

Tax competition:

a legal and economic perspective

Richard Teather

Bournemouth University

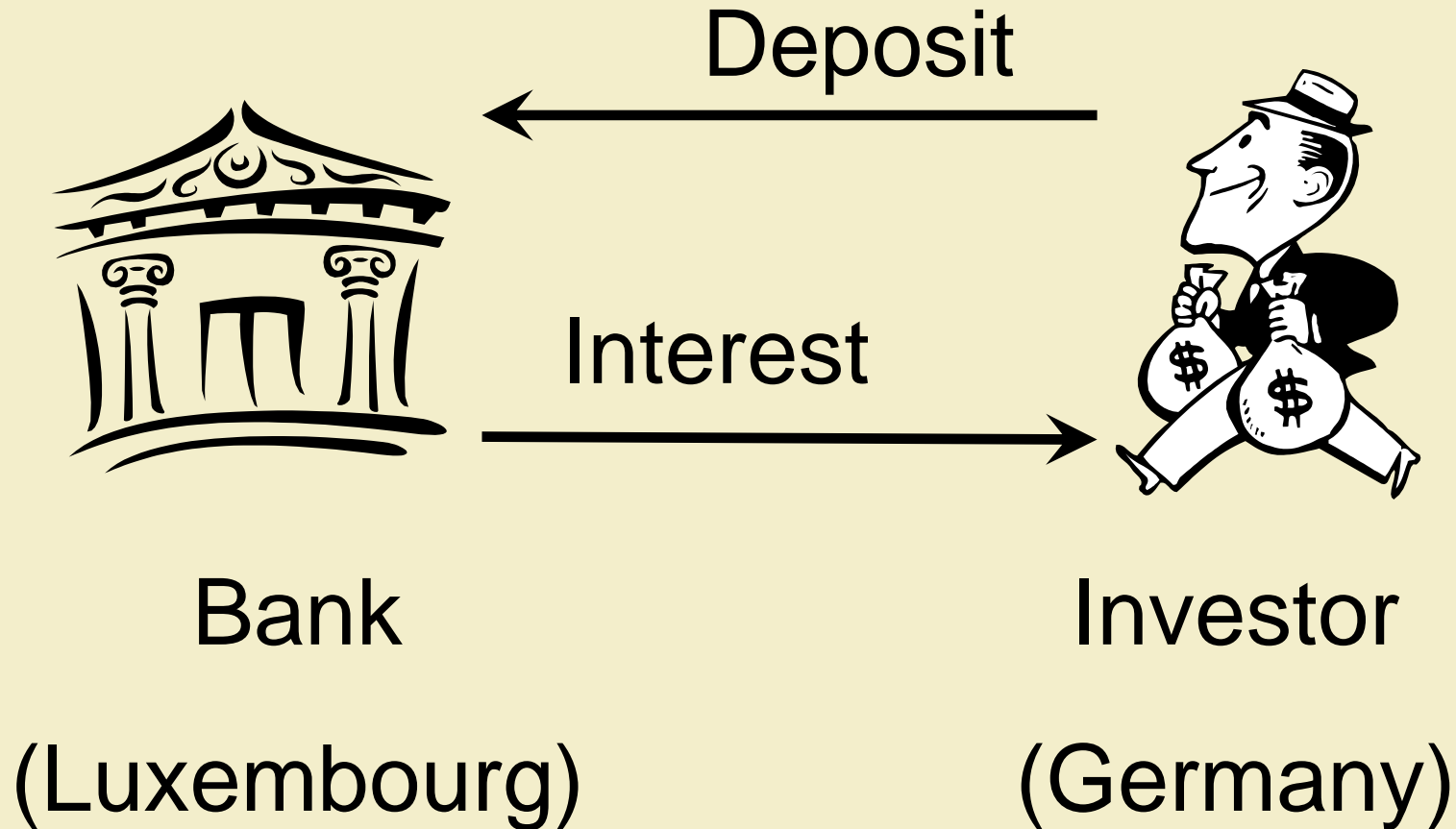
Tax competition

the **use** by governments
of **low effective** tax rates
to **attract**
capital or business activity

Tax haven activity



Tax haven activity



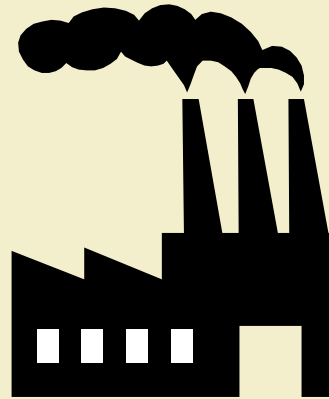
Tax haven activity

Profits

300

Tax 30%

(90)

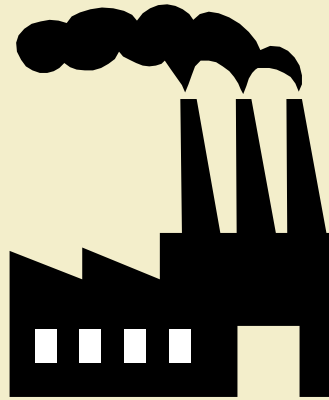


Operating Co.

(UK)

Tax haven activity

Profits	300
Premium	<u>(100)</u>
Net profit	200
Tax 30%	(60)



Operating Co.
(UK)

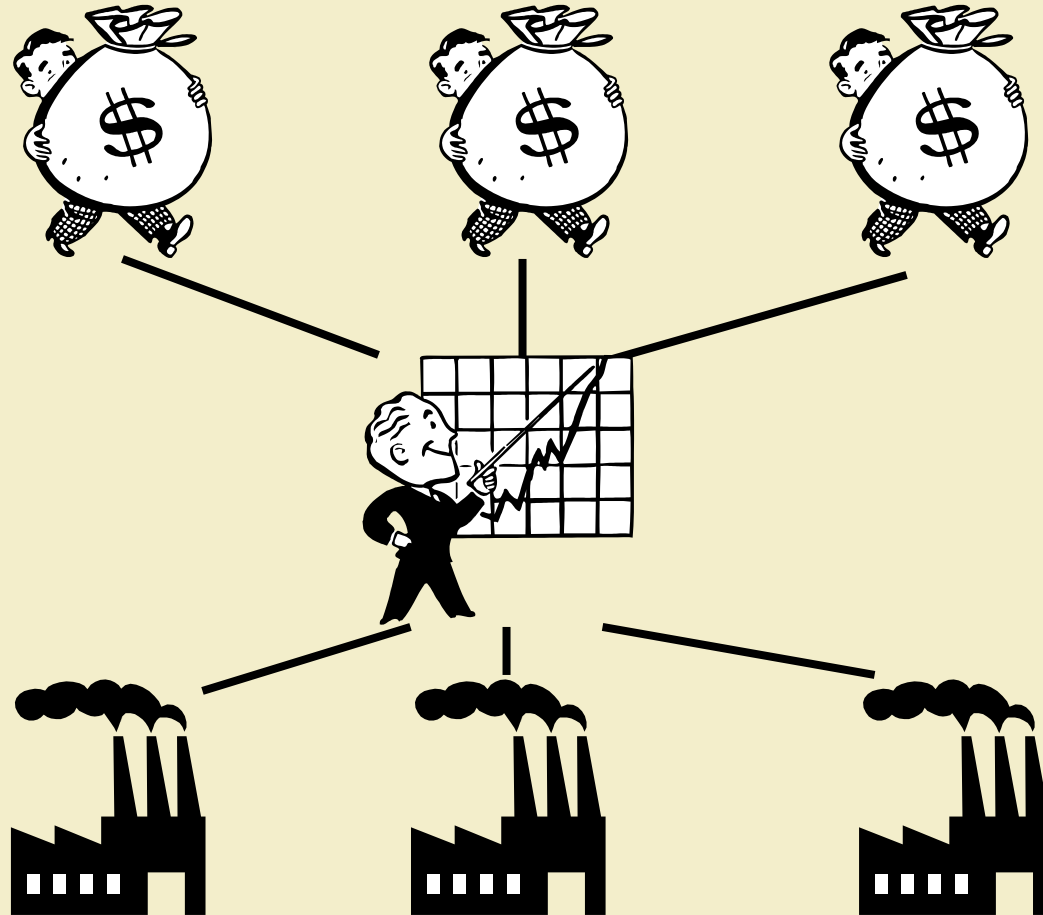
Profits	100
Tax 0%	0



Captive insurer
(Guernsey)



Tax haven activity



Benefits of tax competition

- \downarrow taxes = \uparrow wealth

Benefits of tax competition

- \downarrow taxes = \uparrow wealth
- encourages entrepreneurship
- encourages savings & investment
- encourages work
- encourages inbound investment

Benefits of tax competition

75
VAT (12)
Tax (25)
38

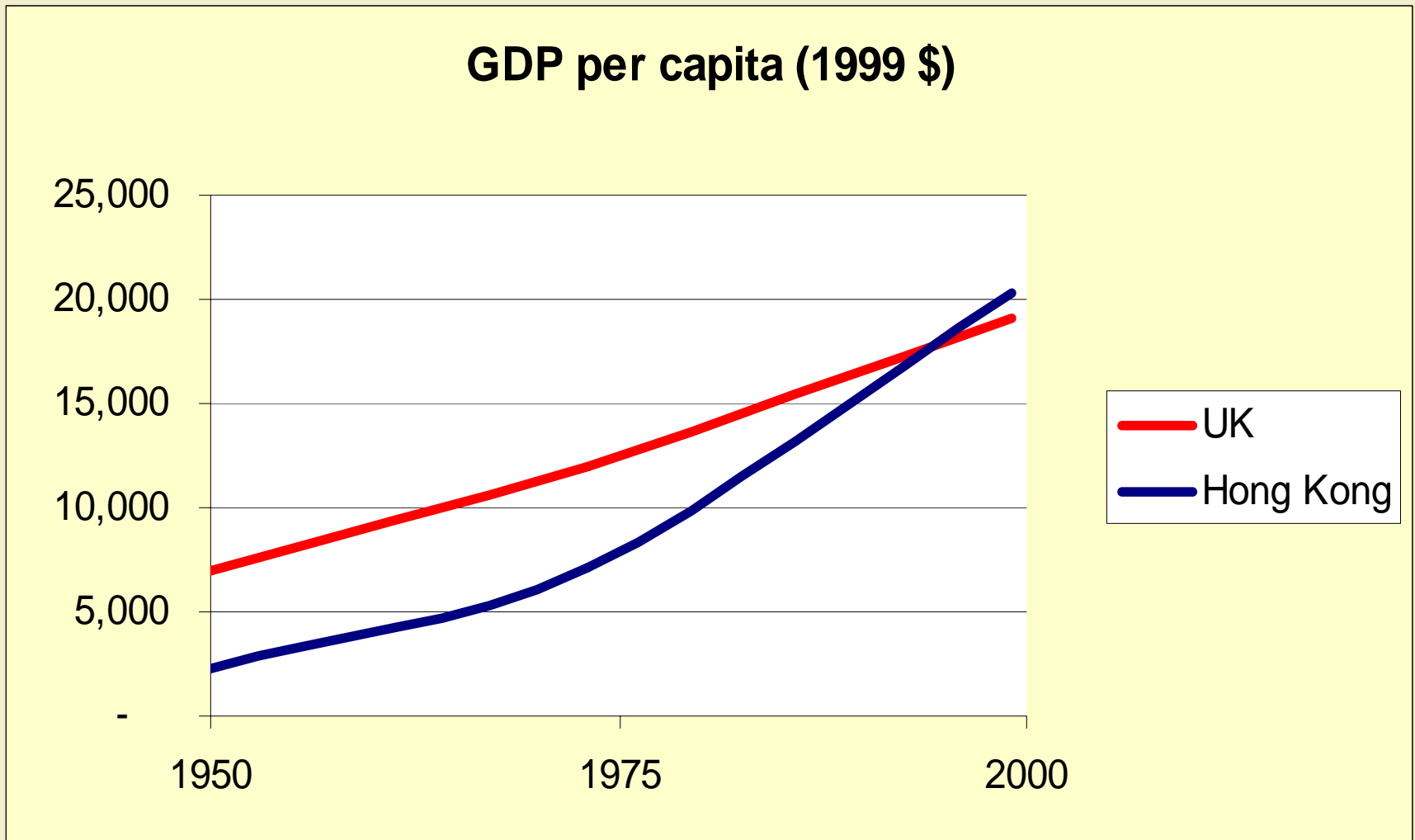


20
Tax 13
NI 4
VAT 7
44

Benefits of tax competition

- Luxembourg
- Bermuda
- Jersey
- Equatorial Guinea
- United Arab Emirates
- Norway
- Guernsey
- Ireland
- USA
- Cayman Islands

Benefits of tax competition



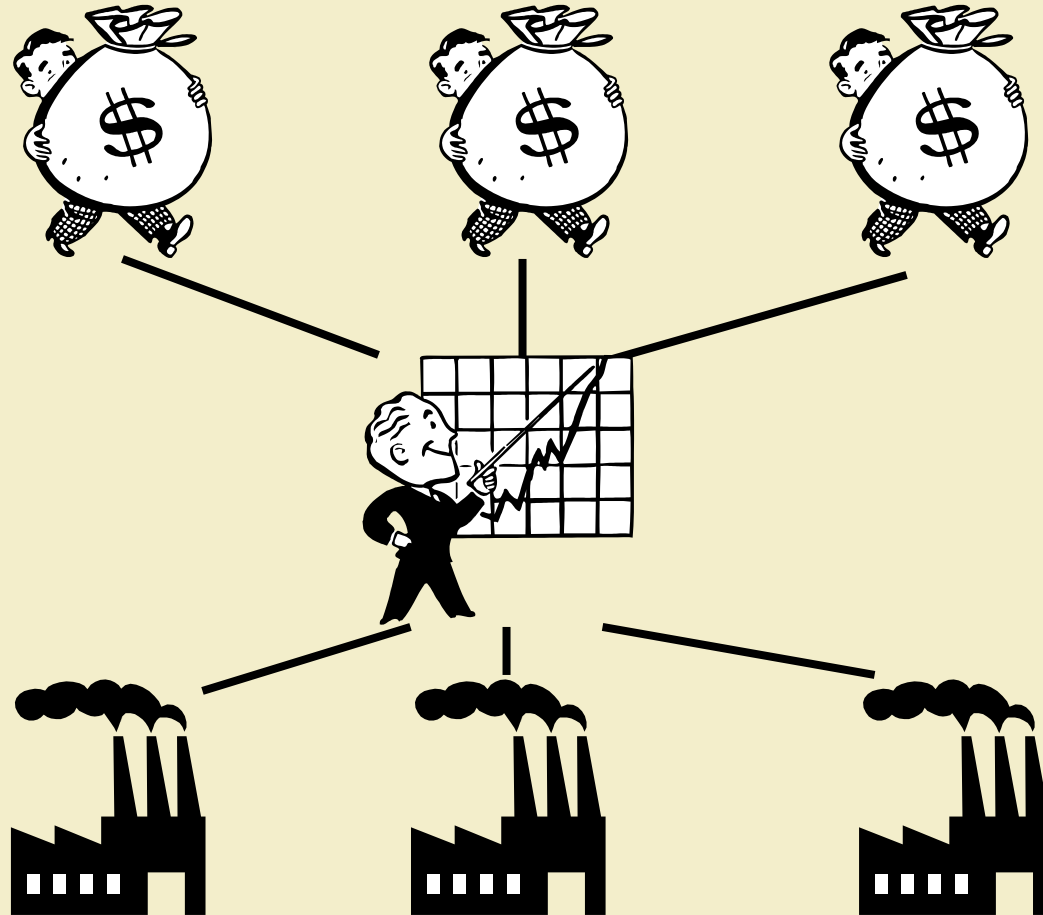
Benefits of tax competition

- \downarrow taxes = \uparrow wealth
- Governments made more efficient

Benefits of tax competition

- \downarrow taxes = \uparrow wealth
- Governments made more efficient
- Efficient global capital markets

Efficient global capital markets



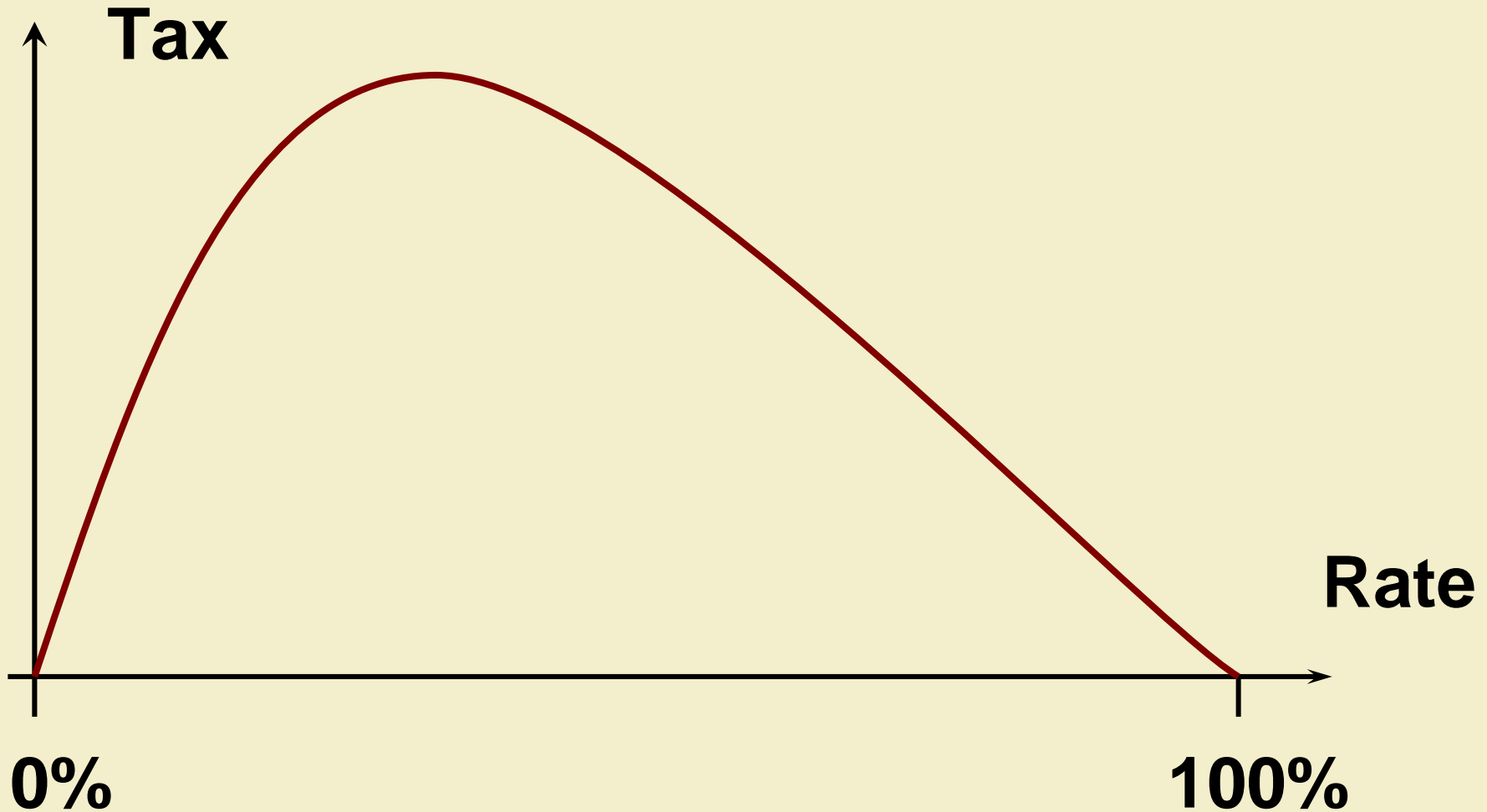
Benefits of tax competition

- \downarrow taxes = \uparrow wealth
- Governments made more efficient
- Efficient global capital markets
- Businesses made more efficient

Government objections

- **Immediate loss of tax revenues**

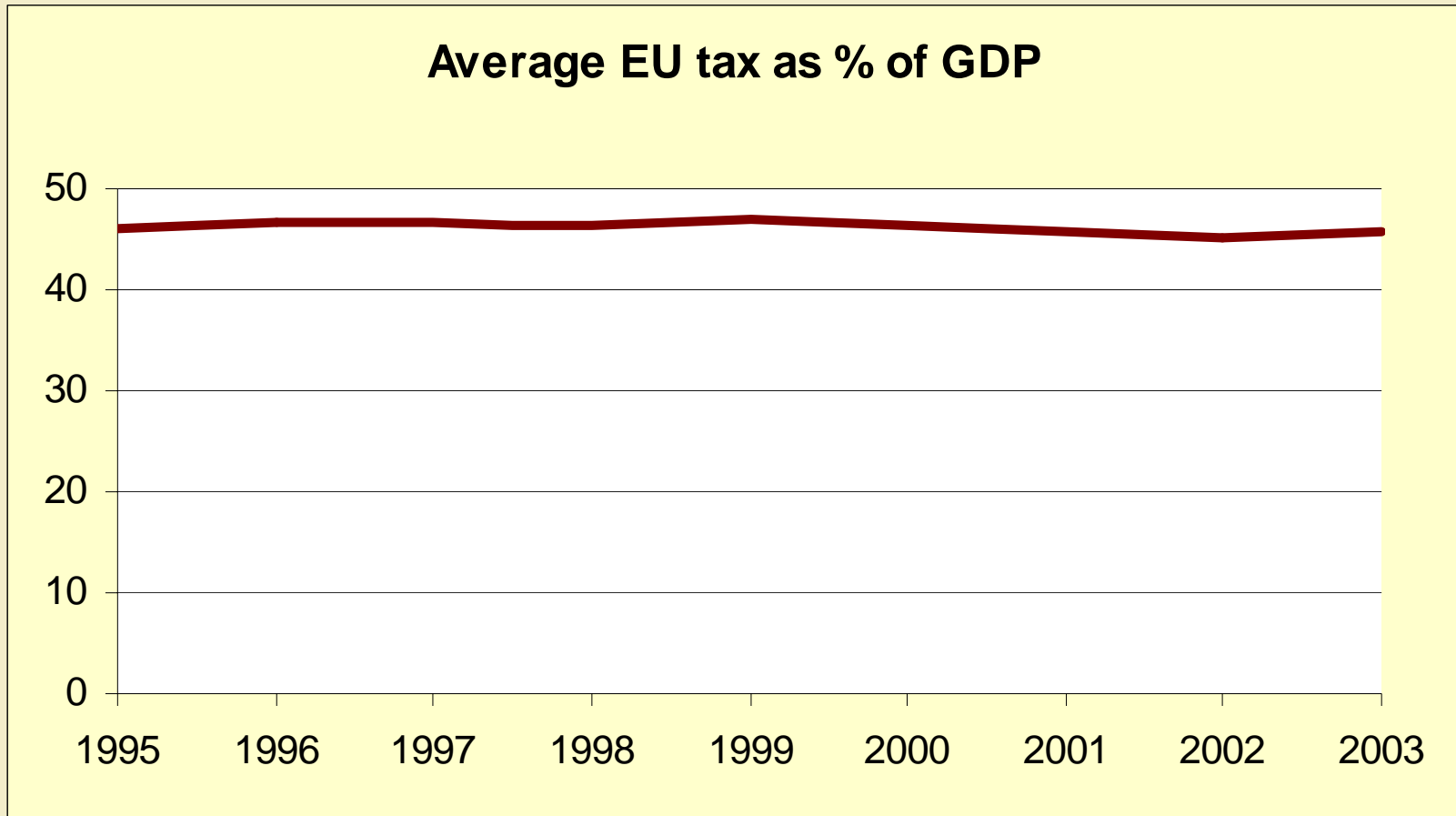
Laffer curve



Government objections

- **Immediate loss of tax revenues**
- **Spiral of competitive reductions**
 - “race to the bottom”

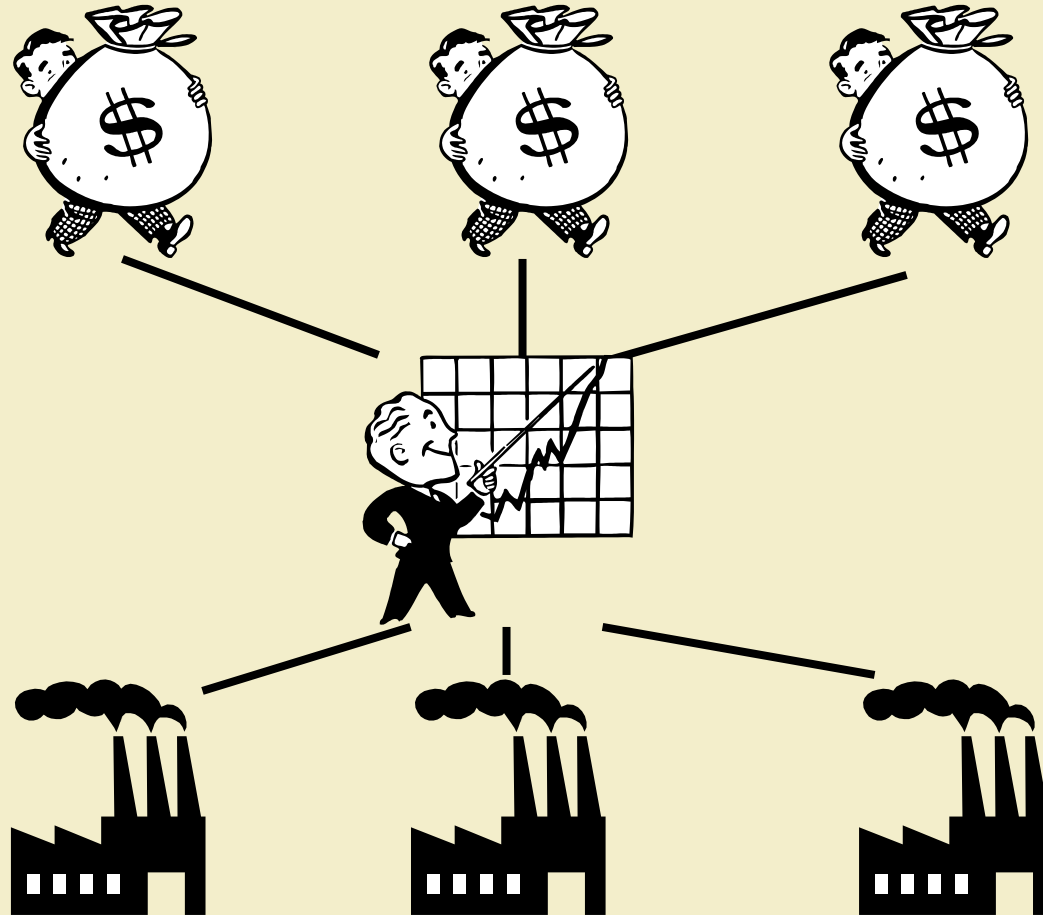
Race to the bottom?



Government objections

- **Immediate loss of tax revenues**
- **Spiral of competitive reductions**
 - “race to the bottom”
- **Distortion of investment**
 - shifts capital to low tax regimes

Tax haven activity



Government objections

- **Immediate loss of tax revenues**
- **Spiral of competitive reductions**
 - “race to the bottom”
- **Distortion of investment**
 - shifts capital to low tax regimes
- **Loss of effective tax sovereignty**
 - tax increases difficult

Harmful?

- Assumptions:
 - Without tax competition, Governments would set taxes at optimal level
 - Therefore tax competition leads to sub-optimal tax levels

Harmful?

- Assumptions:
 - Number entrepreneurs constant
 - International capital constant
 - Taxes democratically approved
 - Governments perfectly efficient

National anti-avoidance

- Worldwide tax basis
 - Look-through for funds
 - needs information
- Transfer pricing
 - restricts, doesn't prevent
- Place of management
 - CFC rules
 - challenge, not a barrier

EU dimension

EU dimension

- “national economic and social policies are built on shared values such as solidarity and cohesion ...

European citizens have greater expectations of the state than their equivalents in Asia or America”

- EU is underskilled, and is losing skilled workers to the USA

Supra-national action

- OECD
 - Harmful Tax Practices initiative
- EU
 - State Aid
 - Savings directive
 - Code of Conduct

Objectives

- OECD
 - “to counter the distorting effects of harmful tax competition ... and the consequences for national tax bases”
- EU
 - “measures which ... may affect ... the location of business activity”

Tax haven

- OECD:
 - Low (or zero) effective tax rate, plus
 - ring-fencing
 - lack of transparency
 - lack of information exchange
- EU:
 - “significantly lower effective level of taxation” than “generally” applies in that country

Harmful?

- OECD:

shift[s] activity from one country to the country providing the preferential tax regime

- Successful?

- **Largely neutralised by “level playing field” condition**
- Antigua & Barbuda:

Those jurisdictions, including OECD Member countries ... that fail to ... satisfy the standards of the 1998 Tax Competition Report, will be the subject of a framework of co-ordinated defensive measures



EU State Aid rules

- Prevents business subsidies
 - includes low effective taxes, IF targeted at specific sectors
- Scope - EU only
- Ireland:
 - 30% standard, 10% finance x
 - 12% standard ✓

EU Code of Conduct

- “significantly lower effective level of taxation” than “generally” applies in that country
- Scope:
 - EU
 - associates & dependencies
- Havens moving to *general* 0% rate

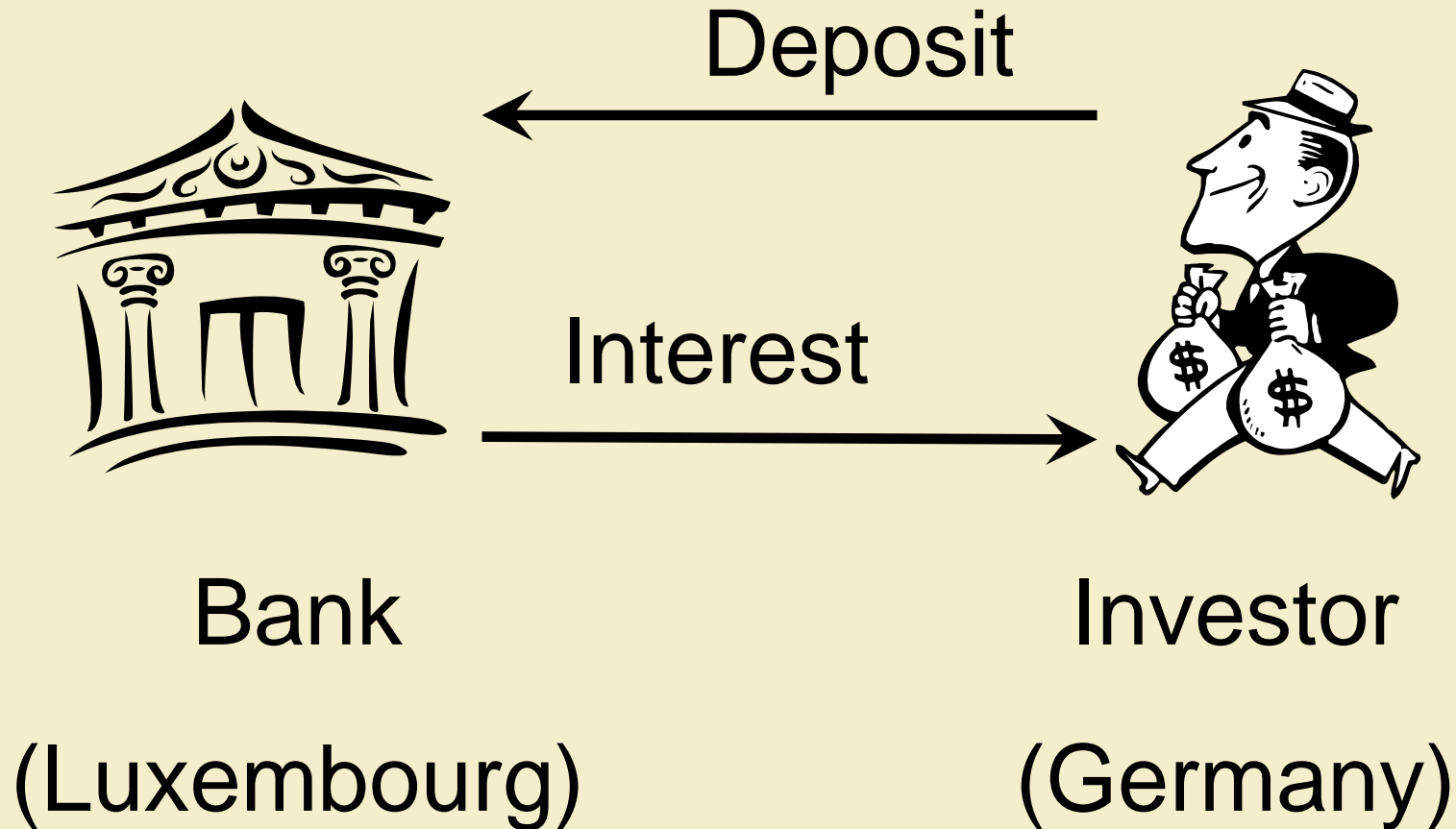
EU Code of Conduct

- “significantly lower effective level of taxation” than “generally” applies in that country
- Jersey:
 - 20% standard, 0% exempt 
 - 0% standard 

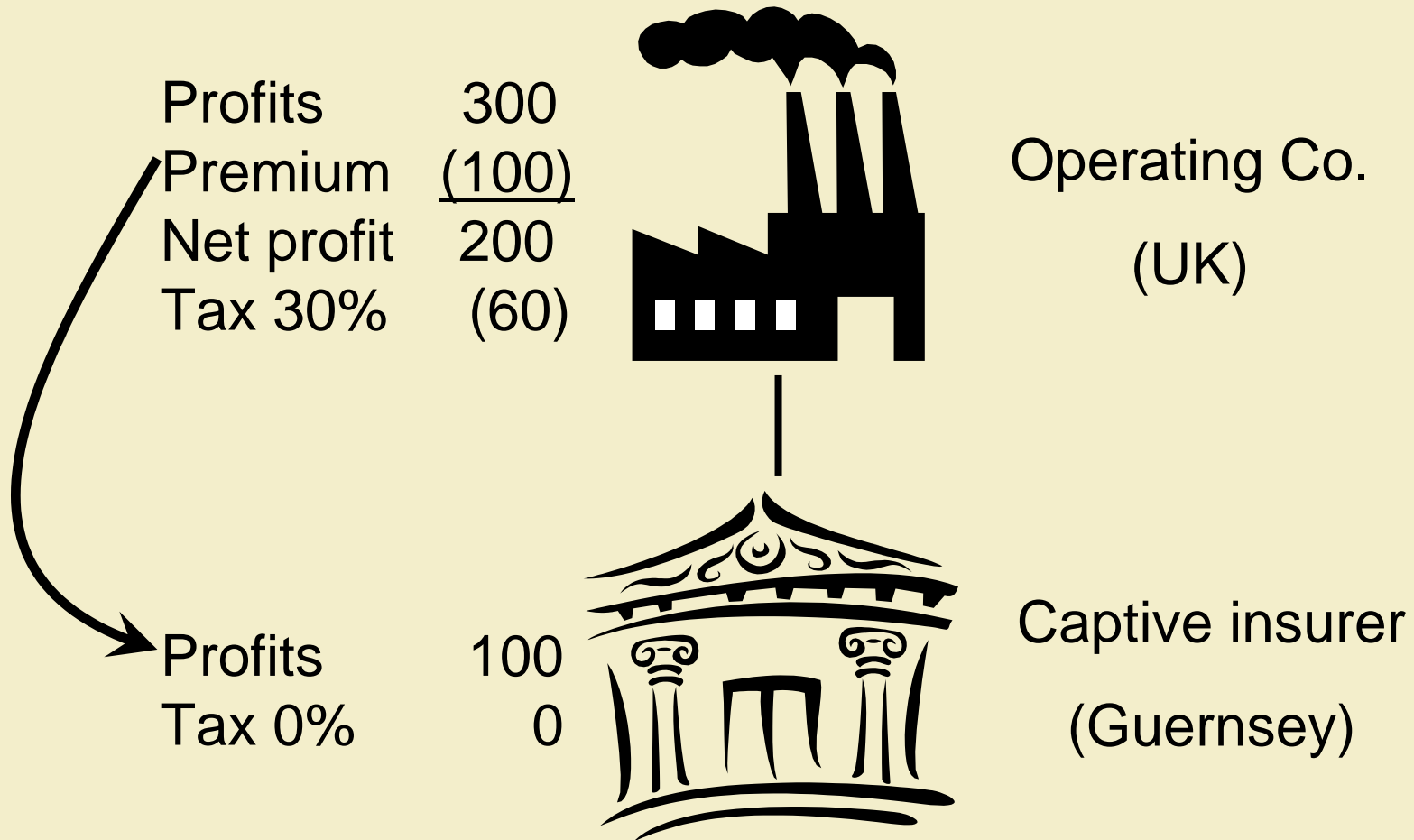
EU Savings Directive

- Prevents tax evasion on interest
 - minimum withholding tax *or*
 - reporting
- Scope:
 - EU
 - Other Europe & associates
- Investments in HK up 56% in 2003

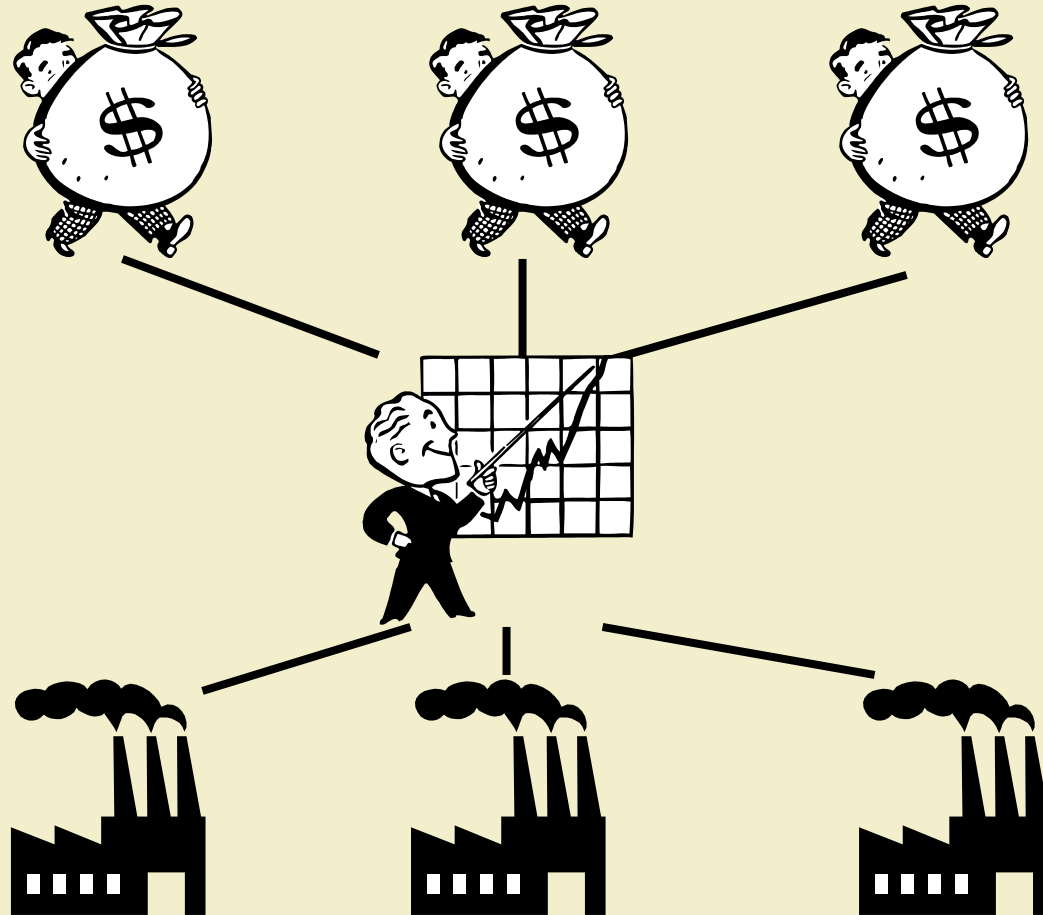
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The future

- Tax competition is beneficial
 - embrace it
- Lower taxes:
 - increase domestic economy
 - attract international capital
- Difficult to do within EU

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