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REGULATING TAX HAVENS: An Imperative Under International Law

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REGULATING TAX HAVENS: An Imperative Under International Law

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[**Abstract:** *This paper examines the relationship between national tax policy resulting into harmful tax competition and its legality under international law. It begins by outlining the notion of harmful tax competition or tax heavens. The paper explores the impact of harmful tax competition for national tax policies and loss of revenue which further erodes the socio-economic development, protection, and promotion of human rights. The author argues that that economic development is sine qua non for the protection human rights, and the existence of the harmful tax competition ensues irreparable loss to the socio-economic development of many countries, especially the developing countries. Since, hinderance into socio-economic development ultimately affects the human right prospects, the authors conclude that the continuation of tax havens is fundamentally against the established rules of International Law.]*

'Taxes are the price we pay for civilization'

—O.W. Holmes[1]

I

General

Second half of the twentieth Century witnessed a strong movement towards globalisation, liberalisation, and privatisation. Under the patronage of International Economic and Trade Institutions, including the World Trade Organization (WTO) and International Monetary Fund (IMF), coupled with technological advancement, the trade relations amongst countries moved beyond the municipal barriers, and the erstwhile local trade corporations became Multinational Corporations (MNCs) of the modern world. These MNCs, having, enormous resources, are now playing decisive role in

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1 *Compañía General de Tabacos de Filipinas* v. *Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).*

trade, business, goods and services, and employment.[2] These MNCs, being capable of influencing government policies at every level, are often found flouting the financial regulations, especially the tax policies. According to various reports,[3] the inherent contradictions in tax regulations at national as well as regional level, often allure these MNCs to manipulate the rules and thereby nations suffer huge loss of taxes.[4] Since, the availability of tax revenue is the pre-requisite for nations, enabling them to go for the developmental activities in terms of trade, business, employment and other welfare measures; the loss in tax collection affects them directly. Thus, the dent in collection of taxes is not mere loss of revenue but a direct blow to development and welfare.

Globalisation has brought the nations together. However, at the same time, globalization of national economies has opened the floodgate of harmful tax competition amongst nations.[5] In an increasingly integrated global economy, tax policies of a country have a greater potential to impose spill-over effects on other countries.

While tax competition has many positive effects, the municipal tax policies of one country can have harmful external effects on other countries, especially where one jurisdiction reduces taxes to attract MNCs to have their corporate office there, without doing anything substantially. These tax havens thus attract MNCs to move to these tax havens for maximising benefits by avoiding taxes. The pattern of tax competition raises doubts as to the very objectives of globalisation.[6]

Existence and continuation of tax havens, across, the world indicates a highly biased world order, in which *fairness* in trade and business becomes the first casualty, leading to inequalities of the highest order. The fact about growing inequality is reflected in various research data collected by agencies, such as Oxfam. According to Oxfam report, with the passing of each year, the number of billionaires is going up, yet these super-rich along with the multinational corporations have kept avoiding their share of taxes by shifting to tax havens. The Oxfam data further reveals that $ 7.6 Trillion was siphoned

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[2] J. Ayesha, *Role of MNC's in Developing Countries* (2020, ECONOMICS DISCUSSION), *Available at*: http://www.economicsdiscussion.net/economic-development/mncs/role-of-mncs-in-developing-countries-economics/30136. (last visited 10 Jan., 2020).

[3] Richard Murphy, *Tax Havens Report* (Apr. 21, 2020, FINANCIAL TRANSPARENCY COALITION), *Available at*: http://www.financialtransparency.org/wp-content/uploads/2015/04/4775_tax_haven_report-1.pdf. (last visited 10 Jan., 2020).

[4] Esteban Ortiz-Ospina & Max Roser, *Taxation*, (2020, OUR WORLD IN DATA), *Available at*: https://ourworldindata.org/taxation. (last visited 15 Apr., 2020).

[5] Within OECD countries the rate of Corporate Income Tax ranges from 6.7percentages (Switzerland) to 32percentages (France)

[6] J.L. Blouin, *Taxation of Multinational Corporations*, 6 (1) FOUNDATIONS AND TRENDS IN ACCOUNTING (2019). *Available at:* http (last visited 10 Apr., 2020).

off to offshore region by individual tax payers.[7] In fact, tax avoidance by these individuals is the biggest reasons behind the financial crunch faced by the developing countries. The much-needed tax revenues are being siphoned off from the developing countries to islands of tax havens, resulting into not only huge loss of revenue but also distorted global economy. According to a report, around forty percent of the global foreign direct investment (FDI) is artificial, as it consists of financial investments passing through corporate shells in tax havens. These investments are not linked to any real or substantive economic activity taking place anywhere in the world.[8]

This paper examines the relationship between national tax policy resulting into harmful tax competition and its legality under international law. It begins by outlining the notion of harmful tax competition or tax heavens. The paper explores the impact of harmful tax competition for national tax policies and loss of revenue which further erodes the socio-economic development, protection, and promotion of human rights. The author argues that that economic development is *sine qua non* for the protection human rights, and the existence of the harmful tax competition ensues irreparable loss to the socio-economic development of many countries, especially the developing countries. Since, hinderance into socio-economic development ultimately affects the human right prospects, the authors conclude that the continuation of tax havens is fundamentally against the established rules of International Law.

The work is divided into three parts. Part-I conceptualises the purpose, process, and *modus operandi* of tax havens. Part-II narrates the accepted international as well as national norms in terms of tax policies and obligations of corporate firms to abide to these norms. Part-III of the paper addresses the issue of tax havens and its impact on the socio-economic development and thereby the protection and promotion of human rights. Finally, the paper argues towards enforceable legal obligation of states under International law in matters of taxation.

II

Tax Havens: The Home for Tax Avoidance

Tax havens have gained significance due to globalization and the greater mobility of capital worldwide. The Multinational Corporations generally shift profits to low-tax jurisdictions or 'tax havens' to reduce their tax liability. For this purpose, MNCs use variety of methods, from transfer pricing to transferring royalty-generating patents etc. Studies conducted in the area of tax avoidance and a tax haven provides ample examples to the methods and mechanism whereby companies, firms, and individual keep siphoning their money. One of such study narrates the pattern of tax avoidance

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[7] Max Lawson *et. al.*, Oxfam, *Public Good or Private Wealth? (2019)*. *Available at*: https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620599/bp-public-good-or-private-wealth-210119-en.pdf. (last visited 10 Jan., 2020).

[8] Jannick Damgaard, *et. al.*, *Piercing the Veil*, 55(2) FINANCE & DEVELOPMENT 52 (2018).

through an example where an MNC operating in Zambia, carrying a business of selling copper from the home country to its subsidiary in Mauritius at €2,000 per tonne. The subsidiary company in Mauritius, resold the same at €6,000 per tonne. By this process, the home country i.e. Zambia, is deprived of the opportunity of tax the margin of €4,000 per tonne.[9]According to a report published by the United Nations University World Institute for Development Economics Research (UNU-WIDER), these corporations across the world are engaged in evading taxes to the tune of $500 billion annually.[10] Realization of taxes from such shifted profits can increase the aggregate revenues of governments across the world by around 4.5 percentages.[11] According to a report published in the Guardian news daily, "as per the OECD estimates as much as $240bn every year is lost in tax revenue as a result of tax avoidance techniques."[12]Another report suggests that four tax havens – Mauritius, Singapore, the Netherlands and Cyprus account for a major chunk of all FDI equity inflows. Mauritius is already India's largest single source foreign investor at $39 billion, almost half of total investment flows. The beautiful tourist island of Mauritius also provides 44 percentages of capital "invested" in India, followed by Singapore at 9 percentages. This often occurs through "round-tripping" where Indians, keen to evade and avoid taxes, park their wealth in Mauritius before "re-investing" in India — tax free (or lesser rate of tax chargeable).[13]

India loses $9,718 million (approximately Rs 69,000 crore) in profits to tax havens across the world. Out of the total revenue, 2 percentages, to the tune of $3,440 million, goes to tax havens in the European Union, while 3 percentages, or $5,988 million, in profits goes to non-European Union tax havens. The tax havens for Indian firms in the European Union are in countries such as Belgium, the Netherlands, Malta, and Ireland, among other countries. Switzerland, Hong Kong, Singapore, and Bermuda are the non-

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[9] Khadija Sharife, *Treasure Islands: Mapping the Geography of Corruption*, (Jul. 2010, MRONLINE), *Available at*: https://mronline.org/2010/07/20/treasure-islands-mapping-the-geography-of-corruption/(last visited 10 Apr., 2020)

[10] Alex Cobham, *Estimating Tax Avoidance*, (Mar. 2017, THE UNITED NATIONS UNIVERSITY WORLD INSTITUTE FOR DEVELOPMENT ECONOMICS RESEARCH), *Available at*: https://www.wider.unu.edu/publication/estimating-tax-avoidance (last visited 22 Apr., 2020).

[11] Tadit Kundu, *The Many Shades of Corporate Tax Evasion,* (28 Mar., 2017, LIVEMINT), *Available at*: https://www.livemint.com/Politics/IokyMXFN1Rpi4GP6mV3F4J/The-many-shades-of-corporate-tax-evasion.html(last visited 10 Apr., 2020).

[12] Erik Solheim, *We're Losing $240bn a year to Tax Avoidance. Who Really Ends up Paying?* (May 10, 2016, THE GUARDIAN) *Available at:*https://www.theguardian.com/global-development-professionals-network/2016/may/10/were-losing-240bn-a-year-to-tax-avoidance-who-really-ends-up-paying (last visited Apr., 10, 2020).

[13] India's Finance Minister declared that corporations in India will be taxed at an effective rate of 25.17 percentages. The Indian government has estimated that the estimated lost tax revenue would be 1.45 trillion Indian rupees (about $20.45 billion) - about 0.7 percentages of India's GDP - according to economists.

European Union tax havens.[14] What is important here to note is that tax avoidance is causing severe revenue loss.

Tax Havens: Identification and Categorisation

Tax havens are often identified as countries with relatively low or zero taxation. However, to get categorised as tax haven, apart from lower tax rate, the country should show peculiar feature including secrecy in operations (no-exchange of information about companies, their beneficiaries, trusts, and taxes). The secrecy feature covers the strong bank secrecy, and information as to companies with respect their beneficiaries such as shareholders, trusts, assets, and financial accounts. Since, the very objective of these tax havens is to attract companies to indulge in tax avoidance, these jurisdictions observe strict secrecy.

OECD defines Tax havens as "a country which imposes a low or no tax, and is used by corporations to avoid tax which otherwise would be payable in a high-tax country."[15] OECD, in the year 1998, published a report titled as '*Harmful Tax Competition: An Emerging Global Issue*'.[16] In this Report, the following characteristics are being attributed to tax haven:

(a) no or only nominal taxes (generally or in special circumstances) and offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence.
(b) laws or administrative practices which prevent the effective exchange of relevant information with other governments on taxpayers benefiting from the low or no tax jurisdiction.
(c) lack of transparency, and
(d) the absence of a requirement that the activity be 'substantial'.

It is to be noted that low or nominal taxation is a precondition to identify a tax haven, however, there is an appreciable distinction between the jurisdictions that are offering low tax rate and the tax havens. The jurisdictions belonging to the former category offer tax at a relatively low rate, but are not engaged in harmful tax competition, whereas tax havens do not only offer nominal or zero tax rate but also engaged in harmful tax competition. Thus, tax havens are described as, "*jurisdictions that have no or only nominal taxation and a reduction in regulatory or administrative constraints, and that refuse to share information with tax authorities, all of which reduce the 'effective' taxation of income located in the jurisdiction*."[17] These tax havens not only permit the residents of other jurisdictions to

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[14] *India loses 5percentages of corporate revenue as firms shift profits to tax havens, shows research*, (Oct., 1, 2019, SCROLL.IN) *Available at*: https://scroll.in/latest/939109/india-loses-5-of-corporate-revenue-as-firms-shift-profits-to-tax-havens-shows-research (last visited 10 Apr., 2020).

[15] OECD, *Glossary of Tax Terms*, *Available at*: https://www.oecd.org/ctp/glossaryoftaxterms.htm (last visited 15 Apr., 2020).

[16] OECD, *Harmful Tax Competition: An Emerging Global Issue*, 23 (1998).

[17] Joann M. Weiner & Hugh J. Ault, *The OECD's Report on Harmful Tax Competition*, 51 (3) NATIONAL TAX JOURNAL 603 (1998).

avoid their taxes in their native jurisdictions, but also facilitate illegal activities including money laundering.

Again, it is not necessary that competitive tax regime should always go for zero tax rate. In many cases, the effective tax rate is applied in such a manner that narrow down the base to an extent whereby the effective rate is much lower than the statutory rate. Factors such as failure to adhere to international transfer pricing principles, negotiable tax rates or tax bases, existence of secrecy provisions, and regimes that are promoted as tax minimization vehicles are need to be considered for categorising a jurisdiction as tax haven.

Categorising Tax Havens: Experience from OECD and EU

The OECD prepared a list of 47 jurisdictions as tax havens.[18] However, in the year 2000, it blacklisted only 35 countries and some of them were eliminated.[19] Similarly, the European Union started blacklisting jurisdiction since, December 2017, based on its policy on tax compliance and harmful tax practices. Initially, there were ninety-two jurisdictions chosen for screening, however, most of them were untagged under constructive dialogue for reforming their tax policies. Recently, the Economic and Financial Affairs Council of the European Union (ECOFIN) revised the EU blacklist of non-cooperative jurisdictions for tax purposes. The new list of 12 jurisdictions includes Cayman Islands, Palau, Panama, and Seychelles.[20]

Researchers have complied data provided in various reports, and have suggested that tax havens are there in almost all parts of the world, beginning from Caribbean, Central America, Coast of East Asia, Europe, Indian Ocean to Middle East, North Atlantic, Pacific and west Africa.[21] Some of the prominent tax haven jurisdictions are Anguilla, British Virgin Islands, Montserrat, Costa Rica, Panama, Macau, Singapore, Cyprus, Liechtenstein, Switzerland, Maldives, and Seychelles etc.[22]

It needs to be pointed out, here, that the very process of blacklisting, is itself very questionable. There is always a space for political bargaining while preparing the list of countries having characteristics of harmful tax policies. Powerful jurisdictions are not being named by any report. Be it OECD or EU, their listings are self-revealing. For

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18 *Towards Global Tax Co-operation*, Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs, (2000, OECD) *Available at*: https://www.oecd.org/tax/transparency/about-the-global-forum/publications/towards-global-tax-cooperation-progress.pdf. (last visited 15 Apr., 2020).

19 Jane Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, 4 (Congressional Research Service, 2010).

20 Raluca Enache, *Euro Tax Flash*, (Apr. 21, 2020, KPMG`S EU TAX CENTRE), *Available at*: https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/02/etf-424-eu-blacklist-update.pdf (last visited 15 Apr., 2020).

21 *Supra* note 19.

22 *Id.*

example, there are tax havens, left out deliberately by European Union for political reasons. The fact that all the jurisdictions listed by EU belong to jurisdictions outside the EU, speaks in volume about it about the report and OECD's outlook.

Tax Havens: Modus Operandi

Harmful tax competition affects the companies or firm which are operating into more than one tax jurisdiction. Such MNCs are subject to several sets of tax rates and also several sets of tax regulations. The interplay between rules and rates leads to a multitude of potential tax obligations. As the income of MNCs faces overlapping tax claims, they develop various avenues for tax avoidance. Such tax-avoiding behaviour may reduce tax revenue and could distort international financial flows and the international allocation of investment by MNCs.[23]

There are five major techniques whereby corporation often shift their tax liabilities to tax havens. These are often described as 'shifting of profits. The shifting of profits is done through allocation of debt and earnings stripping, transfer pricing, contract manufacturing, check-the-box provisions, and cross crediting and sourcing rules for foreign tax credits.

Under the method of *shifting of profits* from a high-tax jurisdiction to a low-tax, companies or the firms borrow more in the high-tax jurisdiction. Under '*earnings stripping*', companies escape high domestic taxation by using interest deductions to their foreign headquarters in a friendly tax regime to lower their corporate taxes. This happens because most of the tax jurisdictions provide provisions for tax relief to a company against the amount of interest paid on debt.[24] This is an incentive for taxpayers to have or increase their debt ratio and take loans from associated enterprises located in tax friendly jurisdictions and claim higher tax deductions. Thus, this rule provides undue benefits and lower tax outgo for multinational groups.[25]

Transfer pricing is another way to shift the profits from high-tax to low-tax jurisdictions. Generally, an income would be reflected in account when the prices of goods and services sold by related companies are shown without any manipulation. However, MNCs having sold goods and services to their related companies show the prices by lowering it. This often happens with pricing of intellectual property rights and other intangible properties. A patent developed by a company in high tax jurisdiction may get it licensed in a tax haven through one of its affiliates. By this process, probable income through that patent would lower due to lower value of the license or royalty. For example, company 'A' located in India purchases a good for Rs. 100/- and sold it to its associated company 'B' for Rs. 200/-, located in a tax haven. The company B, in turn sells the good in the open market for 500 rupees. Had 'A' sold it directly, it would have made a profit of Rs. 400/. But by routing it through B, it restricted the profit Rs. 100/-, permitting B to appropriate the balance. Under this process, the country where

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23 *Supra* note 6.

24 *See,* Section- 94B, Income Tax Act, 1961.

25 The American Jobs Creation Act of 2004 (AJCA; P.L. 108-357).

company 'A' is located (India) will lose the tax on true value of sale. Techniques of transfer pricing have many more ways to flaunt high tax liability in given domestic jurisdiction.

International outsourcing or a contract of manufacturing is another arrangement whereby companies avoid taxes. It is a method wherein a subsidiary is set up in a tax haven and profit shifting occurs *via* contract manufacturing. Similarly, 'foreign tax credit' is designed to mitigate the effects of double taxation of foreign income. However, many a times, the foreign tax credit is used to avoid high tax liability.

III

Anti-Tax Avoidance Policy: An Obligation of All

The idea of tax havens may look good from the perspective of business, but such practices are causing irreparable damage to the prospect of socio-economic development. The tax havens are not only violating the economic interest of the other countries by causing spillover effect but also perpetrating illegalities. The "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework", developed by United Nations, on the issue of human rights and transnational corporations, prescribes detailed guidelines for conduct of business enterprises.[26] These guiding principles are grounded in recognition of (a) state's obligations to respect, protect and fulfil human rights and fundamental freedoms; (b) the role of business enterprises as a specialized organs of society performing specialized functions, required to comply with all applicable laws and to respect human rights; and (c) the need for rights and obligations to be matched to appropriate and effective remedies when breached. These guiding principles apply to all states, and to all business enterprises, both transnational and others, regardless of their size, sector, location, ownership, and structure. Principle-1 of the policies provides that "states must protect against human rights abuse within their territory and/or jurisdiction by third parties, including business enterprises. The principle requires the state to take appropriate steps to prevent, investigate, punish, and redress such abuse through effective policies, legislation, regulations, and adjudication. Further, Principle-2 of the policy imposes a duty on each state "to set out clearly the expectation that all business enterprises domiciled in their territory and/or jurisdiction respect human rights throughout their operations." These principles are expected to be applied by all the states, and are expected to be binding on all business enterprises, national as well as transnational, regardless of their size, sector, location, ownership, and structure etc. The very objective behind these guidelines is to enhance the standards and practices with regard to business and human rights. It further conceived to achieve socially sustainable

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[26] *See, Report of the Special Representative of the Secretary General on the issue of human rights and transnational corporations and other business enterprises,* A/HRC/17/31. U.N. Doc.GE.11-12190 (Mar.21, 2011) (by John Ruggie).

globalization. Thus, guidelines are in addition to the existing obligation of states under international law in respect to of protection and promotion of human rights.

While exploring the reasons and objectives of these guidelines, in the light of tax havens, these principles themselves highlight the importance of re-examining the whole setup of tax havens under present international law.

Tax Havens: Antithesis to Progressive Taxation

The idea of progressive taxation has brought new dynamism to the tax system. Under the progressive tax system, state is required to arrange her tax system in such a manner that it could be used bridge the inequalities [of wealth and income]. A progressive tax is defined as tax that imposes a lower tax rate on low-income group as against those with a higher income. It is system that seems to be primarily based on reverse discrimination i.e. it reduces the tax burdens on people who can least afford to pay them, and charges with higher rate to those who comes under higher tax bracket. It is because of this reasons that progressive taxation effectively becomes the tool for income redistribution. Thus, the true nature and characteristics of 'tax' is not what often [miss] understood in terms of revenue generation. It is rather reflected in the words of Oliver Wendell Holmes, when he says… '*Taxes are the price we pay for civilization*'.

The idea that tax policy should aim towards minimising inequalities and promote human rights is based on the three fundamental assumptions:

> '*Firstly*, that the generation of income through taxes can provide revenue to the state to facilitation the cause of human rights.
> *Secondly*, that the taxes can operate as an instrument of redistribution of income and wealth; and,
> *Thirdly*, that the tax compliance by individual or corporations shall essentially contribute to development.'

Thus, a progressive tax is a tax system wherein the average tax rate or the total amount of tax paid, as a percentage of income, increases with the increase of the income of the taxpayer. Progressive taxation is antithetical to the very idea of tax havens. It is assumed that companies or firms, exploiting the natural and other resources of a given country and thereby making enormous profit, are expected to serve the state by paying higher taxes. This could be possible when these firms or companies disclose their true income. However, by opening subsidiaries in tax havens, these companies manipulate their true income, and thereby avoid taxes. The domestic legal system, where these companies primarily work, faces formidable tax of procuring financial information about tax avoidance due strong secrecy rules of tax havens. Kofi Annan's Africa Progress Panel highlighted mining deals involving two FTSE100 multinationals, carried out through companies in the British Virgin Islands, Panama and Gibraltar, which the panel claims have deprived the Democratic Republic of Congo of an estimated $1.36bn – almost twice the country's education and health budgets combined.[27]

The idea of progressive is also dented further due to low number of tax payers. For example, though direct taxes contribute 54.78 percentages of the total tax revenue in India,[28] for the financial Year 2018-19, only 8,45,21,487 taxpayers paid the taxes.[29] According to a report published in the Economic Times, 93.2 percentages of Indians don't fall in the tax bracket as they declare their income between 0-2.5 lakhs *per annum*, and thus exempted from taxes.[30] Only 6.2 percentages declare their income between 2.5 to 5 lakhs and thus leave only 0.35 percentages who fall in the higher tax slabs. In the year 2016, the Government of India set up a committee to review the Fiscal Responsibility and Budget Management Act, 2003. The Committee recommended that the government should target a fiscal deficit of 3 percentages of the GDP by 2020, cut it to 2.8 per cent in 2021 and to 2.5 per cent by 2023. On the tax fronts, in the last 10 years, while the absolute volume of Central tax collection increased by 3 per cent, the share of direct tax collection declined by 3 per cent, which has been compensated by the rise in indirect taxes. The story of the corporate tax collection is not different. Its share in direct tax fell from 63 percentages in Financial Year-2009 to 56 percentages in Financial Year 2018. However, the personal income tax, which is considered as a secured source, has seen a healthy rise from 35 percentages to 41 percentages during the same period as the number of taxpayers under the direct tax net increased in the last 10 years.[31] The Kelkar Committee report mentions the 'missing middle', which includes professionals (like CAs, lawyers, and doctors), which manages a leeway to report actual income. Also, tax exemptions to agricultural income need to be plugged smartly. It is beyond doubt that in understanding the role of taxes in analysing the economic development, it would be pertinent to look beyond the tax enforcement and compliance. One needs to examine

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[27] Richard Miller, *Tax havens are entrenching poverty in developing countries*, (May 14, 2013, THE GUARDIAN) *available at*: https://www.theguardian.com/commentisfree/2013/may/14/tax-havens-entrenching-poverty-developing-countries(last visited 18 Apr., 2020)

[28] Income Tax Department, Government of India, Time Series Data, Financial Year 2000-01 to 2018-19, *Available at*: https://www.incometaxindia.gov.in/Documents/Directpercentages 20Taxpercentages 20Data/IT-Department-Time-Series-Data-FY-2000-01-to-2018-19.pdf (last visited 20 Apr., 2020)

[29] A "Taxpayer" is a person who either has filed a return of income for the relevant Assessment Year (AY) or in whose case tax has been deducted at source in the relevant Financial Year, but the taxpayer has not filed the return of income.

[30] Preeti Motiani, *Post tax, Rs 5 lakh income will be higher than Rs 5.16 lakh: Here's why* (Feb., 28, 2020, The ECONOMIC TIMES) *Available at:* https://economictimes.indiatimes.com/wealth/tax/post-tax-rs-5-lakh-income-will-be-higher-than-rs-5-16-lakh-heres-why/articleshow/74311201.cms?Utm _source=contentofinterest&utm_medium=text&utm_campaign=cppst (last visited 20 Apr., 2020)

[31] Rahul Mazumdar, *A case for widening the tax base*, Business Line, (Jan., 31, 2019, BUSINESSLINE) *Available at:* https://www.thehindubusinessline.com/opinion/a-case-for-widening-the-taxase /article26130123.ece# (last visited 20 Apr., 2020)

how revenues are actually spent, as tax revenues can also be mismanaged, misspent, and misappropriated, thereby resulting in no positive outcome.

From the above data, it is quite visible that state would face financial crunch, and would be far behind in her duty to provide welfare facilities, ranging from basic needs to that of facilities for health care, education, social security, and employment.

Human Right Concern

It must be noted here that failure of states in non-compliance to the core values of Human rights goes to the roots of the very functioning of state. Thus, wherever there is a violation of Human Rights, it is none other than the state which is to be blamed. The International Covenant on Economic, Social and Cultural Rights, 1966 states that 'each state party to the present covenant undertakes to take steps, individually and through international assistance and cooperation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.[32] Constitution of India through its Part 3rd and Part 4th mandates the state to protect and promote various principles of human rights enshrined in the Constitution.[33] In *Keshavananda Bharti* v. *State of Kerala*,[34] the Supreme Court observed, "the Universal Declaration of Human Rights may not be a legally binding instrument but it shows how India understood the nature of human rights at the time the Constitution was adopted." Supreme Court, realising her constitutional duty towards protecting human rights developed the instrument of 'Public Interest Litigation', and also created a web of judicial activism.

It is, thus, amply clear that state is under constitutional mandate to devise the instrumentalities whereby human rights are going to be protected and promoted.

IV

Tax Havens and International Legal Obligation

The existence and continuation of competitive tax regime is causing adverse impact on the globalised international economy. The worst sufferers of this system are the developing countries. The tax havens are perpetrating tax illegalities by poaching corporations and firms to their jurisdiction, and thereby causing severe dent to limited revenue resulting into shrinking economic growth and development. Thus, question

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32 *See, International Covenant on Economic, Social and Cultural Rights, 1966.* G.A. Res.2200A (XXI). U. N. Doc. 14531 (Dec. 16, 1966).

33 Constitution of India, 1949, Articles: 14, 19, 21, 22 & 32 and Provision of Directive Principles of State Policy such as Article 39, are pivotal in protecting the human rights.

34 A.I.R. 1973 S.C. 1461 at 1510

arises to the very legality and legitimacy of thee tax havens in present regime of international law.

The question about fixing the state responsibility requires fulfilment of two elements; *Firstly*, the theoretical base wherein international norm could be created without offending the age-old state *sovereignty*, and *secondly* a normative obligation under International Law.

Limits of State Sovereignty

Sovereignty, as generally appreciated under the International Law, is a social phenomenon, which is intricately connected with the state, its role in international relations. In fact, the notion of sovereignty developed along with the emergence of modern state under the International Law.[35]It is because of this reason, the *sovereignty* is often linked with independence of state in regulating their municipal affairs including fiscal matters. Professor G. Tunkin characterizes state sovereignty as "… the inherent supremacy of the State in its territory and independence in international relations."[36]Ian Brownlie characterise state sovereignty to that of "equality of states [which] represent[s] the basic constitutional doctrine of the law of nations."[37] It is to be noted that the conceptions of sovereignty is primarily identified with ultimate, effective political power of state, and it stems primarily from prevailing political culture.[38] The concept of sovereignty is stated to be the product of European soil, through the treaty of Westphalia, wherein these states developed the notion of sovereignty based on their political culture. Interestingly, new trends in sovereignty and related political culture is now more visible in Asian and Africa.[39] It is argued here that 'sovereignty' is a dynamic concept which has helped the state in terms of power-bargain in international relations. The concept has never hindered the states in developing new international legal system including international institutions such as International Monetary Fund, World Trade Organisation etc.

The opening line of United Nations Charter could be taken as first definite hint towards diminishing value assigned to the traditional notion of sovereignty. The opening line "We the Peoples of the United Nations determined…" uses interesting expression 'peoples' and 'nations', coupled with the term 'determined', clearly suggesting that it is desired and framed, not by states but the people of the United Nations. Theoretically, it could be argued here that the peoples of the world are the ultimate source of international authority.[40] Article 2(7) read with other provisions of Article 2 of the U.N.

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[35] I.D. Levin, SOVIET STATE AND LAW, 35 (1949).

[36] G.I. Tunkin, BASICS OF CONTEMPORARY INTERNATIONAL LAW, 15 (1956).

[37] Ian Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 287 (4thedn. 1990).

[38] Gabriel Almond & Sidney Verba, THE CIVIC CULTURE: POLITICAL ATTITUDES AND DEMOCRACY IN FIVE NATIONS 498 (1963)

[39] Dieter Fleck (ed.), THE HANDBOOK OF HUMANITARIAN LAW IN ARMED CONFLICT, 13 (1995).

[40] Thomas M. Franck & Faiza Patel, *UN Police Action in Lieu of War: The Old Order Changeth*, 85 AM. J. INT'L L. 63, 66-67 (1991)

Charter further indicates about the possible limits of traditional sovereignty. Though Article 2(7) prohibits the UN not to intervene "in matters which are essentially within the domestic jurisdiction of any state", however, at the same time all states are subject to a good faith obligation to honour the Charter values and are required to settle disputes by peaceful methods.[41] A comprehensive reading of various provisions of UN Charter would suggest that the Charter represents a continuing constitutional process of conflict and collaboration. Later developments in international law are nothing but reflection of this approach.

The development of Human Rights jurisprudence, and the international legal regime thereof, for protecting and promoting human rights is another such instance where rigid notion of sovereignty faded away. For example, while accepting the Universal Declaration of Human Rights, 1948 member states in general assembly of the United Nations agreed to certain categories of Human Rights that are to be upheld by all nations and enjoyed by all individuals. Bare reading of Article 2 of the Declaration, suggests that the states would endeavour to provide these Human Rights "without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status". Thus, a categorical standard is set with universal applicability. The United Nations Declaration states that a nation's action, its laws should mirror the standards set out in the document. The UDHR could be taken as an example, which notion of sovereignty, in its traditional form give way to contemporary human rights argument.

Development of strong legal regime in tackling the international humanitarian crisis,[42] issues pertaining to environment,[43] protection of trade, and intellectual property, and the new movement towards nuclear weapons[44] clearly suggest that world order has never ever been understood in doctrinaire sense. It has enough dynamism to deal with issues which affect human lives. It is thus, visible that notion of sovereignty has never ever been hindrance in developing new international legal regime in dealing with system. Based on this theoretical foundation, it is hereinafter argued that tax havens, which are causing severe human right violation as argued elsewhere, cannot be shielded in the name of sovereignty. Protection of human rights is *erga omnes*, and thus it is

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41 U. N. Charter art. 1(2), 1(3).

42 See, *Geneva Convention for the Amelioration of the Condition of the Wounded and Sick in Armed Forces in the Field*, *1949*, U. N. Doc. 75 UNTS 31(Aug. 12, 1949).

43 Numerous Conventions and treaties have been executed for addressing environmental concern vis., *the Vienna Convention for the Protection of the Ozone Layer, 1985*, U.N. Doc. 26164 (Sep. 22, 1988); *the Montreal Protocol on Substances that Deplete the Ozone Layer, 1987*, U.N. Doc. 26369 (Jan. 1, 1989,); *United Nations Framework Convention on Climate Change*, *1992*, U.N. Doc. 30822 (Mar. 21, 1994).

44 The International Court of Justice (vide A/51/218) declared unanimously that "there exists a legal obligation to pursue in good faith and bring to a conclusion negotiation leading to nuclear disarmament in all its respects." Similarly, the UNGA adopted Resolution vide (A/RES/51/45M) titled as "Advisory Opinion of the International Court of Justice on the legality of the threat or use of nuclear weapons" to deal with nuclear weapons.

responsibility of each state to deter from every act which result into violation of these rights.

Normative Obligation

Can it be said that tax havens, for having harmful tax regime are responsible to other states under International law? The answer to this question depends on existence of certain legal obligation under international law. For ascertaining state responsibility under International Law, could it be said that the 'act' of having a harmful tax regime causes 'legal damage' to other state(s), the same is enforceable under International Law (treaty or customary).

In reference to twin question of state's sovereignty and the existence of obligation to have fair tax policy under international law, OECD committee on Fiscal Affairs questioned the legitimacy of tax havens and stated that 'countries should remain free to design their own tax systems *as long as they abide by internationally accepted standards in doing so*.[45] The report hints towards the existence of '*internationally accepted standards'* which the states are expected to be abide by. The approach of OECD about 'terminating double taxation conventions with uncooperative tax havens' and 'initiatives deployed in cooperation with non-member countries, the advance commitment letter, agreements etc.' are categorical indication towards certain international norms, even if in infancy, which each country is expected to observe.[46] Commentators like T. Rosembuj argue that the

> *'this responsibility, harming tax interests of other states by institutional concealment of the income itself originates an obligation to rectify and even repair the state considered to be a victim for the damage caused. The ordinary source of responsibility due to state evasion is the treaty. But, in the absence of this, the principle of harmful tax competition may be used as a platform for reparations of damages to other states given the fact that without its participation it would not have been possible to carry out*.'[47]

J.G. Starke states that '*it is indeed a matter of international law whether or not, and under which circumstances states, as subjects of international law, are accountable towards other subjects of international law"*.[48] In this regard, the Draft Articles adopted by the International Law Commission, recognized as being authoritative, may provide some futuristic argument for state's responsibility against harmful tax regime.[49] As per Article 1 of the Draft Article, every states which commits internationally wrongful act entails the

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45 *See, OECD Report on Harmful Tax Competition*, OECD, 26 (1998).

46 Advance commitment letter, agreements etc., are subject matter of International law.

47 T. Rosembuj, *Harmful Tax Competition*, INTERTAX 316-334 (1999); *See also*, J. Malherbe, *Harmful Tax Competition and the EU Code of Conduct,* TAX. NOTES INT'L, 151 (2000); J. David B. Oliver, *Tax Sovereignty*, INTERTAX, 146 (2000).

48 J.G. Starke, INTRODUCTION TO INTERNATIONAL LAW, 58 (1989)

49 International Law Commission, *Analytical Guide to the Work of the International Law Commission 1949-1997*", (A/51/10)) 226-256 (1998). *Available at*: https://legal.un.org/ilc/guide/gfra.shtml (last visited 05 May 2020).

international responsibility. Such liability may arise either by way of act which could be termed international crime,[50] international delicts,[51]or liability arising out of internationally permissible act.[52] Whether tax evasion could be cover under the definition of 'international crime' or not, is yet to be determined. However, it is certainly a *transnational act* resulting into huge damage to other states. There is no denying that these tax regimes are attributable to the state.

Conclusion

Gone are the days when tax regulations were treated as essentially domestic in nature, and state use to have complete command over tax policy regulations. With the surge of globally linked trade and business, tax policies need to be balanced in the line of international standards. When financial policies, specially tax policies, are adversely affecting state in terms of their financial wellbeing, it is imperative to evolve alternative tax jurisprudence. It need to reemphasise that any failure in preparing and executing a proper tax policy will inevitably result into revenue loss, and consequently, the human rights are going to be the first casualty. In developing countries, increasing inequalities and poverty can be tackled only by way of articulating a robust tax policy and strict implementation thereof. States have to forge new tools and techniques whereby corporations, companies, and super rich, who usually try to avoid tax liabilities through sophisticated mechanisms, may not get out of tax net.

Tax havens and the manipulation of transfer pricing are global problems, which require global attention. If states do not come together and take strong measures against tax abuses, they will fail to have adequate financial resources to fund their welfare programs and thereby protect human rights of vulnerable strata of their society. It is further cautioned that Double Taxation Avoidance Agreement (DTAA) would have limited impact, as they are applicable between the two states, and it is very doubtful as to whether the tax haven regimes would enforce them in its true spirit. After all, the Double taxation Avoidance Agreement does not contain any obligation to refrain from adopting new tax law, or to maintain any kind of *status quo* in tax laws between the states. Since the effectiveness of state responsibility, in tax matters, is impeded due lack of international obligations on the states, it is high time to develop a comprehensive framework.

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[50] Responsibility of States for Internationally Wrongful Acts (2001), art. 19. Text reproduced as it appears in the annex to General Assembly resolution 56/83 of 12 December 2001 and corrected by document A/56/49(Vol. I)/Corr.4.

[51] *Id.*, art.19(4).

[52] *See, International liability for injurious consequences arising out of acts not prohibited by international law*, II (1) Y.B. INT'L L. COM. (1997).