

DEVELOPMENT OF SLOVAK CAPITAL IN TAX HAVENS

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ABSTRACT. Countries with tax benefits are still attractive for business entities operating in the conditions of the Slovak Republic. The paper aims to quantify the number of offshore companies based on data from the financial report of the Ministry of Finance of the Slovak Republic and Bisnode A Dun & Bradstreet Company and evaluate the development of Slovak companies in tax havens in 2008-2020. The second aim is to verify the hypothesis about statistically significant differences in the number of Slovak offshore companies in analyzed countries between 2020 and 2008. The development of the number of Slovak companies is assessed in absolute and relative terms using a chain index, a base index, a growth rate, and a geometric mean. The stated hypothesis is tested using Wilcoxon Signed-Rank Test. The results showed that the number of companies in tax havens increased to the greatest extent in 2020. The highest average annual growth rate in the tax haven countries was 52.85% in the Marshall Islands and the lowest average annual growth rate for the analyzed period was in the Netherlands Antilles (3.75%). The USA, the Netherlands and Cyprus are the countries of tax havens with the highest value of Slovak capital.

Keywords: company, tax haven, tax, index

JEL Classification: F38, H26

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Introduction

Offshore companies are an integral part of the global financial world. Tax havens are often referred to as a tax oasis, as they represent a low-tax country or an opportunity for businesses to avoid tax liabilities. When defining tax havens, it is necessary to respect economic dependencies and, at the same time, the legal environment. There is no general definition of tax havens. Still, it is most often said to be an area or country where incomes and wealth are subject to low or no taxes and have developed antitrust legislation. Therefore, asset management is extremely advantageous there. The term "tax haven" or "tax paradise" is associated with several other terms, e.g., "offshore", "offshore financial center" ("OFC") and "onshore". Individual entities represent legal entities that arise in offshore countries, the so-called tax havens, and are registered under the legislation of that country. Countries attract entrepreneurs from all over the world to very favorable conditions, especially regarding taxation. Offshore companies are used mainly for legal tax optimization, to create the structures necessary for the efficient operation of international companies and to protect assets. The aim of the paper is to quantify the number of offshore companies based on data from the financial report of the Ministry of Finance of the Slovak Republic and Bisnode A Dun & Bradstreet Company and evaluate the development of Slovak companies in tax havens in 2008-2020. The second aim is to verify the hypothesis about statistically significant differences in the number of Slovak offshore companies in analyzed countries between 2020 and 2008.

Theoretical background

Tax havens have been the research subject of many studies. Babčák (2018) examines the issue of tax havens in detail. Stojáková (2018) deals with the current issue of introducing sanctions for tax havens, focusing on the advantages, disadvantages, and risks associated with doing business in tax havens. Bujňáková (2018) points out selected measures and forms of combating the effects of tax havens. Červená and Romanová (2018) study the history of tax havens. Korečko (2012) deals with the issue of tax harmonization and tax competition, which affect the existence of tax havens. Finally, Slemrod and Wilson (2009) developed an equilibrium model of tax havens and tax competition.

The term tax haven is a general and, in fact, to some extent pejorative, with a particular ideological undertone, perceived as an island paradise only for the chosen ones. Such a definition had its partial justification only in the beginnings of the existence of tax havens (Babčák, 2018, p. 16). The existence of tax havens does not, in principle, undermine the effects of indirect taxes, as they are harmonized in the EU (notwithstanding the difficulties that the current harmonization system currently causes). However, a possible harmonization of income taxation would not completely solve the problem of the existence of tax havens, but it would bring to the system of corporate income taxation in the EU a much higher expected level of balance (Babčák, 2018, p. 31).

In 1998, the OECD (1998) characterized four key factors that a country should meet to become a tax haven:

- no or nominal tax on the relevant income (does not apply to domestic),
- lack of effective exchange of information,
- lack of transparency,
- no substantial activities.

Mara (2015) identified the major determinants of tax havens in the actual economic context. Logistic regression reveals the most important factors that favor a country's tax haven status.

Tax and non-tax benefits tend to divert financial capital from other countries, which has a very detrimental effect on the income bases of other countries. Because tax havens offer a way to minimize taxes and gain financial secrecy, tax havens affect corporate and individual investors. In addition, tax havens provide a place to hold passive investments, provide a place where paper profits can be settled, and allow taxpayers' matters, especially their bank accounts, to be effectively protected from control by the tax authorities of other countries (Bujňáková 2018).

Červená and Romanová (2018, p. 142) summarize reasons why to operate in tax havens:

- no or nominal tax on the relevant income (does not apply to domestic),
- lack of effective exchange of information,
- lack of transparency,
- no substantial activities.
- high taxes in the country of residence of individuals,
- high (even prohibitive) tax rates for legal entities,

- high inheritance and donation taxes,
- the possibility of avoiding a high tax burden by implementing the relevant contract abroad,
- to avoid the problem of nationalization of assets or confiscation of movable property, which is also related to the desire for anonymity,
- protection of savings by depositing in countries that guarantee the protection of bank secrecy,
- choice of countries with low taxes in the selected geographical and climatic (more pleasant) environment,
- the political stability of a country that can offer long-term guarantees, a country with considerable freedom of trade and no foreign exchange restrictions,
- optimal tax planning enabled by countries that have numerous double taxation treaties,
- the possibility of obtaining cheap, skilled labor in countries that have easily accessible and achievable optimal structures,
- the period of validity of the preferential tax rates laid down by the laws of the country concerned,
- countries that offer special incentives for production and industrial initiatives to gain significant fiscal and financial benefits,
- countries, in which sophisticated laws apply to companies such as family foundations,
- private foundations or entrusted groups,
- the possibility to transfer capital in a short time and without particular difficulties of the company.

The use of tax havens to avoid taxes otherwise payable in countries with high tax rates is well documented (e.g., Hines & Rice, 1994; Graham & Tucker, 2006; Dyring & Lindsey, 2009; Dyring, Lindsey, & Thorne, 2013). Number of companies in tax havens was studied in Jenčová, Vašaníčová, and Gombár (2020); Jenčová, Vašaníčová, and Lukáčová (2021).

Methodology

The aim of the paper is to quantify the number of offshore companies and evaluate the development of Slovak companies in tax havens in 2008-2020. The second aim is to verify the hypothesis about the existence of statistically significant differences in the number of Slovak offshore companies in analyzed countries between 2020 and 2008,

Used data are obtained from the financial report of the Ministry of Finance of the Slovak Republic and Bisnode A Dun & Bradstreet Company (Bisnode, 2020; Bisnode A Dun & Bradstreet Company, 2021). The development of the number of companies in tax havens is assessed in absolute and relative terms using a chain index (CI), a base index (BI), a growth rate (GR) and a geometric mean (G). Index (I) is a dimensionless number that arises from the ratio of two values of the same indicator, confronting the same indicator achieved at different times, thus indicating the development. The base index has the same base period as its basis. For the chain index, the base is shifted. The index is calculated as:

$$I_{X_{jk}} = \frac{X_k}{X_j} . \quad (1)$$

The average growth rate is determined by the geometric mean in the form of:

$$G = \sqrt[n]{I_1 \cdot I_2 \cdot \dots \cdot I_n} . \quad (2)$$

To verify the stated hypothesis, we use a nonparametric Wilcoxon Signed-Rank Test.

Results and Discussion

At present, the owners have invested more than € 10.45 billion in the registered capital of companies in tax havens. According to Olexová (2018), there are significant differences in the estimates of world wealth in tax havens. Nevertheless, all estimates lead to the conclusion that the property in tax havens is increasing.

Leontiev (2020) states the legal, semi-legal and illegal reason for founding a company. The legal reason is to establish a company in a state whose laws, e.g., allow for the advantageous arrangement of property in the event of the divorce of its owner or the event of his death. Semi-legal reasons for companies can be different tax-optimization schemes, i.e., if it is a holding company in a state, where income from equity participations is subject to no or only low taxes. The illegal reason can be the establishment of a company for the purpose of money laundering or covering up real owners who would have a conflict of interest in trading with the state.

The number of Slovak business entities in the countries of tax havens since 2008 is increasing. In 2020, the number of Slovak companies in tax havens reached 5,274, which is an increase of 3,271 companies compared to the year 2008. In 2008, only 2,003 Slovak companies were in tax havens.

Table 1. Development of the number of Slovak companies in tax haven countries

Country	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
USA	470	559	601	671	760	859	1 028	1 064	1 028	989	1 068	1 228	1 406
Netherlands	750	975	1 050	1 052	1 110	1 124	1 154	1 140	1 142	1 139	1 154	1 163	1 166
Cyprus	319	413	535	600	767	755	750	917	1 066	1 106	1 099	1 059	944
Luxembourg	227	291	318	344	392	354	393	411	402	414	412	420	411
United Arab Emirates	17	22	32	37	41	53	67	80	127	157	174	172	170
Latvia	6	11	16	26	44	49	69	71	92	112	126	144	180
Panama	29	32	25	38	62	6	5	6	153	145	146	137	149
Malta	30	28	33	36	45	54	83	131	92	102	109	118	118
Republic of Seychelles	2	7	18	65	180	220	205	254	207	169	141	112	320
British Virgin Islands	60	72	78	81	78	88	101	138	127	122	107	100	85
Lichtenstein	4	13	15	18	28	32	36	62	82	84	84	83	81
Belize	26	33	51	75	96	117	114	98	91	91	86	82	76
Hongkong	15	16	20	25	30	35	36	35	41	39	50	51	50
Marshall Islands	0	0	0	0	2	2	24	46	21	24	39	39	37
Monaco	13	12	11	16	18	60	2	19	40	37	22	24	24
Gibraltar	9	16	23	17	7	8	16	14	15	14	14	16	15
Jersey (Great Britain)	4	10	11	9	16	13	10	10	14	15	12	14	14
Bahamas	4	5	5	4	7	15	13	11	10	10	10	9	7
Guernsey (Great Britain)	2	3	7	6	6	6	10	9	10	9	10	9	5
Cayman Islands	2	2	2	3	3	6	4	5	7	8	7	6	7
Isle of Man	11	17	25	38	62	94	158	174	5	5	6	5	4
Netherlands Antilles	2	2	2	2	4	3	3	5	4	3	3	3	3
Bermuda Islands	1	1	0	0	0	0	0	1	1	2	2	2	2

Source: *own processing*

Table 2. Development of growth rate (in %) in tax haven countries

Country	09/08	10/09	11/10	12/11	13/12	14/13	15/14	16/15	17/16	18/17	19/18	20/19
USA	18.9	7.5	11.6	13.3	13.0	19.7	3.5	-3.4	-3.8	8.0	15.0	14.5
Netherlands	30.0	7.7	0.2	5.5	1.3	2.7	-1.2	0.2	-0.3	1.3	0.8	0.3
Cyprus	29.5	29.5	12.1	27.8	-1.6	-0.7	22.3	16.2	3.8	-0.6	-3.6	-10.9
Luxembourg	28.2	9.3	8.2	14.0	-9.7	11.0	4.6	-2.2	3.0	-0.5	1.9	-2.1
United Arab Emirates	29.4	45.5	15.6	10.8	29.3	26.4	19.4	58.8	23.6	10.8	-1.1	-1.2
Latvia	83.3	45.5	62.5	69.2	11.4	40.8	2.9	29.6	21.7	12.5	14.3	25.0
Panama	10.3	-21.9	52.0	63.2	-90.3	-16.7	20.0	2450.0	-5.2	0.7	-6.2	8.8
Malta	-6.7	17.9	9.1	25.0	20.0	53.7	57.8	-29.8	10.9	6.9	8.3	0.0
Republic of Seychelles	250.0	157.1	261.1	176.9	22.2	-6.8	23.9	-18.5	-18.4	-16.6	-20.6	185.7
British Virgin Islands	20.0	8.3	3.8	-3.7	12.8	14.8	36.6	-8.0	-3.9	-12.3	-6.5	-15.0
Lichtenstein	225.0	15.4	20.0	55.6	14.3	12.5	72.2	32.3	2.4	0.0	-1.2	-2.4
Belize	26.9	54.5	47.1	28.0	21.9	-2.6	-14.0	-7.1	0.0	-5.5	-4.7	-7.3
Hongkong	6.7	25.0	25.0	20.0	16.7	2.9	-2.8	17.1	-4.9	28.2	2.0	-2.0
Marshall Islands	-	-	-	-	0.0	1100.0	91.7	-54.3	14.3	62.5	0.0	-5.1
Monaco	-7.7	-8.3	45.5	12.5	233.3	-96.7	850.0	110.5	-7.5	-40.5	9.1	0.0
Gibraltar	77.8	43.8	-26.1	-58.8	14.3	100.0	-12.5	7.1	-6.7	0.0	14.3	-6.3
Jersey (Great Britain)	150.0	10.0	-18.2	77.8	-18.8	-23.1	0.0	40.0	7.1	-20.0	16.7	0.0
Bahamas	25.0	0.0	-20.0	75.0	114.3	-13.3	-15.4	-9.1	0.0	0.0	-10.0	-22.2
Guernsey (Great Britain)	50.0	133.3	-14.3	0.0	0.0	66.7	-10.0	11.1	-10.0	11.1	-10.0	-44.4
Cayman Islands	0.0	0.0	50.0	0.0	100.0	-33.3	25.0	40.0	14.3	-12.5	-14.3	16.7
Isle of Man	54.5	47.1	52.0	63.2	51.6	68.1	10.1	-97.1	0.0	20.0	-16.7	-20.0
Netherlands Antilles	0.0	0.0	0.0	100.0	-25.0	0.0	66.7	-20.0	-25.0	0.0	0.0	0.0
Bermuda Islands	0.0	-100.0	-	-	-	-	-	0.0	100.0	0.0	0.0	0.0

Source: *own processing*

Table 1 shows the development of the number of Slovak companies in tax havens from 2008 to 2020, with the most significant number of offshore companies in 2018 in the Netherlands. In 2019 and 2020, there was a change, while most offshore companies were in the USA. Table 2 presents the growth rates in each country, with the highest growth rate given in the blue cell.

According to Štěpánová (Bisdone, 2020), US business has been growing most significantly in recent months. While 57 new companies settled there in the first quarter of 2020, in the second quarter of 2020, it was 56 companies. Altogether, we register 1,341 companies with a Slovak owner in the USA; even though the USA is not a typical tax haven, but provides entrepreneurs with several business benefits, including better tax conditions than in Slovakia. On the other hand, a significant decline was recorded in Cyprus because 20 Slovak companies left this country in the first quarter of 2020 and 24 companies in the second quarter of 2020. This time, Bisnode registers a total of 944 Slovak entrepreneurs in Cyprus. Nevertheless, Cyprus is the third most popular tax haven for Slovak entrepreneurs, right after the USA and the Netherlands, where 1,166 companies are based (see TASR, 2020a; TASR, 2020b; TASR, 2020c).

The development of the growth rate (GR), chain index (CI), and base index (BI) over the analyzed period is shown in Figure 1.

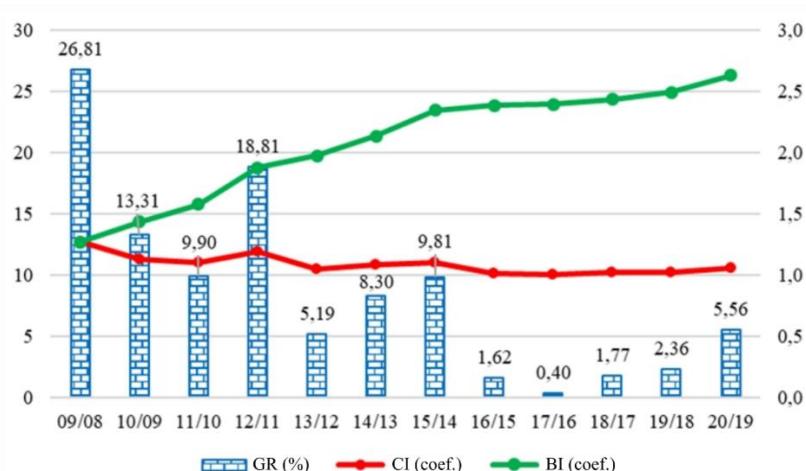


Figure 1. Development of the growth rate, chain index, and base index of Slovak companies in tax havens

Source: *own processing*

Differences among analyzed period 2008-2020 among TOP 10 tax havens are in Box and Whiskers plot in Figure 2. Table 3 presents the Wilcoxon Signed-Rank Test results that were used to verify the stated hypothesis: There are statistically significant differences in the number of Slovak offshore companies in analyzed countries between 2020 and 2008; the p-value of 0.0000 confirmed this hypothesis.

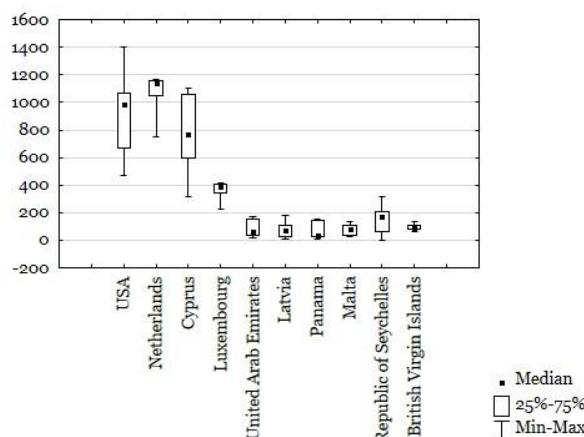


Figure 2. Development of number of Slovak companies in TOP 10 tax havens

Source: *own processing*

Table 3. Results of Wilcoxon Signed-Rank Test

N	W+	W-	Z	p-value
23	269	7	3.9692	0.0000

Source: *own processing*

A specific group of Slovak business entities involved in tax fraud intends to look for opportunities and ways to reduce their operating costs or ensure anonymity. The reason is the illusion of low or zero taxes and other benefits, the absence of excessive administration and bureaucracy, as these countries do not place much emphasis on bookkeeping and tax returns but also cover their property and keep the actual owner's secret. These are most often public figures with an impact on decision-making processes. Among the world's best-known cases in this context are, e.g., Panama Papers, Offshore Leaks, LuxLeaks, which revealed unfair financial operations of various world politicians and other personalities (Kullová, 2020).

Conclusion

During the analyzed period 2008-2020, most companies in tax havens were established in 2020. In 2020, most companies were established in the USA (1,406), where the number of companies increased by 178. The number of Slovak companies in 2019 that have owners in tax havens was 4,996, which is 115 companies more than in 2018 and 2,993 companies more than in 2008. The most significant year-on-year change occurred in 2012 when 595 companies were established, and the total number of companies was 3,758. The smallest year-on-year increase of 19 companies is recorded in 2017 (4,796 companies). The average annual growth rate in the tax haven countries was 52.85% in the Marshall Islands, followed by 44.18% in the Republic of Seychelles, 33.49% in Latvia and 31.74% in Liechtenstein. The lowest average growth rates for the analyzed period were in the Netherlands Antilles (3.75%), the British Virgin Islands (4.75%) and Gibraltar (5.36%). In 2020, the largest number of companies was recorded in the Republic of Seychelles, where the increase was almost 186%, the number of Slovak companies in the country reached 320.

In general, from a macroeconomic point of view, the prevailing view is that although the number of Slovak companies in tax havens is growing from year to year, tax havens have reached their ceiling. The owners have invested more than 10.45 billion € in the registered capital of companies in tax havens. Most Slovak companies established in tax havens do business in the field of wholesale and retail (970), in the field of professional and scientific activities (904) and the field of real estate (656). Further research will aim to analyze the impact of changes in the Income Tax Act, where measures were implemented to combat tax evasion so that individuals do not export their income to tax havens.

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