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**OFFSHORE SOCIETIES IN “PANAMA PAPERS” ERA. LATIN AMERICAN DILEMMAS ABOUT TAX EVASION AND FOREIGN INVESTMENT INCENTIVE**

**Abstract:**

The research problem is: Should the Colombian State restrict the inflow of capital through the use of offshore companies and avoid tax evasion in this way? This problem contemplates two current scenes: Firstly, Colombian State should prevent the inflow of foreign investment based on offshore companies established in tax havens, because these are used as a strategy to avoid paying taxes. Secondly, Colombian State should not restrict access of foreign investment by means of offshore companies. However, to guarantee due taxation cooperation agreements with those countries considered by the OECD as tax havens, should be signed in order to achieve greater control and monitoring of financial movements.

The presentation defines the legal nature of offshore companies, assessing their advantages and the relationship they have with tax havens. It describes the effect of Colombian law on the issue and the impact that these societies have on the system of taxation and the financing of social policies. It identifies the criminal consequences that arise when these types of societies are used as a mechanism of money laundering or tax avoidance and will analyze the implications for a developing country such as Colombia, to restrict or prevent their entry into the country.

**Keywords:**

Offshore Society, Tax Evasion, Panama Papers, foreign investment, Latin America

**JEL Classification:** K20

In 2016 Latin American, European, African and Asian countries, were shaken for the called "Panama Papers" scandal. Colombia was affected as well for this situation, worsen to be a neighbouring country with serious problems of tax evasion, corruption and money laundering. The country has a traditional societal and fiscal, that has forced the governments in charge to implement rules that make it more flexible trying to increase foreign investment and boost the development of the local economy. This presentation will study the offshore societies and their relationship with tax havens including tax evasion, evaluating the effects of the restriction of capital inflows and foreign investments through offshore companies.

The International Consortium of Investigative Journalists and *Süddeutsche Zeitung*, revealed in the first six months in 2016 a report brought to light the creation of about 200.000 companies that would have been used to evade taxes. Among them are 1,854 offshore companies with a record of more than 1,000 Colombian clients. Globally, those involved in offshore companies include 12 heads of state (6 in office), 128 political leaders and senior officials and 29 of the 500 richest people in the world.

Colombia is one of only two countries with which Panama shares the land border, so it was not surprising that when the Panama Papers scandal erupted, the impact in Colombia was as great as in many highly developed states involved. There are 11.5 million documents that make up a compendium of 2.6 terabytes of information, which is 2,300 times larger than the so-called Wikileaks, and involve 320,000 entities and 200,000 names of partners and associates. For Colombia, 1845 companies and 1245 people have been identified. It has been called Panama Papers, but there are more offshore partnerships involved in Bahamas and British Virgin Islands than in that country. Some of the Colombian characters implicated in the scandal are the brother-in-law of Petro (former mayor of the capital and presidential candidate), De la Calle (chief negotiator of the government with the FARC and presidential candidate) and the two children of former president Álvaro Uribe.

Offshore companies are those that are constituted under a foreign law, which allows them "to carry out commercial activities outside the jurisdiction, are exempt from all taxation." They are characterized by banking secrecy, little or no taxation, "armor of assets, absence of rules of capitalization delegated [...] bearer shares and freedom of investment. These types of companies generate a correlative benefit between the offshore center and the persons who constitute the company since that one receives the capitals that stir his economy into action while the businessmen receive a great tributary relief.

They have been termed "black holes" as acknowledged at the Lyon G7 summit in July 1996 as economic globalization encourages the emergence of "fiscal schemes designed to attract mobile, financial and other activities, can create harmful tax competition between States, with the risk of distorting trade and investment." Hence the relationship between offshore companies and tax havens is close. A tax haven is that:

(...) country or locality that does not apply any income tax or earnings; or that applies a relatively low rate of tax in comparison with the rates of taxes normally used in the principal industrialized countries; or that offer some particularities in his tributary laws that assign treatments favorable to persons or specific transactions.<sup>1</sup>

According to the OECD, a tax haven is characterized by having a jurisdiction that does not impose taxes or these are only nominal, lack of transparency, laws or administrative practices do not allow the exchange of tax information with other countries and facilitate non-residents to benefit from discounts, even if it does not effectively develop an activity in the country.

For the Colombian case, it is estimated that in 2014 four trillion pesos were lost due to tax havens. According to estimates by the Republic Bank, in the last two decades, 34% of foreign investment in the country comes from offshore companies based in tax havens and correlatively 30% of investments and payments made from Colombia have gone to tax havens.

Colombia ranks 53 out of 190 states in the ease of doing business according to the Doing Business ranking of the World Bank, being the second best Latin American country, only surpassed by Mexico (47th place). The best evaluated aspects for the country are obtaining credit (1st in Latin America and 2nd in the world), handling construction permits, protecting minority investors, registering property and solving insolvency. The weaknesses of the country are in terms of contract compliance (31st in Latin America among 32 countries, surpassing only the Republic of Suriname), post-border trade and payment of taxes.<sup>2</sup>

Colombia has a commercial status and a tax regime that discourage business activity. Discounting the simplified corporations regulated by Law 1258 of 2008, the formation of companies commits the entrepreneur or contractor with declaratory and tax burdens greater than those offered by offshore companies in Panama where they are governed by Law 32 of 1927 (on corporations). Offshore are not illegal since they have been accepted as a kind of Limited Liability Company or corporation, according to the convenience of the businessmen.

Hence, through Law 788 of 2002<sup>3</sup>, the government took the first step to control the issue by being obliged to define a list of jurisdictions considered as tax havens, according to the following criteria: a) no tax rates or nominal rates on the low income, with respect to those that would be applied in Colombia in similar operations; B) lack of an effective exchange of information or existence of legal norms or practices that limit it; (C) lack of transparency in the legal, regulatory or administrative functioning, and (d) lack of a requirement for

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<sup>1</sup> CHIARELLA PRIVETTE, José. Some notes about so-called "tax havens". *Ius et veritas* - 26. file: /// C:/Users/NN/Downloads/16247-64568-1-PB.pdf.

<sup>2</sup> Panama has a high tax rate for its national companies, ranking 28th in Latin America and 170th in the world.

<sup>3</sup> LAW 788 of December 27, 2002. By which rules are issued in tax and criminal matters of the national and territorial order; And other provisions are issued. Official Gazette No. 45,046 of December 27, 2002

substantive local presence, the exercise of a real activity and economic substance (DIAN, 2014).

The list of 37 countries or territories that was issued on October 21, 2014, does not include Panama and is the one that remains in force (Decree 1966 of October 7, 2014 modified by Decree 2095 of October 21, 2014, Incorporated in the Single Regulatory Decree 1625 of October 11, 2016)<sup>4</sup>.

The most common forms of offshore companies are the International Business Company, which may take the form of a limited liability company or limited liability company, and the Limited Liability Company, which is limited liability and is required to declare the benefits you get.

In Colombia, foreign companies only tax when they obtain income or profits from a national source, so that offshore companies are exempt from liquidating and declaring presumptive income if in Colombian territory they have not obtained any gain (article 20-2 of the Tax Statute modified by Article 87 of Decree 1607 of 2012).

The following are two examples of tax evasion customary in Colombian offshore companies:

- Elusion of incomes without national source: 1. Offshore Company turns the money, 2. Society in Colombia receives the money, 3. Absence of national source gain and 4. Absence of taxation and presumptive income.
- Mining companies: 1. Purchase the percentage of mineral that corresponded to the territorial entity for royalties, 2. The royalties are included in the expenses reducing the value of taxes, 3. Sale of the mineral to an offshore company owned by the same Company for a lower value than the purchase, 4. The offshore company sells it to another company for a much higher value, so what spent on the alleged sale makes them pass as a counter-utility, which decreases taxes

The national legislation penalizes criminally anyone that they are well involved in offshore companies when dealing with money laundering. In tax matters, it is only a crime to evade taxes from operating activities of a legal rent monopoly. The Ministry of Finance and Public Credit has in recent years proposed tax evasion in general, but has not found support from most legislators.

I believe that it should be a crime, with a high punitive aggravation for tax havens, since tax evasion offends high social interests by preventing the fulfillment of the ethical-social function of the State via tax, hence criminal law should help, to restore the desired balance,

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<sup>4</sup> Not included in this list are 12 of the 15 territories that have been identified as the "most aggressive" tax havens classified by Oxfam "because they facilitate the most extreme mechanisms of tax evasion and corporate tax avoidance, fueling unrestricted tax competition" ( Oxfam, December 12, 2016, pp. 4-5). The three territories included are Bahamas, Hong Kong and Mauritius.

as it is the most extreme instrument available to the legal system, and extreme is the offense that the evader to the administration and society.

It is estimated that by 2014, Colombian offshore companies had US \$ 100 billion in tax havens, equivalent to the state budget for 2017, plus an additional third. Thus, not only should penal sanctions be imposed on tax evasion of offshore companies, but the administrative sanctioning regime should be strengthened to seek the recovery of the evaded taxes, and the sanctioned person should assume severe severity charges.

In this way an adequate tension between three factors could be achieved: the need for social defense, the characteristics of business operations and the guarantees inherent in the core of traditional criminal law, and thus avoiding the overflow of criminal law.