

Garayev A. A.♦

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Tax Havens in the Context of Azerbaijani and International Legislation

Abstract: This article examines the dynamics of tax havens within the frameworks of Azerbaijani and international law, focusing on efforts to counteract tax evasion facilitated by offshore financial centers. It highlights taxpayers' preference for minimizing tax liabilities through jurisdictions that offer low to zero tax rates and significant confidentiality, noting the emergence of such zones post-World War I. The global response, led by the OECD, has involved developing regulatory measures to increase transparency and cooperation between countries, including the categorization of countries based on compliance with international tax standards.

The discussion extends to Azerbaijani legislation, which has adapted through specific amendments to its Tax Code to identify and regulate transactions involving preferential tax treatment countries. These include criteria for such countries, taxation of transactions with them, and the introduction of regulations around controlled foreign companies to tax profits made in tax havens by Azerbaijani residents. The conclusion underscores the persistent global challenge of balancing taxpayer desires for favorable tax regimes against regulatory efforts to ensure equitable tax collection.

Keywords: Tax havens; Offshore financial zones; Azerbaijani legislation; International law; OECD; Tax evasion.

Introduction

The primary desire of taxpayers is to minimize their tax payments as much as possible in order to increase their incomes further. Currently, instead of evading taxes and facing administrative and criminal liabilities, enterprises strive to minimize their taxes in the most optimal way by adhering to legislative requirements. Although this approach seems legal on the surface, the tax that should be paid is not being contributed to the budget. For example, Jeff Bezos was exempt from paying federal income tax in 2006 and 2018 by investing more than the income he earned in those years [1]. Yet, during those years, his earnings were measured in billions of dollars.

One of the most well-known and effective methods of legally avoiding taxes is operating through corporations established in countries known as "Tax Havens."

Where are tax havens and how did they come about?

Tax havens, or offshore financial centers, are countries where foreign investors pay very low, even zero, taxes. Although this term began to be used more extensively in the 1950s, the initial seeds of offshore zones were sown in the 1920s, following World War I, with several small countries led by Switzerland declaring themselves as "tax havens" [2]. As it appears, the term "tax haven" began to gain more relevance in the post-war periods. This is related to the fact that countries

♦ **Garayev Alikhan Aminagha oglu** - a Master's student specializing in Tax Law at the Law Faculty of Baku State University and a Corporate Lawyer at "Unibank Commercial Bank" OJSC (Azerbaijan). E-mail: alikhangarayev9@gmail.com

with large economies wanted to restore the financial resources they lost during the war by collecting taxes. Therefore, not only were tax rates increased, but additional types of taxes were also introduced. Corporations, looking for a way out, started turning to newly independent countries that offered low tax rates.

Regulation of Offshore Zones with International Legislation

Such countries have been of interest to large taxpayers in recent years, with taxes that should be paid to the state remaining in the pockets of entrepreneurs through these offshore zones. In America alone, an amount of \$427 billion that should be paid to the budget every year is evaded through offshore zones [3].

As a result, during the Global Economic Crisis, economists considered one of the main reasons for the crisis to be the offshore zones, referred to as "tax havens" [4].

Such situations prompted the Organisation for Economic Co-operation and Development (OECD) to prepare a comprehensive action plan regarding offshore zones. As a first step, the OECD published a report in 1998, identifying the main characteristics of tax haven countries [5]. According to the report, for a country to be recognized as an offshore zone, it must exhibit the following characteristics:

- i. Zero or very low taxation;
- ii. Secrecy - The existence of laws in such countries that protect the confidentiality of corporate shareholders, their transactions, bank dealings, and property rights, keeping them anonymous to outsiders;
- iii. Lack of transparency and oversight over banking operations;
- iv. The ability to easily establish corporations within a short period (usually 1-2 days);
- v. No active business operations within the country's territory - Registered companies typically conduct their business activities in other countries [6].

The OECD published its next report on this topic in 2000, identifying 35 countries worldwide as tax havens based on the aforementioned standards.

It should be noted that the only positive aspect of these countries is not just the low tax rates but also the emphasis on privacy. The setting of tax rates at low percentages does not pose a threat to other countries. This is because an entrepreneur operating in one country should pay the tax in that country, which they would have avoided in the offshore zone. It was impossible to determine the amount of tax that these enterprises should pay because it was not possible to access information about the companies' bank transactions, financial status, profits, assets, and property. Therefore, implementing an exchange of information on tax matters between countries was crucial to prevent tax evasion.

The Organization for Economic Cooperation and Development (OECD) published a model agreement for the Exchange of Information on Taxes (TIEAs) on April 18, 2002 [7]. According to the agreement, the parties undertake to provide information related to the taxpayer in question to the other party. This would somewhat prevent cases of tax evasion faced by countries. Currently, there are hundreds of such bilateral and multilateral agreements between countries.

In 2009, as part of efforts to prevent tax evasion through offshore zones, the OECD divided countries into three groups based on their compliance with international standards [8]:

- i. Black List - Offshore zones that do not comply with any international standards;
- ii. Grey List - Countries that have accepted international standards but have not substantially implemented them;

iii. White List - Countries that have accepted and implemented international standards.

The White and Grey lists cover countries that comply with international standards. The only difference is that to be included in the White List, a jurisdiction must sign at least 12 Exchange of Information on Taxes Agreements [9].

Finally, one of the main topics of discussion at the G20 summit in London in 2009 was the measures concerning countries on the Black List. The action plan included [10]:

- i. Requiring taxpayers to disclose their operations in these countries;
- ii. Denying tax concessions for expenses paid to residents of these countries;
- iii. Imposing additional taxes on payments to these countries;
- iv. Restrictions on investment in these countries and assistance to them by international organizations.

Regulation of tax evasion through offshore zones should be managed not only by international legislative acts and international organizations but also with the help of national legislation. In this form of tax evasion, there are two participants: the country recognized as a tax haven and the company or individual evading taxes. While international organizations and agreements can monitor the activity of the first participant, control over the companies evading taxes must be directly implemented with the help of national legislation.

How effective is the legislation of the Republic of Azerbaijan in preventing tax evasion through offshore zones?

First, it's important to note that in our local legislation, offshore zones are referred to as countries with preferential tax treatment. The concept of a country with preferential tax treatment is defined in Article 128.2 of the Tax Code. According to this article, a foreign country or territory with a tax rate two times or more lower than the rate specified in this Code, and/or where laws exist that allow for the confidentiality of financial information, or the actual ownership of property or income (profit) beneficiaries, is considered to have preferential tax treatment.

As seen, two requirements are set for a country to be included in this list:

- i. The tax rate being two times or more lower than the rate specified in this Code;
- ii. The existence of laws that allow for the confidentiality of information about companies regarding financial information, or the actual ownership of property or income (profit) beneficiaries.

For a country to be considered a country with preferential tax treatment, these two conditions must be met. Additionally, the list of countries meeting these criteria is regulated by a list compiled by the relevant executive authority. For 2022, this list included 37 countries [11].

According to Article 13.2.16.14-1 of the Tax Code, payments made to bank accounts or companies in countries with preferential tax treatment are considered income from Azerbaijani sources, and taxes are withheld at the source of payment. Here, the banks making the payment act as tax agents.

Lastly, to prevent tax evasion by enterprises operating in countries with preferential tax treatment, Article 14-2 titled "Controlled foreign company and its tax liability" was added to the Tax Code in 2021 [12].

A controlled foreign company refers to enterprises that are not residents of the Republic of Azerbaijan and are registered in countries with preferential tax treatment. If a person considered a resident of the Republic of Azerbaijan has more than 50 percent of the voting rights in a company registered in a country with preferential tax treatment, or owns more than 50 percent of its charter

capital, or has the right to obtain more than 50 percent of the profit of the foreign company, then the profit of that company is subject to tax in the Republic of Azerbaijan.

Also, the tax actually paid on the profit of the controlled foreign company, if it is two times or more lower than the income tax that should be paid from that profit according to the Tax Code, and if more than 30 percent of the foreign company's annual income consists mainly of passive income as envisaged by the Tax Code, then it is also applicable [13].

This article directly aims to prevent residents from transferring their incomes to countries with preferential tax treatment to evade taxes.

Conclusion

As it appears, preventing tax evasion through offshore zones is a focal point of both international and national legislation. Therefore, these countries are encouraged by international organizations to cooperate, sign tax information exchange agreements, and additionally, local legislative acts impose extra taxes and duties on payments to countries with preferential tax treatment to curb the flow of money to offshore zones.

There is a well-known fact that taxpayers are always interested in paying less tax and will continue to look for countries that offer them these conditions. On the other hand, offshore zones, due to their tax incentives, attract billions in investments and seem unlikely to abandon this trend. Therefore, the issue of tax evasion through offshore zones will remain a topical subject for countries for a long time.

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Гараев А.А.♦

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Офшорные зоны в контексте азербайджанского и международного законодательства

Аннотация: Рассматривается динамика налоговых убежищ в рамках азербайджанского и международного права, с акцентом на усилия по противодействию уклонению от налогообложения, облегчаемому офшорными финансовыми центрами. Освещается предпочтение налогоплательщиков минимизации налоговых обязательств через юрисдикции, предлагающие низкие или нулевые налоговые ставки и значительную конфиденциальность, отмечая появление таких зон после Первой мировой войны. Глобальный ответ, возглавляемый ОЭСР, включал разработку регулирующих мер для увеличения прозрачности и сотрудничества между странами, в том числе категоризацию стран на основе соответствия международным налоговым стандартам.

Обсуждение расширяется до азербайджанского законодательства, которое адаптировалось через конкретные поправки к Налоговому кодексу для идентификации и регулирования транзакций, вовлеченных в страны с преференциальным налоговым обращением. К ним относятся критерии таких стран, налогообложение транзакций с ними и введение регуляций вокруг контролируемых иностранных компаний для налогообложения прибылей, полученных в налоговых убежищах азербайджанскими резидентами. В заключение подчеркивается постоянная глобальная задача балансирования между желаниями налогоплательщиков по благоприятным налоговым режимам и регуляторными усилиями по обеспечению справедливого налогового сбора.

Ключевые слова: налоговые убежища; офшорные финансовые зоны; законодательство Азербайджана; международное право; ОЭСР, уклонение от налогообложения.

♦ Гараев Алихан Аминага оглы - магистрант юридического факультета Бакинского государственного университета специализирующийся на налоговом праве, корпоративный юрист в ОАО «Коммерческий Банк Унибанк» (Азербайджан). E-mail: alikhangarayev9@gmail.com

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