

“Tax Havens”: what happens in them, and why are we there?

There has been much public debate in recent years about activities which take place in ‘offshore’ financial centres, often referred to as “Tax Havens”.

While there is no commonly agreed definition of a “Tax Haven”, the OECD definition is widely used and includes 4 characteristics, namely: no or low effective tax rates; ring fencing of preferential regimes for non-residents; lack of transparency; and lack of effective exchange of information. Many (but not all) of the locations considered to fall within the scope of such a definition have typically been islands with a strong financial sector. We have a presence in many of these financial centres.

There are broadly 3 categories of activity which may be summarised as follows:

1. Pooled investment assets at significant scale

The creation of pooled investment funds and related services in the finance industry has been long-established as an efficient way of dealing with a diverse range of investors (including pension funds) - and this is done in a range of both “onshore” and “offshore” financial centres across the world. These funds are usually treated as “tax neutral”, in that no tax is payable at the level of the fund itself to prevent double taxation, and it is the investors who are liable to pay tax according to the rules in their home country.

Many of our services supporting this activity are not typically the subject of policy debate. These activities are generally consistent with the policy intent of territory governments and support their policy objectives related to savings, investments and pensions. In fact many of these activities also take place in onshore financial centres with the active support of the relevant policy makers.

2. Location of business activities of Multinational Companies (“MNCs”)

Offshore financial centres also have a place in the context of structuring for MNCs - namely the location of intellectual property, group financing, treasury or hedging activities or holding company activities. We provide services relating to that structuring, consistent with the tax and other requirements of the various jurisdictions involved.

In this area, there continues to be a debate about the extent to which the tax policies adopted by countries to attract investment, and the resulting strategies adopted by MNCs, are “acceptable” from an international tax policy perspective. The “BEPS” (“base erosion and profit shifting”) project led by the OECD has led to very significant changes to the tax treatment of certain international activities, including those referred to above. As a general principle, these BEPS changes have been designed to deal with perceived weaknesses in the existing tax framework, and are expected therefore to address these kinds of concerns.

Once again it should be noted that many of these activities and the related services also take place in many large onshore commercial locations.

However there is also a broader debate in progress, focused on more fundamental changes to the basis on which international activities are and should be taxed. This debate has largely been triggered by changes to business models driven by digitalisation. This includes proposals by countries and regions to introduce digital services taxes, as well as very fundamental changes to international tax principles.

While this process is also being led by the OECD, there is as yet no agreement between countries on what the answer is, so this area will continue to be a matter of debate for some time. The reality is that countries continue to use their tax systems as a means of competing for investment, and so there is likely to be continued debate about what is or is not acceptable, with very different views depending on the particular perspective. We will continue to contribute constructively to the discussions, including our ongoing engagement with the OECD.

Given the continuing debate and lack of clarity in this area, the risks for our clients and for our firm, and our commitment to our Purpose, we aim to ensure that our advice reflects such risks and uncertainty, and is consistent with our Global Tax Code of Conduct. We support our teams to do this with our Tax Policy Panels which give advice to client facing teams on complex tax issues.

3. Illicit financial flows

There are concerns related to the way in which it is believed “Financial Centres” can be or are used for criminal activities (whether that is tax evasion, money laundering or other criminal activity).

We do not condone or support any such activities, and we fundamentally support any appropriate measures to eliminate opportunities for such activities to take place. We will also continue to contribute our experience and expertise as authorities develop their responses to such risks.