TAX JUSTICE NETWORK

Haven Indicator 4: Capital gains tax

What is measured?

This indicator measures the extent to which a jurisdiction taxes corporate capital gains arising from the disposal of domestic and/or foreign securities. As such, it assesses the lowest available tax levied on corporate capital gains, applicable for large for-profit corporations which are tax resident in the jurisdiction, irrespective of whether the capital gains are taxed as part of corporate income tax or as part of another type of tax, such as wealth tax or an independent capital gains tax.

This indicator has two components which are equally weighted:

a) the lowest available tax levied on corporate capital gains arising from the disposal of domestic securities; and

b) the lowest available tax levied on capital gains arising from the disposal of foreign securities.

By securities, we mean any negotiable financial instrument with monetary value, including equity shares, corporate debt, government bonds, hybrid financial products and derivatives.

It is worth noting that, although we consider the capital gains tax generally applicable to companies in a jurisdiction, we assess the lowest capital gains rate applicable to any type of (domestic or foreign) security. Thus, if there is a specific type of domestic or foreign security from which companies can derive capital gains at a lower rate, we consider such lower rate for purposes of this indicator.

The lowest available corporate capital gains tax rate in each of the two components is then assessed against 35% in line with Haven Indicator 1 on the lowest available corporate income tax rate ("spillover risk reference rate").[1] A zero capital gains tax rate or an exemption from capital gains tax in each of the components equals a haven score of 50 in each of the components. If both types of securities are exempt from capital gains tax or are taxed at 0%, the combined resulting haven score is thus 100. If the lowest available capital gains tax rate is 35% in each of the components, the haven score is zero. Any rate in between is linearly scaled against 35%.

In cases where different tax rates applies, the haven score is calculated in the following way: 1) determining the jurisdiction's lowest available tax levied for each of the components; 2) subtracting each of these tax rates from the spillover risk reference rate of 35%; 3) scaling the resulting metrics in proportion to a haven score between 0 and 50 for each of the components; and 4) calculating the total haven score by a simple addition of the two components.

While, in general, we consider the lowest capital gains tax rate that is applicable to any company that is tax resident in the jurisdiction, disregarding tax rates applicable to special types of entities, we exceptionally include the tax rate applicable to special types of entities in two situations. First, if a special type of entity can engage in economic activities in a broad range of sectors (4 or more) which are exempt, we consider lower tax rates applicable to such company, if any.[2] Second, when holding companies are offered lower tax rates for domestic or foreign capital gains, we also consider these entities for this Haven Indicator 4.[3]

Investment funds as well as other types of funds that are open to the general public (both "regulated" funds such as mutual funds or hedge funds, and any investment entity that may not be regulated, such as a family trust) are not considered within the scope of this Haven Indicator for various reasons. First, their legal form varies significantly depending on the country and in some cases, they are not considered a company (but rather a partnership or trust or other legal form); second, they usually can undertake a very narrow range of business activities whereas Haven Indicator 4 takes a more holistic approach and thus does not consider specific types of entities; finally, investment funds which are open to the public are usually not subsidiaries of large multinational corporations given the shareholding is diluted within a large group of corporate and individual shareholders.

The data for this indicator was collected primarily from country analyses and country surveys in the International Bureau of Fiscal Documentation (IBFD) database.[4] In some instances, we have also consulted additional websites and reports of accountancy firms.

The scoring matrix is shown in Table 4.1, with full details of the assessment logic presented in Table 4.3 below.

Table 4.1: Scoring Matrix Haven Indicator 4

Regulation	Haven Score [100 = maximum risk; 0 = minimum risk)
Component 1: Taxation of corporate capital gains from domestic securities (50)	
A zero capital gains tax or an exemption from capital gains tax is equal to a haven score of 50.	50
Where the capital gains tax rate is higher than 0% and smaller than 35%, it is subtracted from 35% and then linearly scaled in proportion to determine a haven score between 0 and 50.	0> and <50
Capital gains tax which is set at 35% (or above) is equal to a haven score of zero.	0
Component 2: Taxation of corporate capital gains from foreign securities (50)	
A zero capital gains tax or an exemption from capital gains tax is equal to a haven score of 50.	50
Where the capital gains tax rate is higher than 0% and smaller than 35%, it is subtracted from 35% and then linearly scaled in proportion to a haven score between 0 and 50.	and <50
Capital gains tax which is set on 35% (or above) is equal to a haven score of zero.	0

All underlying data can be accessed in the Corporate Tax Haven Index database[5]. To see the sources we are using for particular jurisdictions please consult the assessment logic in Table 4.3 and search for the corresponding info IDs (IDs 513 and 514) in the database report of the respective jurisdiction.

Why is this important?

By purchasing and holding assets through intermediary companies in jurisdictions with no or low capital gains taxation, the corporate income tax and capital gains tax systems of any jurisdiction can be easily circumvented. Therefore, the availability of jurisdictions with low or no capital gains taxation jeopardises the tax base of other jurisdictions and creates tax spillover effects.

In a response to these profit shifting techniques regarding highly mobile financial and other service activities, countries often choose to enter the race to the bottom by providing lower taxes for holding passive investments. As a result, nowadays many countries in practice apply very low or no taxes on the income from shareholdings (a term jointly used to refer to dividend income and capital gains).[6]

One of the ways to do this is through the application of special rules of a holding company regime.[7] For example, in Dominica, International Business Companies are exempt from corporate tax and capital gains and can be used as holding companies.[8] Otherwise, capital gains are often exempt through what is known as a participation exemption system.[9] Participation exemption is widely used by European Union member states, countries in the European Economic Area[10] and many other countries as well. The legislation which regulates participation exemption regimes may either establish no conditions for granting the exemption or alternatively may require a minimum threshold and/or business activity test and/or holding period.[11]

The extent of participation exemption varies among jurisdictions. Some jurisdictions, such as Malta[12] and Aruba[13] exempt from tax all capital gains on domestic and foreign shares derived from a participating holding or from the disposal of such holding. Other jurisdictions, such as Germany[14], France[15] and Italy[16], may only partially exempt from tax capital gains by adding back to the taxable income a lump sum of a certain percentage of the capital gains.

The OECD does not perceive low or no effective tax rates imposed on income from shareholdings as harmful per se, given that these rates may be a result of a policy that seeks to mitigate double taxation.[17] However, these policies seeking to mitigate double taxation can result in double non-taxation as the transformation of regular income into capital gains is a key pillar of many tax avoidance strategies. As long ago as 1998, the OECD, in its Harmful Tax Competition Report ('1998 Report'), recommended countries not to exempt capital gains (from the disposal of securities) from tax in cases where the investee company is subject to a low-tax regime.[18] In addition, it specified low or no effective tax rates as a gateway criterion (one of the four key factors) in determining whether a preferential regime is considered potentially harmful.[19] Another of the factors is whether the jurisdiction excludes resident taxpayers from taking advantage of the preferential regime or if an entity that can benefit from the regime is prohibited from operating in the domestic market.[20]

According to the OECD's approach – which was further developed in its Base Erosion and Profit Shifting Action 5 report[21] – where low or no effective taxation and one or more of the remaining three key factors apply, a regime will be characterised as potentially harmful. The meaning of a 'potentially harmful' regime according to the OECD, is that "the features of the regime implicates one or more of the criteria, but that an assessment of the economic effects has not yet taken place to make a determination as to whether the regime is 'harmful'".[22]

The OECD also defines a two-step process for determining whether a preferential regime is 'potentially harmful but not actually harmful'. First, the review of the regime's legal framework leads to a decision on whether it is possible for the regime to negatively affect the tax base of other jurisdictions, for example by being designed as a low-tax and ring-fenced regime.

Second, the regime is assessed as to whether it has a negative impact in practice by reviewing the historical economic data about the operation of the regime. This can be done by analysing the number of taxpayers and the amount of income benefiting from the regime.[23] Given that the historical statistical data about the operation of the regime may subsequently change, this approach is hardly suitable for a reliable test of "harmfulness".[24]

In any case, the existence of the gateway criterion of low or no capital gains tax may be abused in itself by investors that can avoid capital gains taxation in their country of residence by structuring their investment accordingly. Hence, jurisdictions that exempt domestic or foreign capital gains from taxation contribute to base erosion and profit shifting in other countries.

Haven Indicator 4: Capital gains tax

Results Overview

Figure 4.1: Capital Gains Taxation: Domestic Securities

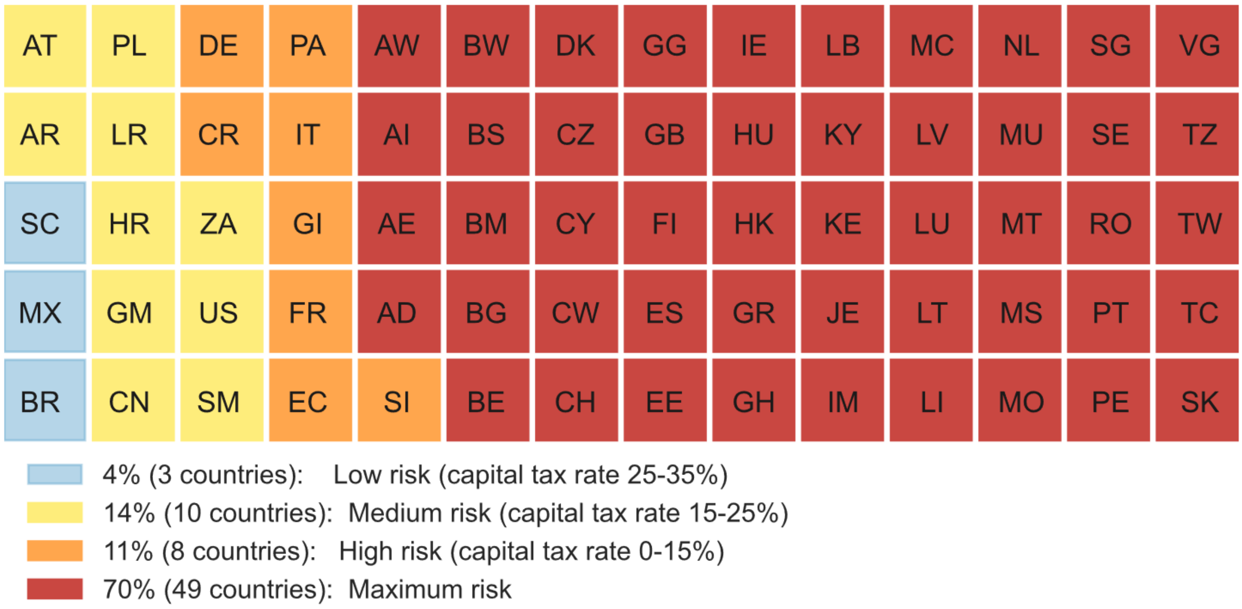

Figure 4.2: Capital Gains Taxation: Foreign Securities

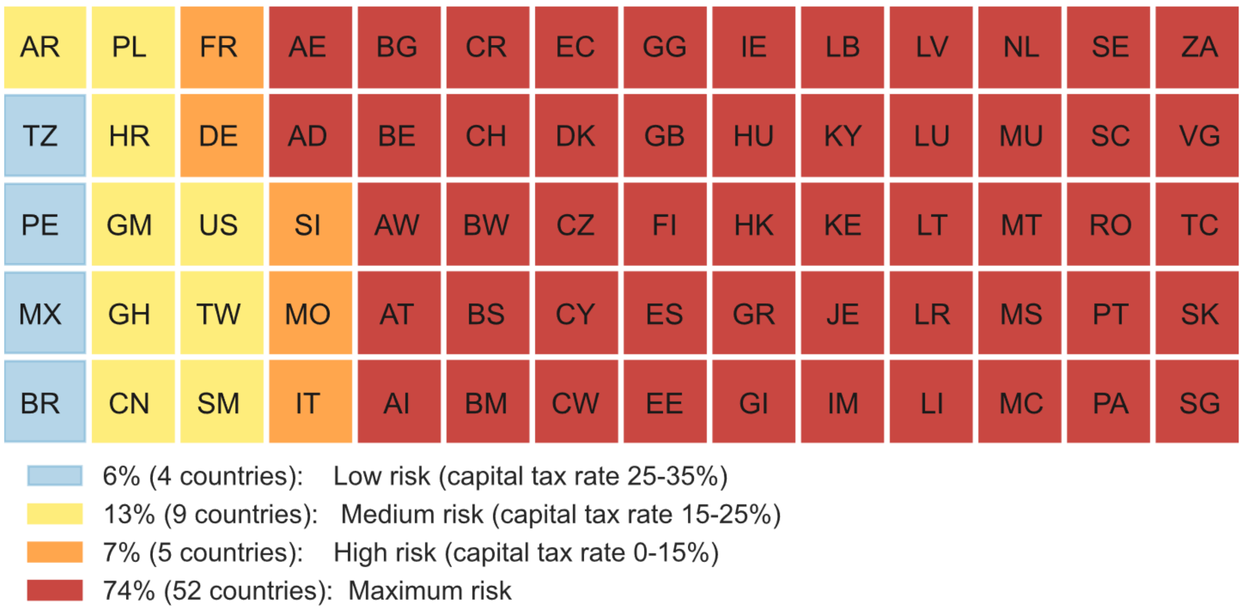

Table 4.2: Capital Gains Taxation – Haven Indicator Scores

Haven Score	ISO2: Country Name	
100	AW:	Aruba
100	AI:	Anguilla
100	AD:	Andorra
100	AE:	United Arab Emirates
29	AR:	Argentina
64	AT:	Austria
100	BE:	Belgium
100	BG:	Bulgaria
100	BS:	Bahamas
100	BM:	Bermuda
3	BR:	Brazil
100	BW:	Botswana
100	CH:	Switzerland
29	CN:	China
79	CR:	Costa Rica
100	CW:	Curaçao
100	KY:	Cayman Islands
100	CY:	Cyprus
100	CZ:	Czechia
97	DE:	Germany
100	DK:	Denmark
86	EC:	Ecuador
100	ES:	Spain
100	EE:	Estonia
100	FI:	Finland
89	FR:	France
100	GB:	United Kingdom
100	GG:	Guernsey
64	GH:	Ghana
86	GI:	Gibraltar
29	GM:	Gambia
100	GR:	Greece
100	HK:	Hong Kong
49	HR:	Croatia
100	HU:	Hungary

Haven Score	ISO2: Country Name	
100	IM:	Isle of Man
100	IE:	Ireland
97	IT:	Italy
100	JE:	Jersey
100	KE:	Kenya
100	LB:	Lebanon
64	LR:	Liberia
100	LI:	Liechtenstein
100	LT:	Lithuania
100	LU:	Luxembourg
100	LV:	Latvia
83	MO:	Macao
100	MC:	Monaco
14	MX:	Mexico
100	MT:	Malta
100	MS:	Montserrat
100	MU:	Mauritius
100	NL:	Netherlands
86	PA:	Panama
58	PE:	Peru
46	PL:	Poland
100	PT:	Portugal
100	RO:	Romania
100	SG:	Singapore
51	SM:	San Marino
100	SK:	Slovakia
73	SI:	Slovenia
100	SE:	Sweden
57	SC:	Seychelles
100	TC:	Turks and Caicos Islands
71	TW:	Taiwan
57	TZ:	Tanzania
40	US:	United States
100	VG:	British Virgin Islands
68	ZA:	South Africa

Haven Score

Low Haven Score ← → High Haven Score

0 to <25 | 25 to <50 | 50 to <75 | 75 to 100

Table 4.3: Assessment Logic

Info_ID	Text_Info_ID	Answers (Codes applicable for all questions: -2: Unknown; -3: Not Applicable)	Valuation Haven Score
513	Domestic Securities Capital Gains Taxation: What is the lowest available capital gains tax rate arising from disposal of domestic securities applicable for large "for profit" companies which are tax resident in the jurisdiction?	Capital gains tax rate (between 0 and 35)	Score = ((35 – answer)/35)*50
514	Foreign Securities Capital Gains Taxation: What is the lowest available capital gains tax rate arising from disposal of foreign securities applicable for large "for profit" companies which are tax resident in the jurisdiction?	Capital gains tax rate (between 0 and 35)	Score = ((35 – answer)/35)*50

Reference List

Cayman Islands Monetary Authority, 'Definition of Mutual Fund', *Cayman Islands Monetary Authority*, 2021 <https://www.cima.ky/investment-funds#:~:text=The%20Cayman%20Islands%20has%20company,and%20the%20exempted%20limited%20partnership.> [accessed 19 January 2021]

Davis Tax Committee, *Addressing Base Erosion and Profit Shifting in South Africa - Interim Report.* <http://www.taxcom.org.za/docs/New_Folder/4%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%205%20-%20Harmful%20Tax%20Practices,%202014%20deliverable.pdf> [accessed 1 January 2019]

Guglielmo Maisto, and Jacques Malherbe, *Trends in the Taxation of Capital Gains on Shares under Domestic Law -Part One.* <https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Taxation-of-Companies-on-Capital-Gains-sample.pdf> [accessed 1 January 2019]

IBFD, *Tax Research Platform: Country Surveys, Country Analyses, Country Key Features*, Accessed 2018-2019, 2018 <https://research.ibfd.org/> [accessed 9 May 2019]

OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (2015) <http://www.oecd-ilibrary.org/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en> [accessed 16 August 2018]

———, *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project (2017) <https://www.oecd-ilibrary.org/taxation/harmful-tax-practices-2017-progress-report-on-preferential-regimes_9789264283954-en> [accessed 16 August 2018]

OECD Centre for Tax Policy and Administration, *Consolidated Application Note- Guidance in Applying the 1998 Report to Preferential Tax Regimes.*, 2004 <https://www.oecd.org/tax/transparency/about-the-global-forum/publications/1998-consolidated-application-note.pdf> [accessed 31 December 2018]

Organisation for Economic Co-Operation and Development, *Harmful Tax Competition. An Emerging Global Issue* (Paris, 1998) <http://www.oecd.org/dataoecd/33/0/1904176.pdf (accessed 11 Jan 2006)>

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[1] The rate of 35% is the spillover risk reference rate defined for haven indicator 1. The rate was determined by filtering: a) all jurisdictions for democracies, and b) sorting for the highest corporate income tax rates observed. As a result of this analysis, the spillover risk reference rate is set at 35%. The highest rates found in democracies are Pakistan and Brazil, with 35% and 34%, respectively. In both countries, capital gains are included in the corporate income and are thus taxed equally at the corporate income tax.

[2] The basis for this exception is the following: If a jurisdiction allows a special type of entity that is able to engage in a broad range of economic activities, then such entity may be the vehicle of choice for large multinationals, regardless of the specific business carried out. Thus, it is appropriate to consider that the lowest tax rate applicable to a tax resident subsidiary of a multinational company is the tax rate applicable to such special type of entity.

[3] The rationale in this case is similar: Large multinationals often use holding companies to manage shareholdings in other companies in the corporate group, or set up financing arrangements. Because this type of company is the legal vehicle of choice for multinationals accruing capital gains upon the sale of domestic or foreign securities, we consider any lower rate applicable to holding companies, for the assessment of the capital gains rate in Haven Indicator 4.

[4] IBFD, *Tax Research Platform: Country Surveys, Country Analyses, Country Key Features*, 2020 <https://research.ibfd.org/> [accessed 2020-2021]

[5] Corporate Tax Haven Index database: https://cthi.taxjustice.net/cthi21/data-downloads

[6] Organisation for Economic Co-Operation and Development, *Harmful Tax Competition. An Emerging Global Issue* (Paris, 1998), 25 <http://www.oecd.org/dataoecd/33/0/1904176.pdf (accessed 11 Jan 2006)>.

[7] OECD Centre for Tax Policy and Administration, *Consolidated Application Note-Guidance in Applying the 1998 Report to Preferential Tax Regimes.*, 2004, 63–64 <https://www.oecd.org/tax/transparency/about-the-global-forum/publications/1998-consolidated-application-note.pdf> [accessed 31 December 2018].

[8] 'Dominica International Business Company (IBC) Formation and Benefits', *Offshore Company*, 2017 <https://www.offshorecompany.com/company/dominica-ibc/> [accessed 5 March 2021].

[9] OECD Centre for Tax Policy and Administration, *Consolidated Application Note-Guidance in Applying the 1998 Report to Preferential Tax Regimes.*, 63–64. Participation exemption was adopted after the repeal of the imputation system, often as a way to mitigate against what was called "double taxation".

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[10] Guglielmo Maisto and Jacques Malherbe, *Trends in the Taxation of Capital Gains on Shares under Domestic Law -Part One.*, 9 <https://www.ibfd.org/sites/ibfd.org/files/content/pdf/Taxation-of-Companies-on-Capital-Gains-sample.pdf> [accessed 1 January 2019].

[11] Guglielmo Maisto and Jacques Malherbe, *Trends in the Taxation of Capital Gains on Shares under Domestic Law -Part One.*, 14.

[12] In Malta, capital gains derived from a participating holding or from the disposal of such holding are exempt from tax. For further details, see: Conrad Cassar Torregiani, *Malta - Corporate Taxation - 1. Corporate Income Tax* (16 September 2020), sec. 1 <https://research.ibfd.org/#/doc?url=/collections/cta/html/cta_mt_s_001.html> [accessed 5 March 2021].

[13] In Aruba, capital gains received by an Aruban resident company from domestic or foreign company are exempt under the participation exemption, provided that several conditions are met. For further details, see: Sandy van Thol, *Aruba - Corporate Taxation - 1. Corporate Income Tax* (24 September 2020), sec. 2 <https://research.ibfd.org/#/doc?url=/collections/gtha/html/gtha_aw_s_001.html > [accessed 5 March 2021].

[14] For example, in Germany, a lump sum of 5% of the gains is added back to taxable income representing non-deductible business expenses (section 8b (3) of the KStG). For further details, see: Andreas Perdelwitz, *Germany - Corporate Taxation* (1 October 2020), sec. 2 <https://research.ibfd.org/#/doc?url=/linkresolver/static/cta_de> [accessed 5 March 2021].

[15] In France, the disposal of shares is exempt from capital gains tax but a lump sum of 12% of the gains is added back to taxable income. For further details, see: Pierre Burg, *France - Corporate Taxation* (1 January 2021), sec. 1 <https://research.ibfd.org/#/doc?url=/linkresolver/static/cta_fr> [accessed 5 March 2021].

[16] Italy applies the 95% participation exemption for gains from shares and the remaining 5% of the gains are added back to taxable income. For further details, see: Cesare Silvani, *Italy - Corporate Taxation, Country Tax Guides IBFD* (15 October 2020), sec. 1 <https://research.ibfd.org/#/doc?url=/linkresolver/static/cta_it_s_1.4.9.&refresh=1611210801111#cta_it_s_1.4.9.3.> [accessed 21 January 2021].

[17] OECD Centre for Tax Policy and Administration, *Consolidated Application Note- Guidance in Applying the 1998 Report to Preferential Tax Regimes.*, 67.

[18] Guglielmo Maisto and Jacques Malherbe, *Trends in the Taxation of Capital Gains on Shares under Domestic Law -Part One.*, 14.

[19] Organisation for Economic Co-Operation and Development, *Harmful Tax Competition. An Emerging Global Issue*, 6.

[20] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (2015), 69 <http://www.oecd-ilibrary.org/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en> [accessed 16 August 2018]. For example, the 'headquarter regime' in South Africa- which grants preferential tax treatment to taxpayers was considered potentially harmful by the OECD, among others, because it ring-fences the tax benefits from resident taxpayers while enabling foreign MNEs to use South Africa as a conduit for passive income flows. For further details, see: Davis Tax Committee, *Addressing Base Erosion and Profit Shifting in South Africa - Interim Report.*, 17 <http://www.taxcom.org.za/docs/New_Folder/4%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%205%20-%20Harmful%20Tax%20Practices,%202014%20deliverable.pdf> [accessed 1 January 2019]. See also OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, 64.

[21] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, 20.

[22]OECD, *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project (2017), 15 <https://www.oecd-ilibrary.org/taxation/harmful-tax-practices-2017-progress-report-on-preferential-regimes_9789264283954-en> [accessed 16 August 2018].

[23] OECD, *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes*, 33.

[24] OECD, *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes*, 33.