. The tax levy of the profit is 10% in Cyprus, and the fee for the registered office and the registered agent is 900 dollars. In other tax heavens, such as Belize or the Seychelles, annual fees are fixed and are between 800 and 1,000 dollars.

In Europe, most powerful economies promote advantageous tax regimes for certain activities. Austria, England, Belgium, Denmark, Switzerland, France and Sweden are some of them.

By interposing an offshore company in commercial transactions, the resulting profits can be distributed toward the company and thus can accumulate in a jurisdiction with low or even zero taxes.

Basically, there are situations when the revenue obtained from activities developed in Romania, that falls within the 16% tax quota, is charged in the State where the offshore company is registered and where a lower tax applies. We must take into consideration the existence of treaties which avoid double taxation between Romania and the State where the future offshore company will be registered. A company A from Romania bills 200,000 products to a country in the EU (B), 1.000 lei each, and the price of delivery is 2.000 lei. If the transaction would be made directly by the company from that country, the gross profit achieved in our country from this transaction, that is 200 million lei, the tax would be of 32 million lei.

In the case where in the business enters an offshore, which is obviously controlled by the Romanian merchant (A), the tax on income would be nearly zero. The Romanian company (A) sells to the offshore company (C) at a price of 1.001 lei, after which the intermediary registered in a tax heaven resells the products to the importer from the EU (B) at a price of 2,000 lei. The returns for the Romanian state from this affair are only of 50,000 lei. Instead, the offshore company, registered in Cyprus for example, is taxed by 10%, which means a tax equivalent to 20 million lei. So the earnings of the Romanian company (A), only by this inclusion of an offshore intermediary, would be of 12 million.

Some tax heavens available to Romanians are:

- Delaware (USA) - Income tax at the state level, 0%, U.S.A having a treaty to avoid double taxation with Romania, and non-resident companies which don't operate in the U.S. don't pay federal taxes;
- UK income tax is between 10 and 30% standard social capital - 1,000 pounds (1.310 Euros), the tax can reach to 1-2% per turnover for trade in goods; Holdings registered in the UK may distribute dividends to parent-company set up in a tax heaven in the Caribbean or Pacific, where the charge is zero;
- in Malta, the Companies which don't have resident shareholders have the tax rate of 4.17%, the holdings having a tax rate 0% for a \$ 1500 (980 euro) capital, the owners can be anonymous, the registration is made through mandatory companies.
- In Cyprus, EU member country, the income tax is 10%, the companies that have no resident directors and do not achieve income in Cyprus are exempt from tax, social capital – 1.000 Cyprus pounds (1,640 Euros);

The role of the offshore company should be to provide associates with the opportunity to benefit from a more advantageous tax or give anonymity, but under normality conditions and contractual honesty and

not at all with the intention of starting a fraud and a non-paying debts activity.

4. CONCLUSIONS

Companies registered in tax heavens create, in general, big problems for the authorities in the countries where they develop their activity. In many cases, the offshore firms are members / shareholders in companies registered in Romania, and in which case the funds are placed within the country, mainly through loan contracts. In other cases, the funds are integrated into the economic-financial system in Romania through the use of some commercial contracts and invoices for import / export, sale-purchase of services (especially counseling) or intangible assets or trading of buildings or even of some business.

Often involved in money laundering or crimes which underlie these activities the offshore companies introduce their illicit funds in the State where "lucrative facility " is, either through some loan contracts or by the sale of intangible assets. Services offered by the offshore companies are difficult to quantify. There are cases in which the transfer of funds is made based on a "ghost" contract, rendering services, are almost impossible for the control authorities to prove that those services were never actually rendered.

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