

**TAX TRANSPARENCY: IMPACT OF TAX HAVENS ON DEVELOPING COUNTRIES**

by

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## ABSTRACT

### TAX TRANSPARENCY: IMPACT OF TAX HAVENS ON DEVELOPING COUNTRIES

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#### **Background:**

Tax transparency has been in the limelight for many years and countries around the world have made it a priority as it carries with it more benefits than problems. Developing countries also face these problems. Tax havens, on the other hand, provide opportunities and benefits for those who utilise them and further provide more problems than solutions for countries, especially developing countries. This study conducted a systematic approach which reviewed literature currently available to determine the current status of tax transparency and the impact that tax havens have on developing countries.

#### **Main purpose of study:**

To conduct a systematic review of peer-reviewed academic journal articles found on selected databases with the aim of determining the status of literature regarding tax transparency and the impact that tax havens have on developing countries. The study provides a structured overview of the academic journals publications on tax transparency, tax havens and developing countries.

#### **Method:**

This study was conducted using a systematic review research approach. Keywords were used to search peer-reviewed academic journal articles on databases; articles between 1993 and 2018 were sourced and selected based on relevancy to answer the research

question. The search yielded a total number of sixty-one articles which were analysed and utilised to answer the research question.

### **Results:**

The study included sixty-one articles which were sourced and selected on academic databases based on relevancy to the topic. The findings indicate that tax transparency impacts positively on developing countries' ability to collect revenue and enhance their tax base, along with other benefits. Tax havens have a positive impact on individuals and companies, but they negatively impact countries' abilities to generate more revenue and increase the tax base.

### **Conclusions:**

This study found that tax transparency has a positive impact on developing countries as it provides benefits, such as boosting their revenue collections and tax base while tax havens impact them negatively as revenues which should be generated by those respective countries are diverted to tax havens. Countries, companies and individuals who utilise tax havens enjoy the benefits that they provide, however, countries lose more than they gain with regard to tax havens.

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## KEY TERMS

**Table 1:Key terms used in the study**

<u>Key term</u>	<u>Description</u>
Horizontal Monitoring System	A form of working in the present influenced by mutual trust, understanding and transparency which is between the enterprises and tax authorities (International Tax Review, 2013:4).
<i>De jure</i> bank secrecy	<i>De jure</i> is a bank secrecy that compels the banks and other financial institutions not to disclose investors or depositors' identity, except in cases where there is money laundering and other criminal activity (Spencer, 2005:2).
<i>De facto</i> bank secrecy	<i>De facto</i> is a bank secrecy that allows banks and other financial institutions not to provide information through the use of automatic reporting to governments regarding foreign depositors or investors (Spencer, 2005:2).

## LIST OF ABBREVIATIONS AND ACRONYMS

**Table 2:Abbreviations and acronyms used in the study**

<u>Abbreviation/Acronym</u>	<u>Meaning</u>
ATAF	African Tax Administration Forum
BEPS	Base Erosion and Profit Shifting
CbCR	Country by Country Reporting
CIT	Corporate Income Tax
EIOR	Exchange of Information on Request
EU	European Union
UD	UN Financing for Development

G8	Group of eight countries (Canada, France, Germany, Italy, Japan, Russia, United Kingdom and United States of America).
G20	Group of twenty countries (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and the European Union).
GDP	Gross Domestic Products
OECD	Organisation for Economic Co-operation and Development
PIT	Personal Income Tax
UN	United Nations
UK	United Kingdom

**TITLE**  
**TAX TRANSPARENCY: IMPACT OF TAX HAVENS ON DEVELOPING COUNTRIES**

**CHAPTER ONE**

**INTRODUCTION**

**1.1 RATIONALE/ MOTIVATION FOR THE RESEARCH**

Tax transparency has been on the agenda of many countries including developing countries (Pross, Kerfs, Hondius, Housden & Radhanath, 2016:1), and it is currently a concern for them. Transparency refers to something similar to openness (Woods, 2018:1). Tax transparency has different meanings; it is used by organisations to communicate the tax approach being taken and also the amount of tax being paid. Organisations also use it to provide clarity on complex tax matters and boost stakeholder confidence by providing assurance that a fair share of tax is being paid. Tax transparency is also used by governments to disclose the amount of taxes received and enhance co-operation between countries through information sharing regarding the same taxpayer (Ernst & Young, 2013:9).

Tax transparency can be viewed as openness to communicate tax status. Woods (2018:1) further highlights that tax transparency is critical to good governance. It is also viewed as a crucial weapon in fighting tax fraud; tax evasion; base erosion and profit shifting and it is an important tool to assist revenue authorities to generate more revenue for their respective countries (Pross et al., 2016:1). In addition, tax transparency is also believed to be a weapon in fighting aggressive tax planning and encourages information sharing between countries (Anonymous, 2015:1).

It is a fact that tax transparency is on the agenda of countries, therefore this includes developing countries. According to Ring (2016:26), there is no single agreed definition of developing countries, however, while the United Nations (UN) recognises that it groups countries into three broad categories, namely developed economies, economies in transition, and developing economies. Nielsen (in Ring, 2016:26-27) further states that despite the availability of a range of approaches to country classification, the ultimate purposes of classifying countries as such is to highlight the underlying normative

implications of classification schemes and factors, such as Gross National Income, longevity and education, which are key in assessing the status of a country.

The Organisation for Economic Co-operation and Development (OECD) has laid the foundation and it is continuing to encourage tax transparency through a number of initiatives and standards, including Country by Country Reporting (CbCR) and Exchange of Information on Request (EOIR), to name a few (Pross et al., 2016:1). In an attempt to persuade and uphold greater transparency in tax reporting among South African companies, the tax component of the UK Building Public Trust Awards was also introduced (Venter, Stiglingh, & Smit, 2017:11).

This highlights the importance of tax transparency for countries in general particularly developing countries and the collection of revenues. However, since tax transparency is associated with openness, the opposite of openness is closeness; it can, therefore, be assumed that so far tax transparency appears to be a good thing as it appears to be open and honest. whereas tax havens have been found to hinder transparency as by definition they attempt to hide or be closed off (Whitehead, 2013:2).

Tax havens are found to be the opposite of tax transparency. Karp (1993:1) defines a tax haven as a place with no taxes. It is also defined as a place that seeks to attract businesses by offering facilities that are politically stable to assist individuals or entities get around the regulations, laws and rules of jurisdictions elsewhere (Gilleard, 2014:1). The OECD (in Slemrod and Wilson, 2009:1) define it as a jurisdiction that imposes no or nominal taxes and offers itself as a place where non-residents use to escape paying taxes in their country of residence.

Tax havens have been found to be a problem as they affect the budgetary revenue of countries (Radu, 2012:1) and have a direct impact on tax transparency. According to Grocott and Stevenson (2010:3), a large volume of tax leakages were as a result of lax regulations and poor exchange of information with certain tax havens. This already indicates that tax havens become problematic to tax transparency, especially with regard to non-haven countries. According to Radu (2012:2), companies use tax havens to reduce tax liability. Tax havens appeal to private investors because they have no or nominal taxation and operate under strict secrecy rules. This enables investors to conceal income from the tax authorities

of their respective home countries (Konrad & Stolper, 2016:1). It is therefore assumed that tax havens are a problem for non-haven countries.

Equivalents of 10% of the world's Gross Domestic Products (GDP) are held in tax havens globally (Alstadsæter, Annete, Johanesen, Niels, Zucman & Gabriel, 2018:1). According to Bucovetsky (2014:2), tax havens account for less than 1% of the world population. The OECD estimates that developing countries lose three times more as a result of tax haven operations than they receive through international aid (Ring, 2016:30). Reports suggest that 20 trillion is hidden in tax havens that are currently in operation and over 60 billion of annual tax revenues are lost due to the multinational corporations' use of international tax strategies (Alexander, 2013:3). These estimations already provide a brief overview of how non-haven countries are affected or impacted by tax havens particularly with regard to the tax base and revenue collections.

According to Alstadsæter et al. (2018:2), cross-border wealth management was first developed in 1920 by Switzerland and Hong-Kong has been ranked second after Switzerland. In 2009, thirty-five (35) tax havens were identified which represented over 15% of the world's countries (Slemrod & Wilson, 2009:1). Prior to that, a list of tax haven countries was provided in 2008 (Schwarz, 2011:10). Johannesen and Zucman (in Alstadsæter et al. 2018:9) finds that Europeans held 90% of the wealth in Switzerland and it is further estimated that 90%-95% of the wealth owned by Danish and Norwegian households at HSBC Switzerland was undeclared.

Literature reveals that the absence or lack of tax transparency is partly the source of problems in countries who seek to maximise revenue collections and there are many more problems associated with it (Grocott & Stevenson, 2010:3, Anonymous, 2012:2, Alexander, 2013:2, Teather, 2016:2). According to Grocott and Stevenson (2010:4), African Business (2015:2), Anonymous (2012:2), loss of revenue was, to a certain extent, as a result of lack of tax transparency. While Grocott and Stevenson (2010:3), together with Houlder (2016:2) believe that tax havens also contributed to the problem.

It is clear that countries particularly developing countries have problems with increasing their tax base and maximising revenue collections according to the above brief findings. It is noted that, so far, literature highlighted the importance of tax transparency for countries and the

fact that tax havens are problematic to these countries, however at this stage it is not known whether developing countries are also affected in the same manner. Currently, the extent of the impact of tax transparency and tax havens on developing countries is not known. Hence, this study seeks to provide a structured overview of the current status of literature with regard to this issue.

## **1.2 PROBLEM STATEMENT**

There is literature available on the current status of tax transparency and the impact that tax havens have on developing countries. This study seeks to systematically review the identified literature on the topic of interest to answer the research question, namely to determine the current status of tax transparency and the impact that tax havens have on developing countries.

Conducting this study will benefit developing countries by discovering what their current status is, as far as tax transparency and tax havens are concerned. Future researchers can assist in identifying research that can be conducted on tax havens and developing countries.

## **1.3 RESEARCH QUESTION**

What is the present status of peer-reviewed academic journal articles regarding tax transparency and the impact that tax havens have on developing countries?

## **1.4 RESEARCH OBJECTIVES**

- To identify and analyse peer-reviewed academic journal articles in order to determine the current status of literature relating to the impact that tax transparency has on developing countries.
- To further identify and analyse peer-reviewed academic articles in order to determine the current status of literature relating to the impact that tax havens have on developing countries.

## **1.5 RESEARCH DESIGN AND METHODOLOGY**

### **1.5.1 Introduction**

This chapter will address the research design and methodology. It focuses on addressing the theoretical part of research design and methodology. Brief theory descriptions will be provided on each research design element. A research design is a blue print or plan for the collection, measurement, and analysis of data, created to assist in answering the research questions (Sekaran & Bougie, 2016:95). There are six elements of research design, namely: philosophical stance, nature of the study, method of reasoning, time horizon, unit of analysis and nature of the data.

### **1.5.2 Theory behind research design elements**

#### **1.5.2.1 *Philosophical stance***

- **Positivism**

Positivism strongly believes that there is an objective truth to understand the world well enough so that we are able to predict and control it. According to Sekaran and Bougie (2016:28), the key approach for positivist researchers is the experiment, which allows them to test cause and effect of relationships through manipulation and observation. They use deductive reasoning to put forward theories that they can test by means of a fixed, predetermined research design and objective measures (Sekaran & Bougie, 2016:28).

Some positivist researchers believe that the goal of a researcher is only to describe phenomena that one can directly observe or objectively measure. For these types of researchers, knowledge of anything such as feelings, emotions and thought is impossible. This results in no alternatives and clear findings or results and the definite truth about the phenomena (Sekaran & Bougie, 2016:28).

- **Interpretivism**

According to Rolfe (2006:1), interpretivist researcher strongly believes that in order to understand this world of meanings, one must interpret it. Interpretivism, also known as interpretivist involves interpreting elements of the study, thus interpretivism integrates human interest into a study (Dudovskiy, 2018). The researcher must elucidate the process of meaning construction and clarify what and why meanings are embodied in the language and actions of social actors (Rolfe, 2006:1).

They are principally concerned with matters of knowing and being, not methods *per se* (Rolfe, 2006:1). Accordingly to (Dudovskiy, 2018), interpretive researchers assume that access to reality that is given or socially constructed is only through social constructions such as language, consciousness, shared meanings, and instruments. Their meanings are actually shaped according to the intent of their users; they merely suggest directions along which to look, rather than providing descriptions of what to see (Rolfe, 2006:1).

#### - **Pragmatism**

Pragmatic research is described as a process where concepts and meanings (theory) are generalisations of our past actions and experiences, and it is further described as interactions we have had with our environment. The pragmatic researcher is not concerned with taking a particular position regarding to what makes a good research. They feel that research on both subjective meanings, observable phenomena and objectives, can produce useful knowledge, depending on the research question of study (Sekaran & Bougie, 2016:29).

According to Sekaran and Bougie (2016:29), "the focus of pragmatists is on practical, applied research where different viewpoints on research and the subject under study help in solving a ... problem". For pragmatism, these different perspectives, ideas, and theories help us gain an understanding of the world. Unlike positivism, pragmatism views the current truth as tentative and changing over time and the value of research lies in its practical relevance; the purpose of theory is to inform practice (Sekaran & Bougie, 2016:29).

#### **1.5.2.2 Nature of the study**



## - **Causal study**

According to Sekaran and Bougie (2016:44), causal studies test whether or not one variable causes another to change; they are at the heart of the scientific approach to research. The researcher is interested in delineating one or more factors that are causing a problem and that means that the intention of the researcher for conducting a causal study is to be able to state that variable X causes variable Y, therefore if variable X is removed or altered in some way or another, problem Y is solved.

This implies that there will be interdependency on the variables as one will cause another to change.

In order to establish a causal relationship, the following conditions should be met:

- “The independent and dependent variable should co-vary.
- The independent variable ... should precede the dependent variable.
- No other factor should be a possible cause of the change in the dependent variable.
- A logical explanation is needed and it must [explain] why the independent variable affects the dependent variable” (Sekaran & Bougie, 2016:44).

## - **Descriptive study**

The objective of a descriptive study is to obtain data that describes the topic of interest. Descriptive research is either qualitative or quantitative in nature. Descriptive studies are often designed to collect data that describe characteristics of objects such as persons, organisations, products or brands, events or situations (Sekaran & Bougie, 2016:43).

Such studies are correlational in nature and describe relationships between variables, however finding correlation does not mean that one variable causes change in another variable and sometimes a researcher is interested in associations among variables to describe populations, events or situations.

Descriptive studies may help the researcher to:

- understand the characteristics of a group in a given situation;
- think systematically about aspects in a given situation;
- offer ideas for further probe and research; and
- Assist in making certain simple decisions (Sekaran & Bougie, 2016:44).

### **Exploratory study**

This study is typically developed when not much is known about a particular phenomenon, existing research results are unclear or suffer from serious limitations, the topic is highly complex or there is not enough theory available to guide the development of a theoretical framework. An exploratory study is necessary especially when some facts are known, however more information is needed for developing a viable theoretical framework (Sekaran & Bougie, 2016:43).

An exploratory study often relies on secondary and/or qualitative approaches to data gathering, such as informal discussions. It is also used for a more formal approach, such as interviews, focus groups, projective methods or case studies. According to Sekaran and Bougie (2016:43), the results of exploratory studies cannot, typically, be generalised to the population and they are flexible in nature. The focus of this type of research study is broad at first; it becomes increasingly narrower as the research proceeds (Sekaran & Bougie, 2016:43).

#### **1.5.2.3 Method of reasoning**

##### **- Deductive reasoning**

According to Hurley (in Walton, 2014:2), deductive reasoning is an argument in which the premises are claimed in order to support the conclusions. This implies that there is a direct relationship between the premises and the conclusion as it is impossible for the premises to be true and the conclusion false. This means that if the premises are true it is a fact that the conclusion will also be true, the two cannot be separated. It directly applies to the inferential link between the premise and the conclusion. Deductive reasoning begins from a hypothetical state of things (Walton, 2014:8).

A deductive approach is more concerned with a hypothesis concerned with developing a hypothesis (or hypotheses) based on theory that already exist, and then designing a research strategy to test the hypothesis. It has been stated that deductive reasoning means reasoning from the particular to the general. The beginning of deductive reasoning is an expected pattern which is tested against observations; whereas inductive reasoning begins with observations which seeks to find a pattern within them (Dudovskiy, 2018).

- **Inductive reasoning**

Hurley (in Walton, 2014:2) defined inductive reasoning as an argument in which the premises are claimed in order to support the conclusions. This implies that the relationship between the premises and the conclusion is not direct as it is improbable that the premises be true and the conclusion false. The inferential link between the premises and the conclusion is not that of necessity, but of probability (Walton, 2014:2). Inductive reasoning is based on the data but extrapolates partially beyond them (Walton, 2014:3).

Inductive reasoning starts with the observations and ends with theories that are proposed only towards the completion stage of the research process, as a result of observations. The purpose of this approach is to generate meaning from the data set collected for the purposes of identifying patterns and relationships that are used to build a theory. It must be noted that, it is more concerned with learning from experience. Patterns, resemblances and regularities in experience which represent premises that are observed in order to reach conclusions or to generate a theory (Dudovskiy, 2018).

- **Abductive reasoning**

When following an abductive reasoning approach, the researcher is more concerned with seeking to choose the best possible explanation among many alternatives in order to explain surprising facts or puzzles which are identified at the start of the research process (Dudovskiy, 2018). According to Walton (2014:3), abductive reasoning is also referred to as inference; as reasoning from given data leads to a hypothesis that explains the data. In the course of explaining 'surprising facts' or 'puzzles', the researcher is able to combine both numerical and cognitive reasoning (Dudovskiy, 2018).

The abductive inference has most often been seen as an important kind of reasoning used at the discovery stage of scientific hypothesis formation and testing (Walton, 2014:1). It is further described as a notion that has become familiar to some of us, but the idea is a relative newcomer as something that is widely known or accepted in logic (Walton, 2014:3). Walton (2014:3) further explains that it tends to be the weakest of the three and a conclusion is drawn as an intelligent guess.

#### **1.5.2.4 Time horizon**

There are two studies of time horizon namely: cross-sectional studies and longitudinal studies.

##### **Cross-sectional**

This study is undertaken once when data are gathered. It can be taken over a period of days, weeks or months, in order to answer a research question. Such studies are called one-shot or cross-sectional studies. An example will be where data was collected between April and June of last year to study the current status of literature on the topic being researched. This means that data with respect to that particular research had not been collected before, nor will be collected again for the research (Sekaran & Bougie, 2016:104).

Another example will be where data or statistics on unemployment percentages in South African are collected once, at a particular point in time of the research to determine the cause of unemployment and identify possible solutions and remedies and this data was never collected before and after the research serves its purpose; the data will not be collected again. Hence it is a one-shot or cross-sectional study which is conducted at that particular point in time.

##### **- Longitudinal**

In cases where a researcher seeks to study people or phenomena at more than one point in time in order to address a research question, it is classified as a longitudinal study. They

help to identify the cause-and-effect of relationships. Data for this type of study will be gathered at two different points in time. Longitudinal studies are used by experimental researchers as data are collected both before and after a manipulation (Sekaran & Bougie, 2016:105). For example, where data or statistics on unemployment percentages in South African is collected at a particular point in time of the research to determine the cause of unemployment and identify possible solutions and remedies and again collected later to see if there is a change in unemployment statistics after solutions and remedies are implemented. Hence it is longitudinal, as data is collected at two or more points in time to answer the research question.

#### **1.5.2.5 *Unit of analysis***

Unit of analysis refers to the level of aggregation of data which is collected during the subsequent data analysis stage and the unit of analysis is determined by the research question. Examples of a unit of analysis are individuals as the unit of analysis, dyads as the unit of analysis, groups as the unit of analysis, divisions as the unit of analysis, the industry as the unit of analysis and even countries as the unit of analysis (Sekaran & Bougie, 2016:102).

In a case where the unit of an analysis is countries, the study might seek to discover which country has the highest unemployment rate. Therefore, data on unemployment statistics of each country included in the unit of analysis will be aggregated. Depending on years, sampling size in terms of countries to be included in the study and any other determinants that the research seeks to cover to answer the research question will clearly be dictated by the research question.

#### **1.5.2.6 *Nature of the data***

- **Primary data**

Primary data can be described as first-hand data after being processed and having arrived at certain results. If used after that it will be a secondary data. It generally uses interviews, observations and questionnaires and these methods allow the researcher to collect a wide

variety of different sorts of data from human respondents. The selection process involves method(s) which are used to obtain information needed and the research process integrates other steps (Sekaran & Bougie, 2016:111). Hence the choice of method(s) to be selected will depend on the objective(s) of the study, the question which the researcher seek to answer and the research strategy.

In addition to the above, the choice of method(s) available for purposes of data gathering depends on a number of factors including facilities available for the study, the level of accuracy required to complete the study, the type of data required, the time frame of the study, the expertise that the reviewer have and other resources and costs associated with the study. (Sekaran & Bougie, 2016:112).

- **Secondary data**

Secondary data involves the re-use of pre-existing qualitative data which was used in previous research studies (Heaton, 2008:2). According to Sekaran and Bougie (2013), it refers to literature that already exists in the form of articles, journals, books and publications to gain more understanding and knowledge of the topic of interest. This type of data includes materials such as semi-structured interviews, responses to open-ended questions in interview questionnaires, field notes and research diaries (Heaton, 2008:2).

Secondary data can be used for two main purposes, namely, to investigate the new or additional research question or alternatively it can be used to verify the findings of the previous research (Heaton, 2008:3). Secondary data analysis have three main modes, namely through informal data sharing, using datasets obtained through informal data sharing or finally, researchers may re-use their own self-collected data for purposes of investigating new or additional research (Heaton, 2008:3-4).

- **Quantitative**

The quantitative research method is usually used to quantify a problem by way of generating numerical data which can be used for statistical purposes. It is used to quantify attitudes, opinions, behaviours and other defined variables and generalise results from a larger sample population (DeFranzo, 2011). After collection and analysing the data the next step

will be to answer the research question, however before the research question is answered, the data must be analysed by following some preliminary steps to help ensure that it is accurate, complete and suitable for further analysis (Sekaran & Bougie, 2016:271).

Quantitative data analysis uses measurable data to formulate facts and reveal patterns in research. Examples of qualitative data include surveys, face-to-face and telephone interviews (which are longitudinal in nature), to name a few. The results from the tested data will certainly provide more information on the variable and provide corrective action that needs to be taken if any (DeFranzo, 2011).

#### - **Qualitative**

Qualitative data method, which is primarily exploratory, is used to gain an understanding of reasons, opinions and motivations. It provides broader view and insights into the problem or assist in developing ideas or hypotheses for potential quantitative research (DeFranzo, 2011). It is important to note that qualitative data analysis is not a step-by-step linear process but rather a continuous and iterative process (Sekaran & Bougie, 2016:333).

According to (Sekaran & Bougie, 2016:333), there are three steps in qualitative data analysis, which are as follows:

1. Data reduction, which refers to the process of selecting, coding and categorising data.
2. Data display, which refers to a way in which data is presented.
3. Data coding, which helps to simultaneously develop ideas on how the data may be displayed, as well as generating some preliminary conclusions.

Once data is analysed, conclusions are drawn and it is at this point where the research question can be answered; by determining what identified themes stand for, by thinking about explanations for observed patterns and relationships or by making contrasts and comparisons (Sekaran & Bougie, 2016:347).

## **1.6 STRUCTURE OF THE MINI-DISSERTATION**

### **1.6.1 Chapter One: Introduction**

This chapter discusses the rationale or motivation for conducting this study by providing the background and introducing the problem statement. Thereafter the research question regarding what this study seeks to answer is formulated and that is followed by the objectives of the study, which explain how the research question will be answered. The chapter ends with theoretical discussions of research designs and methodology.

### **1.6.2 Chapter Two: Literature review**

This chapter provides the criteria used to select journals for the study. It details how journals were identified and recorded on Qigga, the data analysis software. It provides a brief discussion of reviewed literature, research ethics and it ends with a conclusion.

### **1.6.3 Chapter Three: Research design and methodology**

Chapter Three explains the selected research design elements and how they are applicable to this study. The chapter is concluded by a discussion of systematic review, which is divided by providing the motivation and explanation for this.

### **1.6.4 Chapter Four: Data analysis and presentation of results**

This chapter explains the detailed data analysis and presentations of the results of the literature that was reviewed during the research. It discusses the findings and provides views formulated from the literature reviewed.

### **1.6.4 Chapter Five: Conclusion**

Chapter Five is the last chapter of the research report and it concludes the research. It provides the reflections on addressing the research question and objectives, followed by a discussion of the limitations experienced while conducting the study. Recommendations on future research are included along with concluding remarks.



## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 INTRODUCTION

The purpose of this chapter is to provide an overview of the relevant literature on the impact that tax transparency and tax havens have on developing countries. This chapter will commence with the explanation of the process of identification and recording of academic literature. It defines the inclusion and exclusion criteria used for the study. It will list the keywords and databases used to identify the literature. It will record academic literature reviewed for this study and discuss the theory of research design elements. It will also provide research ethics as applicable to this study and end with a conclusion.

#### 2.2 IDENTIFICATION AND RECORDING OF ACADEMIC LITERATURE

##### 2.2.1 Inclusion and exclusion criteria

The total number of articles which are included in the study amounted to sixty-one for the years between 1993 and 2018. These articles were selected based on the relevance of the article to the study. In deciding which articles were to be used for this study, the researcher first read the title and abstract of the articles and, if relevant, the article was included; if not the article was excluded. One article was published before 1993, hence it was excluded, seven articles were excluded as they were not relevant to the topic of interest and two articles were duplicated. The table below illustrates the results of the inclusion and exclusion criteria.

**Table 3: Inclusion and exclusion criteria**

<u>Item</u>	<u>Inclusion criteria</u>	<u>Exclusion criteria</u>
Years	Academic articles published after 1993	Literature published before 1993
Relevancy	Academic articles relevant to the topic	Academic articles not relevant to the topic
Duplications	Academic articles already included	Academic articles duplicated

### **2.2.2 Keywords**

The keywords below were used to identify and select literature for this study:

- “Tax transparency”.
- “Tax havens”.
- “Tax transparency AND Developing countries”.
- “Developing countries AND Tax Havens”.

The words ‘tax transparency’, ‘tax havens’, ‘tax transparency and developing countries’ and ‘developing countries and tax havens’ were searched on databases with the aim of identifying journals and articles with relevant literature. The literature was identified to gain a better understanding of the topic and to determine the current literature status. Articles were selected based on relevancy to the body of the literature. This study is entirely based on currently available literature.

### **2.2.3 Databases**

Well recognised academic databases found in the University of Pretoria’s library were used to search for articles which provide literature for the topic. Below are the databases that were found to have sufficient relevant literature:

- Accounting, Tax & Banking Collection;
- ABI/INFORM Collection;
- Google Scholar;
- Business Premium Collection; and
- Science Direct.

A summary of articles retrieved from the databases is presented below. In total, sixty-one articles are selected and included for this study.

#### **Table 4: Summary of articles retrieved from databases**

<u>Database</u>	<u>Academic journal articles</u>
Accounting, Tax & Banking Collection	23
Business collection premium	15
Science Direct	12
Google Scholar	10
ABI/IMFORM Collection	1
<b>Total</b>	<b>61</b>

#### **2.2.4 Recording of identified academic literature**

The articles and journals were downloaded to Qigga. Qigga is a system or software that assists a researcher to analyse the literature using tags. The articles are tagged as they are read and groupings are created as tags are identified. This enables the researcher to highlight and make summaries as articles are read. Once the tagging is complete, a report is generated and it can be filtered accordingly.

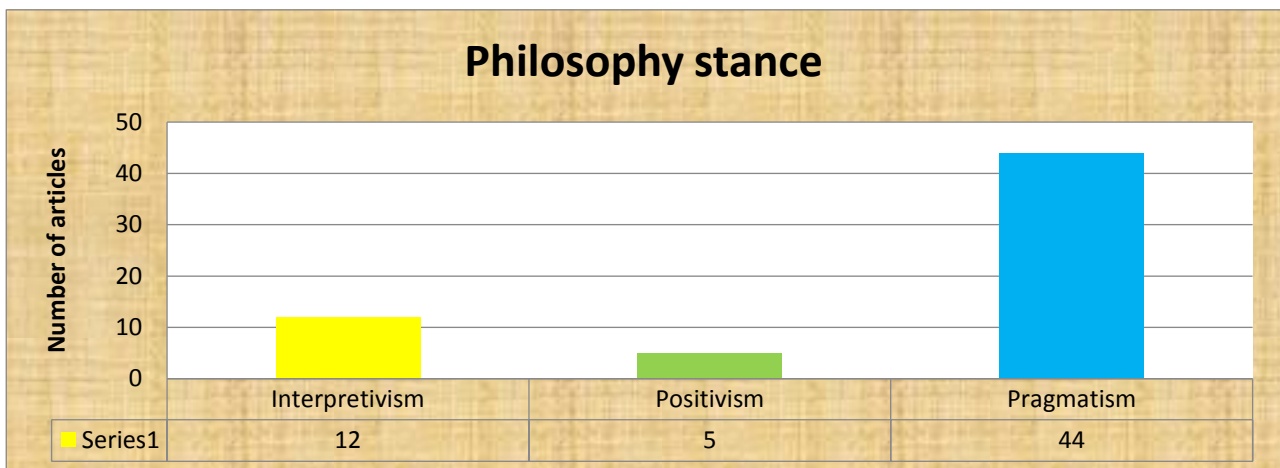
In total, sixty-one articles were downloaded, analysed and tagged on Qigga according to philosophical stance, nature of the study, method of reasoning, time horizon, unit of analysis and nature of data. In addition, the articles were tagged using different summaries that the researcher created and considered relevant in answering the research question and objectives.

#### **2.2.5 Literature reviewed: Research design elements**

##### **2.2.5.1 *Philosophical stance***

The graph below illustrates the results of the literature reviewed on the articles for this study. Sixty-one articles in total were tagged according to philosophical stance. Of the sixty-one articles analysed, forty-four articles were found to be using pragmatism, whereas twelve articles used interpretivism and only five articles were found to have adopted positivism. Details are provided below per philosophical stance.

**Figure 1: Philosophy stance literature results**



- **Positivism**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of philosophical stance, five articles were found to use positivism. The articles were more focused on determining the truth about the topic of interest. The authors tested cause and effect regarding the topic being researched to reach a conclusion or truth.

- **Interpretivism**

Of the sixty-one articles loaded on Qigga, which were all tagged in terms of philosophical stance, twelve articles were found to use interpretivism as these articles were more concerned with the interpretation of elements to arrive at a conclusion.

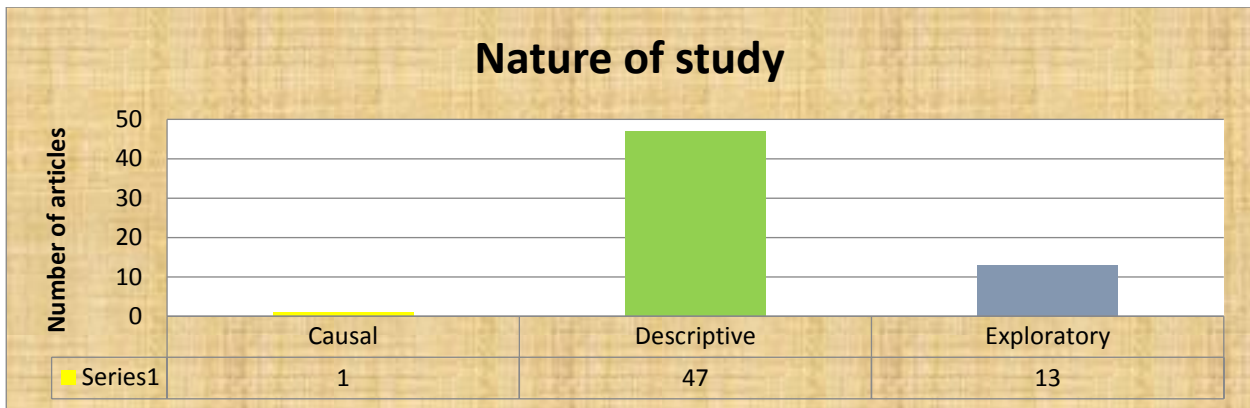
- **Pragmatism**

The remaining forty-four of the sixty one articles loaded on Qigga which were all tagged in terms of philosophical stance were found to use pragmatism, as they present different perspectives, ideas, conclusions, contradictions, solutions, benefits, problems and theories that help the reader gain an understanding and more knowledge of the topic.

### **2.2.5.2 Nature of the study**

The graph below illustrates the results of the literature reviewed for this study. Sixty-one articles in total were tagged according to the nature of the study. Forty-seven articles were found to be using the descriptive method, whereas thirteen articles used an exploratory study and only one article was found to have adopted a causal study. Details are provided below per the nature of the study.

**Figure 2: Nature of study literature results**



**- Causal study**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of nature of study, one article was found to have used a causal study as the article was more concerned with comparing variables to determine if one variable can cause another to change.

**- Descriptive study**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of nature of the study, forty-seven articles were found to have used a descriptive study. These articles provide the theory, characteristics and in-depth understanding and knowledge of the topic of interest.

**- Exploratory study**

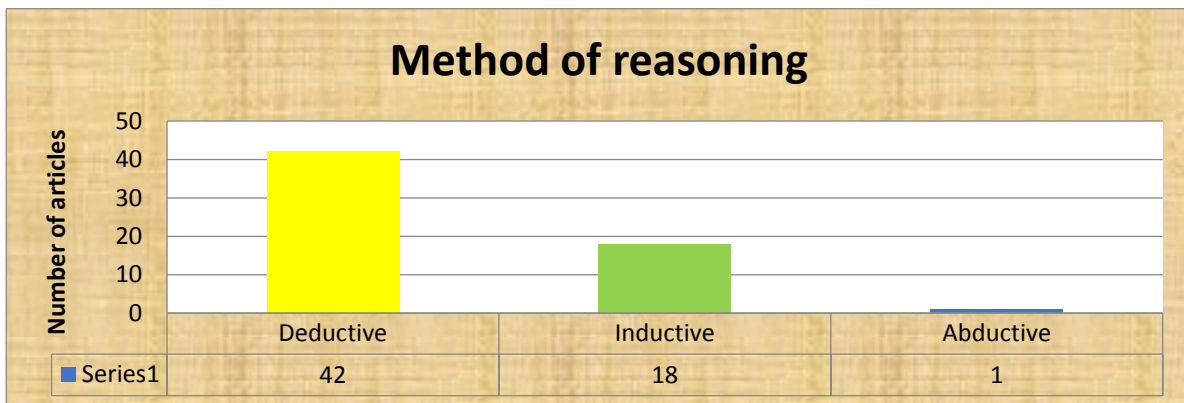
The remaining thirteen articles loaded on Qigga which were all tagged in terms of nature of study were found to be exploratory study. These articles were written when not much was

known about the topic of interest, no data was available to start with; the authors often relied on qualitative literature to explore the topic of interest.

### 2.2.5.3 *Method of reasoning*

The graph below illustrates the results of the literature reviewed on the articles for this study. Sixty-one articles in total were tagged according to a method of reasoning. Forty-two articles were found to have used deductive reasoning, whereas eighteen articles used inductive reasoning and only one article was found to have adopted abductive reasoning. Details are provided below per method of reasoning.

**Figure 3: Method of reasoning literature results**



- **Deductive reasoning**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of method of reasoning, forty-two of the sixty-one articles were found to have used deductive reasoning. These articles provide different views, opinions, meanings, interpretations, descriptions and contradictions; through them patterns are generated in order to identify relationships to build a theory.

- **Inductive reasoning**

Of the sixty-one articles loaded on Qigga, which were all tagged in terms of method of reasoning, eighteen were found to have used inductive reasoning. These articles begin with

observations and propose theories towards the end of the article. The articles generate meanings from the data set collected and identify patterns and relationships to build a theory.

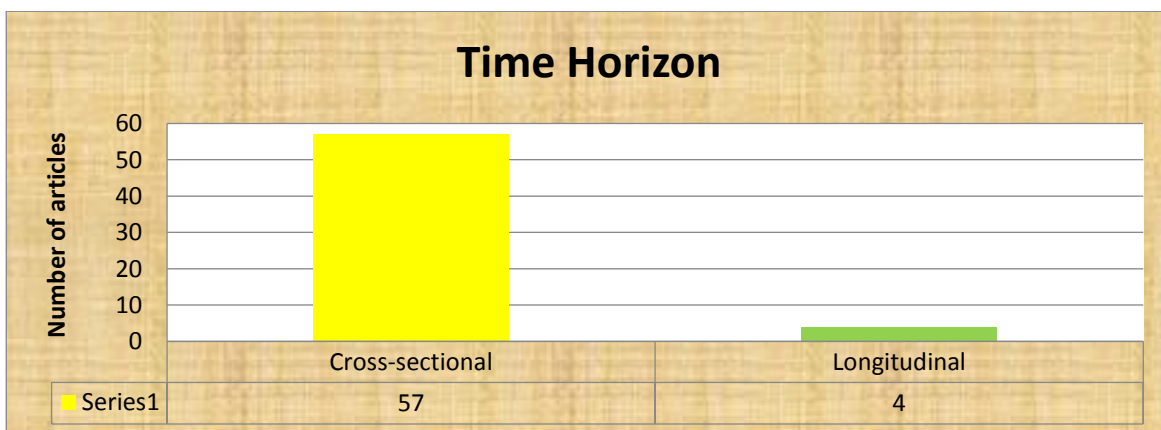
- **Abductive reasoning**

Only one of the sixty-one articles loaded on Qigga which were all tagged in terms of method of reasoning, was found to have used abductive reasoning. This article is not concerned with choosing the best possible explanation. The article begins with observations to seek a pattern.

#### 2.2.5.4 *Time horizon*

The graph below illustrates the results of the literature reviewed on the articles for this study. Sixty-one articles in total were tagged according to time horizon. Fifty-seven articles were found to be cross-sectional, whereas four articles used a longitudinal approach. Details are provided below per time horizon.

**Figure 4: Time horizon literature results**



- **Cross-sectional**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of time horizon, fifty-seven were found to be cross-sectional. Data for these articles were gathered just once

at the time the articles were written in order to answer or arrive at a conclusion. There is no indication of data being collected more than once during the time of writing the article.

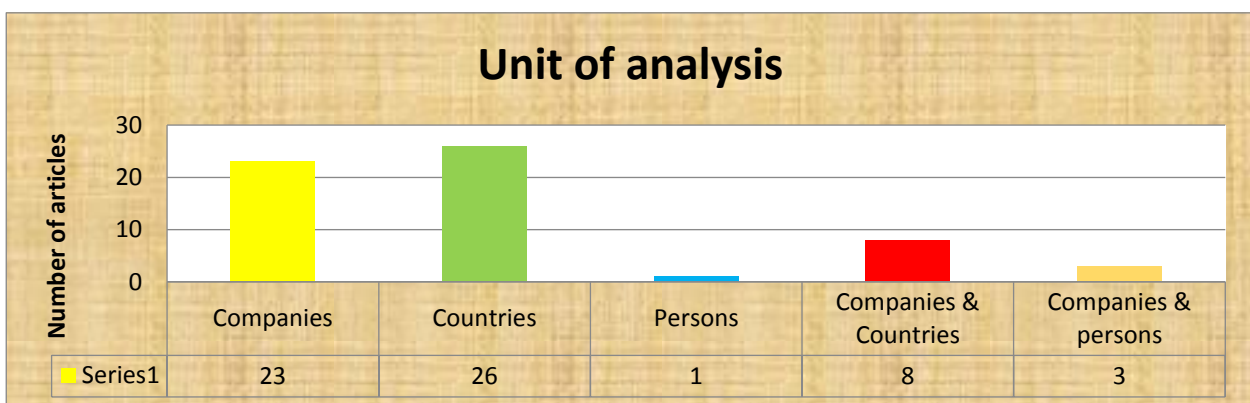
- **Longitudinal**

The remaining four articles loaded on Qigga and tagged in terms of time horizon were found to be longitudinal. Data for these articles were collected at more than one point in time in order to arrive at a conclusion or to describe the topic being written about. The articles compared the situation from previous years to the current situation.

### 2.2.5.5 *Unit of analysis*

The graph below illustrates the results of the literature reviewed on the articles for this study. Sixty-one articles in total were tagged according to a unit of analysis. The units of analysis for these articles were companies, countries or persons and few articles combined any of the three. Twenty-three articles were found to be using companies as a unit of analysis, whereas twenty-six articles were found to have used countries as a unit of analysis, only one article used persons as unit of analysis, eight articles combined companies and countries as a unit of analysis and the remaining three articles combined persons and companies as a unit of analysis.

**Figure 5: Unit of analysis literature results**

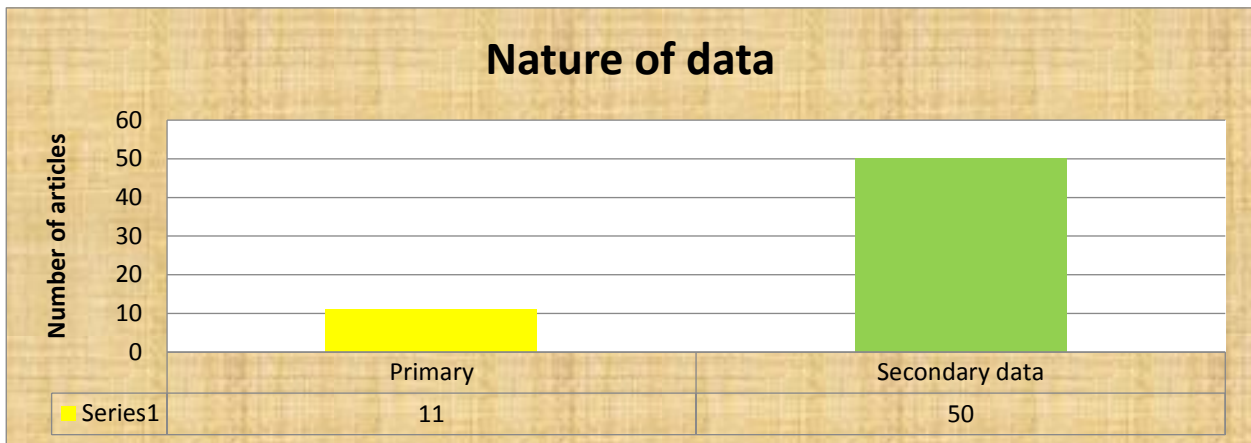


### 2.2.5.6 *Nature of the data*



The graph below illustrates the results of the literature reviewed on the articles for this study. Sixty-one articles in total were tagged according to the nature of the data, eleven articles were found to have used primary data and the remaining fifty utilised secondary data. Details are provided below per nature of data.

**Figure 6: Nature of data literature results**



- **Primary data**

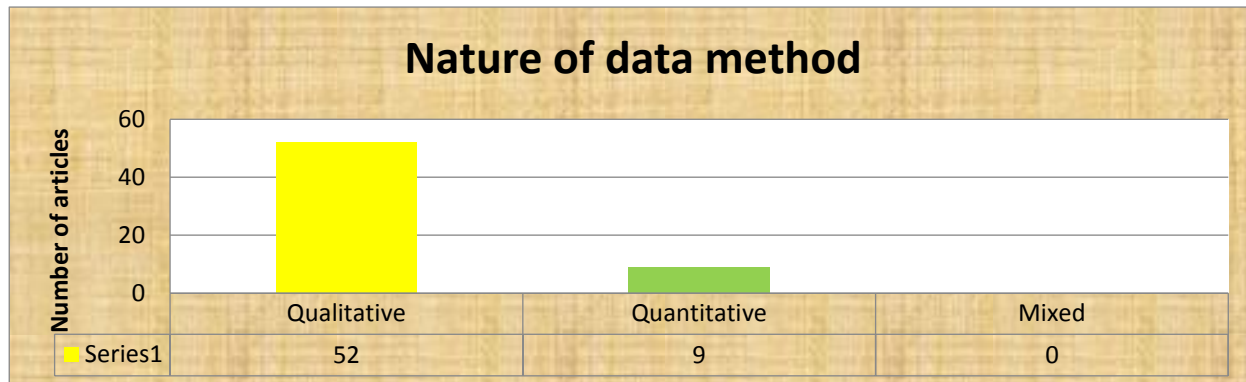
Of the sixty-one articles loaded on Qigga which were all tagged in terms of nature of the data, eleven articles acquired primary data to write articles. These articles gathered data from observations and questionnaires (first-hand data).

- **Secondary data**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of nature of the data, fifty articles acquired secondary data to write articles. These articles were written based on data that already exists and originated from previous studies. This literature was used to determine the similarities, differences, style of thinking and conclusions made regarding the topic.

The graph below illustrates the results of the literature reviewed on the articles used for this study. Fifty-two articles were found to have used the qualitative method and the remaining nine articles used the quantitative method. No articles were found to have used mixed data. Details are provided below for each method.

**Figure 7: Nature of data method**



- **Quantitative**

Of the sixty-one articles loaded on Qigga which were all tagged in terms of method for nature of the data, nine articles used a quantitative method to write articles. Data was used to quantify a problem by way of generating numerical data which was, in turn, utilised for statistical purposes to generalise results from a sample.

- **Qualitative**

The remaining fifty-two of the sixty-one articles loaded on Qigga which were all tagged in terms of nature of the data were found to have used the qualitative method to write articles. These articles used the theory that is already available to gain an understanding of reasons, opinions and motivations, including insights into the problem and these assisted the writer in developing ideas or hypotheses which could be used for potential quantitative research.

- **Mixed method**

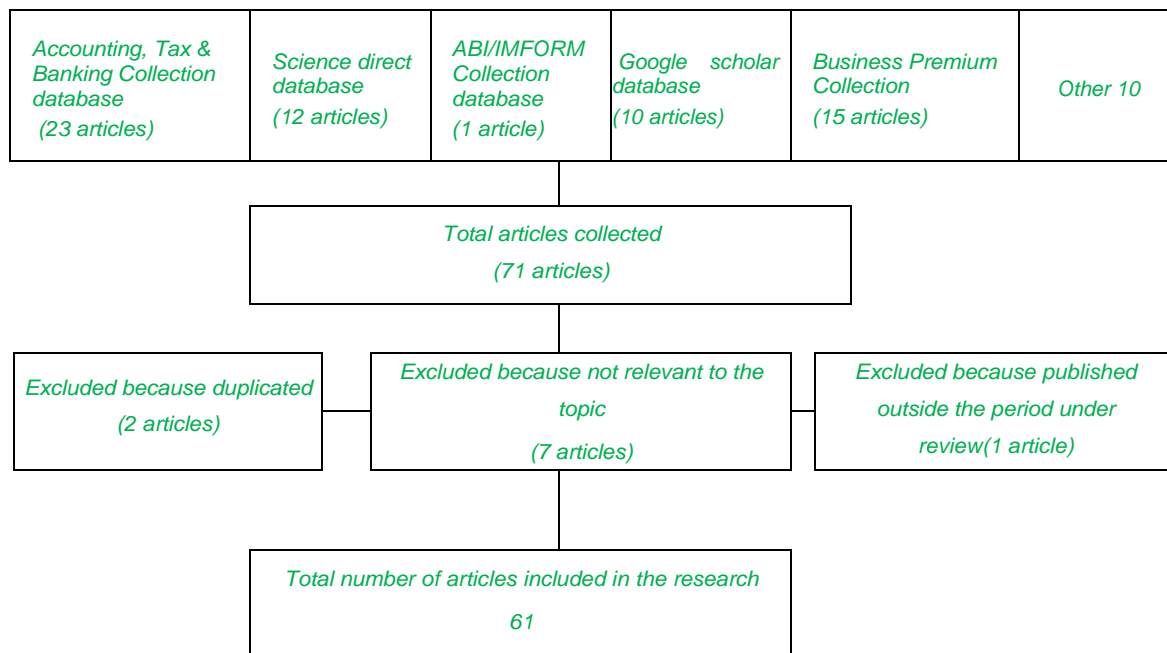
No articles that use mixed data were found.

### **2.3 SUMMARY AND BRIEF DISCUSSION OF REVIEWED LITERATURE**

As indicated below in Figure 8, sixty-one articles were sourced, selected and included for the purpose of this study. All sixty-one articles were tagged using Qigga to determine what

the article is reflecting as the current status of tax transparency and the impact that tax havens have on countries (including developing countries). Articles were selected based on relevancy to the topic of interest. The following findings of the literature reviewed are summarised below.

**Figure 8: Quality assessment: summary of results**



### 2.3.1 Tax transparency

#### 2.3.1.1 Background of tax transparency

As discussed earlier in the study, transparency is something similar to openness (Woods, 2018:1, Meijer, 2015:10). Tax transparency has different meanings but it is generally used by organisations to communicate the tax approach being taken and also the amount of tax being paid. It is used by organisations to provide clarity on complex tax matters and boost stakeholder confidence by providing assurances that a fair share of tax is being paid. Tax transparency is also used by governments to disclose the amount of taxes received and enhance co-operation between countries through information sharing regarding the same taxpayer (Ernst & Young, 2013:9).

According to Meijer (2015:3), many government transparency analyses focus on new and future developments, however, information and communication technologies are seen as the main driver of transparency. The analyses help understand current issues, however, they fail to put issues into an historical perspective (Meijer, 2015:3). Hence, this makes it difficult to provide a clear and measurable background on tax transparency.

The key elements of transparency are the availability of information and the potential use of this information by outsiders (Meijer, 2015:5). Tax transparency has been in existence for 250 years in the Netherlands; the first to introduce transparency legislation and practices in 1750 (Meijer, 2015:4). Transparency consists of social, political and administrative developments (Meijer, 2015:12). According to Hildreth (2005:5), transparency reduces principle-agent problems and it has an impact on the economy as it minimises transaction costs. Transparency is not costless and it may be difficult to prove its benefits (Hildreth, 2005:5). It seems from the above discoveries that tax transparency represents openness and availability of information and the usage thereof, hence it can be suggested that the opposite or lack of transparency could be seen as closeness or secrecy.

The Russian financial crisis of 1998 demonstrated that a lack of transparency with regard to financial markets provides a path to disaster (Hansen, 2001:1). Hansen (2001:2) further states that companies that survived that disaster learned that transparency and good governance are key and necessary in order to restore and maintain the confidence of investors and creditors. Woods (2018:39) and Meijer (2015:3) also agree that, indeed, tax transparency is critical to good governance.

### **2.3.1.2 *The effects of tax transparency***

It has already been indicated that lack of transparency is a path to disaster and literature provides a view of these disasters and problems. According to Teather (2016:1), all countries are affected by tax dodging, however, poor countries are highly affected as 170 dollars of taxes are lost annually by poor countries. This was confirmed by Anonymous (2012:2); that poor countries lose more than they gain as a result of tax avoidance; in other words, the revenues that countries should be collecting for the benefit of residents are lost. Sufficient evidence provides that tax evasion and avoidance cause significant revenue

losses (Brussels, 2015:3). It, therefore, becomes imperative for affected countries to address the situation.

It appears that there is a relationship between countries' revenue collection and tax base. The efforts to protect countries' tax base is an important strategy to expand governments' tax base, which should ultimately improve their fiscal outlook (Franco, 2013:1). Countries with high tax rates have a small tax base whereas smaller tax rate countries have a high tax base (Johannesen, 2010:5). It becomes a priority for countries to protect their tax base as it has a huge impact on the welfare of the residents of those countries (Slemrod & Wilson, 2009:1, M2 Equity Bites, 2013:2).

Tax base and revenue losses are not the only issues affected by lack of transparency. Base Erosion and Profit Shifting (BEPS) is another mountain countries are faced with. BEPS refers to tax planning strategies that artificially shift profits to low or no tax jurisdictions that have little or no economic activity by exploiting gaps and mismatches in tax rules (Shrivastav, 2015:1). Anonymous (2008:2) believes that profit shifting happens frequently for the purposes of avoiding tax. This is a global problem which requires a global solution (Shrivastav, 2015:1). According to Shrivastav (2015), the key pressure points in international tax reform which were identified by the OECD for BEPS are related to party debts, captive insurance, intergroup financial transactions, transfer pricing between related entities, thin capitalisation rules, tax treaty abuse and preferential regimes. The key pressure points mentioned are obviously directly linked to ensuring more transparency so that base erosion and profit shifting can be addressed and the right country can collect their fair share of taxes. On the other hand, banks and other financial institutions are also contributing to problems countries already have.

According to Anonymous (2008:4), lack of transparency particularly in international private banking is a big issue and this is as a result of *de jure* and *de facto* bank secrecy and other confidentiality laws. According to Spencer (2005:2), bank secrecy operates in two basic forms, namely *de jure* and *de facto*. *De jure* bank secrecy compels the banks and other financial institutions not to disclose investors or depositors' identity, except in cases of money laundering and other criminal activity (Spencer, 2005:2). *De facto* bank secrecy allows banks and other financial institutions to not provide information through automatic reporting to governments regarding foreign depositors or investors (Spencer, 2005:2).

Facilitation of the receipt of corruption proceeds by providing bank secrecy and other confidentiality laws as a result of a lack of transparency and tax-free treatment must be given greater focus (Anonymous, 2008:4). A secrecy regime enables investors to hide taxable capital from their respective countries of residence (Konrad & Stolper, 2016:2). This provides a view of how banks contribute to the problem for countries; lack of transparency through bank secrecy hinders countries as they do not receive relevant information regarding their residents and in turn, they cannot effectively and accordingly plan for tax purposes. It is suggested that these secrecy regimes are for the protection of tax avoiders and evaders to prevent countries to correctly enforce provisions of legislation.

According to Radu (2012:4), Monaco is a country of great millionaires; it does not have Personal Income Tax and tax evasion is not considered an offence. There are 340 000 bank accounts held by authorities in this country and these banks maintain strict and absolute secrecy (Radu, 2012:4). Banks, trusts, companies, brokerage firms, other financial institutions and governments facilitate the receipt of corruption proceeds by providing bank secrecy (Anonymous, 2008:3). This indicates how banks play a role in assisting tax evaders to evade tax through secrecy. When it comes to tax transparency, problems do not end there; capital flight also seems to add to the laundry list of problems.

According to Spencer (2005:2), lack of automatic exchange of information facilitates and encourages capital flight and tax evasion. Capital flight was found to be Harmful Tax Competition in a 1998 report published by OECD and it is their objective to limit capital flight in member countries with the aim that it will limit tax evasion. It is understood that capital flight is when residents hide their capital in other countries; it remains unreported or unknown in the home country of that resident. This can be translated as the usage of offshore centres, also known as tax havens.

Houlder (2016:2) estimates that nearly 10 trillion dollars are held offshore. According to Alstadsæter et al. (2018:2), the use of tax havens has a large effect on inequality in the UK, Spain and France. Africa is also losing more money as a result of illicit financial flows (Whitehead, 2013:2). This indicates the impact that transparency has.

Over and above the problems, tax transparency also impacts legislation. Increased scrutiny of corporate affairs (which in essence is tax transparency) will impact existing legislation (Franco, 2013:3). Grocott and Stevenson (2010:8) confirm that it promotes a policy that helps member states fight tax fraud and avoidance. Based on this statement it can be imagined that tax legislation is drafted based on many factors, including observations of taxpayers behaviours, hence lack of information can result in tax legislation that is not effective and therefore does not address relevant tax issues. Limited transparency and disclosure posed a threat to effective tax administration and to a certain extent foreign multinationals contributed (Ring, 2016:33). In the same manner without relevant information effective tax administrations cannot be implemented.

Transparency and cooperation is a vital weapon in the fight against aggressive tax planning and abusive tax practices and to protect the tax base (Brussels, 2015:1, M2 Equity Bites, 2013:2). Haines (2017:1) adds that they have a duty to block tax abuse and profit shifting. Brussels (2015:1) also believes that tax transparency is a crucial weapon for fighting against aggressive tax planning and abusive tax practices. Automatic exchange of information on tax rulings will enable detection of abusive tax practices by companies (Cunningham, 2015:2). Haines (2017:1) also believes that aggressive tax practices, tax abuse and profit shifting can be fought by implementing more transparency. As such, it is believed that transparency will enable developing countries to fight tax evasion, capital flight and corruption and achieve self-sustaining growth (Owens & Moore, 2013:1).

Tax transparency is, however, not as glorified as it appears, as much as it is praised to be very beneficial for countries in dealing with problems, it also comes with disadvantages. In fact, the Liechtenstein government made a strong statement that logistically and politically, tax transparency is never going to happen (Grocott, 2010:3). There is a fear that tax transparency may have an impact on the confidentiality of affected taxpayers (International Tax Review, 2013:4). Exchanged information may fall into the hands of corrupt officials which could result in identity theft and hacking (Houder, 2016:2). It is, therefore, observed that as much as tax transparency is glorified to have advantages and benefits to countries, it comes with huge responsibilities as it poses a threat to taxpayers; countries should treat confidentiality as a priority.

## **2.3.2 Tax havens**

### **2.3.2.1 Definition of tax havens and countries classified as tax havens**

As discussed earlier in the study, a tax haven has been defined as a place with no taxes (Karp, 1993:1). It is further defined by the OECD (in Slemrod & Wilson, 2009:1) as a jurisdiction that imposes no taxes or small taxes and offers itself to people and companies as a place to be utilised by non-residents to escape taxes in their country of residence. The definition has indirectly been affirmed that a tax haven (with regard to private investors) it is primarily used for countries that have no or only nominal taxation and operate under strict secrecy rules that assist foreign investors to conceal capital income from the tax authorities of their respective home countries (Konrad & Stolper, 2016:1).

The three authors confirm the fact that a tax haven is a place where residents escape their tax responsibilities. Richardson and Taylor (2015:2) also agree with the definitions as they characterise tax havens as jurisdictions with nil or only nominal amounts of Corporate Taxes. At this stage, it is confirmed that a tax haven is a place that has no taxes or very low taxes are imposed and it is utilised by non-resident companies and individuals to escape paying tax in their respective countries (Alstadsæter et al., 2018:1, Karp, 1993:1, Slemrod & Wilson, 2009:1).

The literature states that a tax haven was first developed by Switzerland in 1920 and then was followed by Hong-Kong (Alstadsæter et al., 2018:4). The third and fourth rank is unknown at this stage and the Cayman Islands takes the fifth place in world of finance, which constitutes 80% of investment funds around the world and manages assets of approximately 100 trillion dollars (Radu, 2012:2). Choy et al. (2017:8) further split the tax havens between two categories, namely The “Big 7” and “Dot” havens. They confirm that the Big 7 havens are classified by its populations of one million as of 1982. This, therefore, means the Dot havens have less than one million in populations, which they refer them as “the rest”. The “Big 7” includes Hong-Kong, Ireland, Lebanon, Liberia, Panama, Singapore and Switzerland (Choy et al., 2017:8). It is imperative therefore to discover which countries are classified as tax havens.



A list of tax havens was published in 2008 and the following countries were included: Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cyprus, Dominica, Gibraltar, Grenada, Ireland, Jordan, Lebanon, Liberia, Liechtenstein, Luxembourg, Maldives, Malta, Marshall Islands, Mauritius, Netherlands Antilles, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, Singapore, Switzerland and Vanuatu (Schwarz, 2011:10).

More tax havens which are not included in above list have been identified throughout the literature, namely Delaware and Monaco (Radu, 2012:3). According to Alstadsæter et al. (2018:3), Guernsey, Jersey, Austria, Belgium, United Kingdom, Macao, and United States are also identified as tax haven countries. In addition, Grocott (2010:2) identifies Costa Rica, Malaysia, Philippines, Uruguay, and Isle of Man as tax havens. Whereas Desai et al. (2006a:2) adds Caribbean Island and Hong-Kong to the list. Channel Islands, Andorra, and San Marino are also identified as tax haven countries (Anonymous, 2008:4). This confirms that there is a significant number of tax havens that are operational around the world. The next discussion will be on how tax havens operate and that is key as it provides an overview of how and why a country is classified as a tax haven.

#### **2.3.2.2. *How do tax havens operate?***

According to Konrad and Stolper (2016:3) countries that are small can easily become tax havens. Schwarz (2011:6) also believes that small countries that have dense populations are tax havens. According to Radu (2012:3), a tax haven usually has currencies that can easily be converted into dollars, euros or pounds. Tax havens, in general, have a double monetary control system; this system distinguishes between residents and non-residents and local and foreign currencies (Radu, 2012:3). Generally, a tax haven charges a fee for the wealth management of a capital concealing investor and a tax haven country benefits from this economic activity (Konrad & Stolper, 2016:2). Bucovetsky (2014:2) also confirms that tax havens charge a fee for their services. Tax havens are paid in two forms, in cash or through favourable investments that facilitate economic growth (which is indirect compensation) (Slemrod & Wilson, 2009:3).

According to Bucovetsky (2014:2), it is undoubtedly guaranteed that many multinational corporations make use of tax havens to reduce their tax payments. This was confirmed by Desai et al. (2006a:9), that larger international companies are most likely to use tax havens. Corporations register subsidiaries in tax havens and through this channel assets get moved and hidden (Bucovetsky, 2014:2). According to Desai et al. (2006b:1), there is a concern that low tax jurisdictions intentionally introduce low taxes as a way to attract investment which would otherwise be in high tax jurisdictions. This goes as far as setting up dummy corporations, trusts, banks and even insurance companies in tax havens to launder money, not for drug smugglers but for doctors, dentists, lawyers, businessman and white-collar professionals of all kinds (Karp, 1993:1).

Companies also use tax havens by manipulating transfer pricing. They buy products from a branch located in a tax haven without a profit and they resell the product in an open market without paying the fees and taxes (Radu, 2012:3). Richardson and Taylor (2015:2) also agree that multinational corporations shift income between group subsidiaries located in tax havens through transfer pricing, strategic debt location and preferential cost allocation. Firms shift income by manipulating transfer pricing of goods and services which result in providing more benefits and revenues to low-tax jurisdictions (Richardson & Taylor, 2015:3).

Tax havens also operate by utilising profit shifting and corruption. Statistics analysis by specialists indicates that companies deflate and inflate invoices frequently, which facilitates profit shifting for purposes of avoiding tax (Anonymous, 2008:2). This reveals other criteria of utilising tax havens. In September 2007, star report estimated that developing countries and transitional economies contributes 1.6 trillion dollars proceeds annually towards corruption (Anonymous, 2008:3). According to Owens and Moore (2013:1), the G20 already recognised the increasing links between tax transparency and effective action that must be taken against corruption and money laundering.

Alstadsæter et al. (2018:7) state that names and addresses of the owners of all the shell companies created by Panama Papers were published by International Consortium of Investigative Journalists. Panama Papers refers to leaked documents that consisted of detailed financial and attorney client information of offshore shell entities. The shell companies were created over two decades ago and they were referred to as Panama papers. It is interesting to find that amongst the countries that created shell companies,

Zimbabwe and Kenya are also mentioned (Alstadsæter et al., 2018:7). This finding is disturbing as it is common knowledge that both countries are African countries and developing countries at the same time. The question that arises is, therefore, why these countries become problems for themselves; it was confirmed earlier in this study that the use of tax havens is a problem for African or developing countries.

### **2.3.2.2 Why are tax havens used?**

According to the evidence revealed in Desai et al. (2006a:1), the primary use of larger tax haven countries is to reallocate taxable income, whereas smaller tax havens are used to facilitate deferral of United States taxation of foreign income. Bucovetsky (2014:3) adds that investors use tax havens for tax sheltering or for production. On the other hand, Slemrod and Wilson (2009:2) believe that investors use tax havens to reduce the effective marginal tax rate for any given statutory tax rate. The use of tax havens helps firms avoid taxes (Desai et al., 2006a:2). In essence, a tax haven is punished if it levies a positive tax rate, as a result investors will not use that country as a tax haven in future (Bucovetsky, 2014:3).

However, Konrad and Stolper (2016:4) seem to have a different view as they believe that there are a number of reasons why investors use offshore centres and these reasons are not always to evade taxes. Offshore centres may be used for diversification, strong institutions, financial expertise or even insurance against leviathan governments. Konrad and Stolper (2016:1) further state that reasons could just be to enjoy the combination of concealment opportunities and the quality of the property rights regime in a tax haven country.

The investor's decision to use a tax haven depends on the likelihood of its secrecy regime and a tax haven with a secrecy regime attracts large capital inflows from tax evading investors (Konrad & Stolper, 2016:2). A secrecy regime enables investors to hide taxable capital from their respective countries (Konrad & Stolper, 2016:2). It appears that if a tax haven does not guarantee a secrecy regime, it is unlikely to be utilised by investors. Konrad and Stolper (2016:6) confirms that investors relocated their funds away from Switzerland when it entered information exchange treaties with several EU (European Union) countries and also enabled the banks to disclose client information to the US tax authorities.

It was already indicated that tax haven countries have no taxes or use low tax rates. High tax rate countries, on the other hand, attract investors and assist them to evade taxes and as a result haven countries are robust toward political pressure (Konrad & Stolper, 2016:3). A tax haven must provide concealment opportunities in the future to attract business or investors. An overview of what tax transparency is has been discussed, tax havens and their operations have also been mentioned. However, the question remains as to their association with developing countries.

### **2.3.3 Developing countries**

#### **2.3.3.1 *Background on developing countries***

According to Ring (2016:26) there is no single agreed upon definition of developing countries, however, while the United Nations (UN) recognises this fact, it groups countries into three broad categories, namely developed economies, economies in transition, and developing economies. Tanzi (2000:1-2) also provides a view that developing countries have often being characterised by the fact that they share a large portion of agriculture in total output. They have large informal sector activities and occupations, they have a small share of wages in total national income and have many small establishments (Tanzi, 2000:1). He also adds that they are classified by a small share of total consumer spending made in large, modern establishments (Tanzi, 2000:3).

Nielsen (in Ring, 2016:26-27) further states that regardless of variety of approaches with regard to country classification, the purposes for which such classifications are placed and the underlying normative implications of classification schemes, a number of factors seem generally relevant in assessing a country's status, including gross national income, longevity and education. According to these two authors that is how countries are classified as developing countries.

Tanzi (2000:5) further uses a split of four regions to classify developing countries, namely Africa, Asia, the Middle East and the Western Hemisphere to provide thirty-eight developing countries. Within the African region developing countries are Kenya, South Africa, Tanzania, Uganda, Zambia, Zimbabwe (Tanzi, 2000:11). Cote D'Ivoire (Ivory Coast) and Mauritius are

also added to the list (Tanzi, 2000:16). Western Hemisphere includes Argentina, Brazil, Chile, Costa Rica, Mexico, Nicaragua, (Tanzi, 2000:11). Bolivia, Colombia, Dominican Republic, El Salvador, Panama, Peru, Uruguay and Venezuela also adds to Western Hemisphere (Tanzi, 2000:16).

The Middle East developing countries are Egypt, Jordan, Morocco, Pakistan and Tunisia (Tanzi, 2000:16). Asian developing countries includes Fiji, Indonesia, Korea , Philippines, Singapore, Sri Lanka and Thailand (Tanzi, 2000:16). He also adds Vietnam and Paraguay. This provides one with a list of 38 developing countries.

According to (Thaçi and Gërxhaliu, 2018:3), developing countries can use tax to control inflation and to achieve economic and financial stability. Tax is considered vital to reducing (budget) deficits and for business survival (Grocott & Stevenson, 2010:1). This implies that developing countries are generally facing inflation, which is something that can be eliminated or reduced through the collection of taxes. However, the establishment of effective and efficient tax systems is a challenge for developing countries (Tanzi, 2000:1). The economic structure in developing countries makes it difficult to impose and collect certain taxes and many countries have a limited capacity in terms of tax administration (Tanzi, 2000:1).

According to Tanzi (2000:1), the tax system in developing countries is expected to raise enough revenue to finance government essential expenditures without excessive borrowing. They are expected to raise this revenue in equitable ways that minimise negative impacts on economic activities and do so within the international norms (Tanzi, 2000:1). This could be viewed as intense pressure for these countries given the problems they are faced with. Owens (2009:1) clarifies the fact that developing countries are aware of the benefits that can be derived by implementing better tax systems that have more effective tax administrations. However, it is a fact that a well-structured system requires a combination of both direct and indirect taxes and developing countries rely more on direct taxes (Thaçi & Gërxhaliu, 2018:1).

Unlike developing countries, developed countries collected four times more revenue from Personal Income Tax (PIT) than they do in Corporate Income Tax (CIT) (Tanzi, 2000:9). Due to the fact that developing countries have limited tax administration capabilities, the tax

treatment of financial income is problematic (Tanzi, 2000:13). It is a fact therefore that developing countries struggle with the collection of revenues.

Amongst other problems, developing countries are also faced with the limitation of obtaining basic data which makes it difficult for policy makers to assess the potential impact of changes to the statutory tax system (Tanzi, 2000:1-2). It was indicated earlier that lack of transparency has an impact on the ability of countries to implement effective legislation. Tanzi (2000:1) further highlights the fact that the political set-up does not support rational tax policy when compared to developed countries and developing countries, therefore, seems to be affected the most. This study seeks to explore the effect of tax transparency and tax havens, particularly on developing countries.

## **2.4 RESEARCH ETHICS**

No ethical clearance was required as this study is not performed on human beings and animals. The research ethics clearance has been submitted to the research committee for approval. No other research ethics were applicable in this study.

## **2.5 CONCLUSION**

This chapter reported on the literature that was reviewed for purposes of answering the research question and objectives. It is clear that countries may be facing problems and challenges that affect revenue collections and tax base and that have a direct impact on the economy of that country and eventually on the residents.

Overwhelming evidence points to tax havens as part of the reason that non-haven countries are losing to them. Hence they are benefiting from the loss of other countries as revenue that should rightfully be collected to non haven countries is diverted to haven countries. The lack of tax transparency is at the heart of these problems. However, there is hope as it appears that implementation of tax transparency might be the solution for all non-haven countries as this will enable countries to tax the residents accordingly and that will automatically improve the tax base and revenue collections.

It is clear that countries affected include developing countries and it is to this effect that this study is conducted, to contribute to the body of literature on the impact of tax transparency and tax havens; particularly within developing countries. This study will do so by providing the current status of literature on the impact that tax transparency and tax havens have on developing countries.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1 INTRODUCTION**

This purpose of this chapter is to discuss the application of theoretical research design and methodology which were discussed in the previous chapters. The philosophical stance, nature of the study, method of reasoning, time horizon, unit of analysis and nature of the data applicable to this study are discussed. This chapter also covers the systematic review approach and under systematic review a motivation as to the reasons why it is used specifically for this study are provided, together with an explanation of what a systematic review is and how it is generally applicable.

#### **3.2 RESEARCH DESIGN ELEMENTS AS APPLICABLE TO THIS STUDY**

##### **3.2.1 Philosophical stance**

This study falls within the ambit of the pragmatism philosophical stance. Pragmatism does not take on a particular position of the research, however, feels that research on the subjective meanings, objectives and observable phenomena can provide useful knowledge, depending on the research question. This study will utilise perspectives, ideas and theories of the currently available literature to help the researcher gain an understanding and more knowledge of tax transparency and the impact that tax havens have on developing countries.

In gaining this knowledge and understanding, the researcher will then be able to determine the current status of literature regarding tax transparency. A number of studies have been conducted on the impact that tax havens have on countries (including developing countries). The study seeks to determine what the current status of literature is regarding the impact that tax havens have on developing countries. This study will only use a web of knowledge currently available to answer the research question. The literature identified will be reviewed and analysed to find out if there are similarities, differences, contradictions, benefits, impacts



and any other finding that the literature may reveal; that is what this study seeks to accomplish.

### **3.2.2 Nature of the study**

This study is exploratory in nature. Exploratory studies are conducted when much is not known about a particular phenomenon, existing research results are unclear or suffer from serious limitations, the topic is highly complex or there is not enough theory available to guide the development of a theoretical framework. Currently, literature is available on tax transparency and the impact that tax havens have on countries, however, it is scattered and there is no structural overview of the impact that tax havens have on developing countries.

This study seeks to explore and contribute to the body of literature by determining the current status of literature on the impact that tax transparency and tax havens have on developing countries.

### **3.2.3 Method of reasoning**

This study applies the inductive method of reasoning, as the study starts with the observations and end with theories that are proposed towards the completion of the research process as a result of observations. This study aims to generate meanings from literature obtained with regard to the impact that tax transparency and tax havens have on developing countries in order to identify patterns and relationships with the aim of building a theory.

This patterns, resemblances and regularities in literature represent premises that are observed and generated in order to reach conclusions or to formulate a theory on the impact that tax transparency and tax havens have on developing countries.

### **3.2.4 Time horizon**

This research adopts a cross-sectional study. Cross-sectional studies utilise a collection of data over a period of time which can be days, weeks or months in order to answer the research question and objectives. The data for this study was collected from February to

August 2018. Data will not be collected beyond the months specified and beyond the completion of the study as the researcher would have achieved the goals and answered the research question and research objectives as set out.

This is a once-off collection of data over a period specified; hence it is referred to as a one-shot or cross-sectional method.

### **3.2.5 Unit of analysis**

The unit of analysis applicable to this study is published academic articles. The articles focussed on countries and taxpayers who are either companies or individuals. Data has been collected on the topic of interest, namely articles that were downloaded from databases, these articles reveal a web of knowledge and understanding on countries and taxpayers with regard to tax transparency and the impact that tax havens have on countries. There are some minimal articles which are included as literature for purposes of addressing the research question, however, they are not specifically written about countries or taxpayers, but still relevant to the study in terms of information.

The literature available is not based on particular countries, however a general overview of the literature on how different countries experience tax transparency and the impact that tax havens have on those countries that are non-haven. Once the researcher has the general view of the current status of literature on countries, the focus will be narrowed down to specific countries – in other words, developing countries.

### **3.2.6 Nature of the data**

The nature of this study is secondary data. It is applicable to this study as literature in the form of articles, journals, books and publications are already available on the current status of tax transparency and the impact that tax havens have on developing countries. This literature is referred to as secondary data.

The data is collected so that the researcher can gain more understanding and knowledge of the topic. This literature is used to determine the similarities, differences, style of thinking,

conclusions and any other findings that the literature will uncover regarding this study. The knowledge and understanding acquired will then be analysed and summaries will be generated to answer research question and objectives.

### **3.3 SYSTEMATIC REVIEW**

#### **3.3.1 Motivation**

A systematic review is a well-recognised method that has been used over the years and is available to researchers. It follows a systematic approach which assists the researcher to gain more knowledge and understanding of the topic by using literature that is already available to answer the research question. It is easier to utilise as the researcher is able to identify literature at once from online publications and utilise that information to address the study. Unlike other time-consuming methods, such as conducting surveys and interviews which may at times not be accurate, a systematic review enables the researcher to save time as literature is already available (Mallett, Hagen-Zanke, Slater & Duvendack, 2012).

As indicated, systematic review follows certain steps. It starts by classifying the search based on the research question. The researcher seeks to determine the current status of tax transparency and the impact that tax havens have on developing countries; hence the search has been deconstructed as such. The results of the literature searched on databases were produced and covered a wide range of subjects that relate to the topic at various levels of completeness and comprehensiveness, including the research findings. This remarkable method of research is a tool which comes as an added value tool to assist the researcher to pilot and screen the literature to include and exclude based on the relevancy and finalising the data by comparing the results found.

Data gathering and finalisation is the critical stage of a systematic review because if not done properly it can lead to a revision of the search strategy. It is important for the researcher to follow the steps properly so that it can be done once and the research can be concluded sooner. Therefore, it is the most efficient and effective method for this study, given the time frames.

### 3.3.2 Explanation

According to Mallett et al. (2012):

- The starting point of a systematic review will be to develop a research question. A number of things must be considered, including the population of the study, intervention needed to conduct the study, the outcome of the study and comparator, to name a few. This becomes the basis of a string of searches that are used in order to refine the literature search. From this step, a protocol which is often peer-reviewed and piloted is developed and it will describe the definitions and search strategies to be utilised, methods to be used for inclusion and exclusion criteria and which approach to combine. Often this step leads to a repetition of the search strategy.
- The next step will be to conduct a search from academic databases and institutional websites, which must manually be selected. Due to the fact that the researcher seeks to gain as much understanding and knowledge as possible, all studies found are included. The researcher will then start eliminating or excluding studies which are not relevant to the topic of interest. This is normally achieved by reading the abstract and full text of the study. At this stage, the screening process is at times piloted with all other literature that is being screened, to ensure consistency. It can also be piloted on similar studies conducted by other researchers, followed by a comparison of the results. This step will lead to finalising the studies that are included in the final analysis.
- When the final analysis of the data is completed and decided upon, the last step is to extract the relevant data in order to produce the findings and evidence discovered. This step depends on the type or field of study; a meta-analysis may be utilised to synthesise or manufacture evidence and directly compare results. A summary of findings is drawn and that should, in turn, answer the research question and objectives, which conclude a systematic review approach.

## CHAPTER FOUR

### DATA ANALYSIS AND PRESENTATION OF RESULTS

#### 4.1 INTRODUCTION

This chapter records the findings from the literature reviewed and ultimately answers the research question and objectives. The impact of tax transparency and tax havens on developing countries is discussed. The benefits of tax transparency are also discussed in this chapter and it ends with possible solutions identified thus far. As indicated, sixty-one articles were sourced, selected and included for the purposes of this study. All sixty-one articles were tagged using Qigga by analysing each and every one of them to determine the current status regarding the impact that tax transparency and tax havens have on developing countries and also to establish if there are any benefits associated with tax transparency. The study arrived at the findings below.

#### 4.2 APPLICATION OF LITERATURE

A total of sixty-one published articles reviewed yielded the following findings on the impact of tax transparency and tax havens on developing countries. The summarised findings will be interpreted in detail below:

**Table 5: Summary of research findings**

<b><u>The impact of tax transparency</u></b>	<b><u>The impact that tax havens have</u></b>
Boost international cooperation on corporate tax and transfer pricing (Pross et al., 2016:4).	Encourages unfair tax competition (Slemrod & Wilson, 2009:2, Haines, 2017:1).
Impact tax audits as tax authorities have more information through tax transparency to conduct accurate and fair tax audits (Grocott, 2010:2).	Increase reputational risks (Grocott, 2010:2, Franco, 2013:2, Venter et al., 2017:2, Manzano & Pinamont, 2014:2, M2 Equity Bites, 2013:1)

Assists in securing relevant tax data regarding foreign multinationals (Ring, 2016:33).	Assist investors to reduce the final tax liability (Hinneken, 2003:2).
Assists developing countries to have access to information directly from multinationals (Ring, 2016:55)	Positively associated with multinationals, transfer pricing, aggressiveness, thin capitalisation and intangible assets (Richardson & Taylor, 2015:24).
Automatic exchange of information can reduce the mobility of capital and this will assist governments to tax income (Houlder, 2016:3)	Facilitate loss of revenue (Grocott & Stevenson, 2010:3, Anonymous, 2008:4).
Assists developing countries generate more revenue (Grocott & Stevenson, 2010:3).	Reduce revenue collections and decrease the tax base (Radu, 2012:1, Slemrod & Wilson, 2009:2, Alstadsæter et al., 2018:4).
Additional revenue collections have already been witnessed by some countries who implemented tax transparency (Pross et al., 2016:3).	Benefits and assist firms to avoid taxes (Desai et al., 2006a:18).
It encourages policy debates and also discourages aggressive tax minimisation practices (Friezer, 2013:1)	Benefits by providing freedom to foreign exchange control, freedom to build reserves, freedom not to disclose information, freedom to not pay heavy taxes and fees (Radu, 2012:5).
It will enhance communication amongst countries and best practices will be established (Grocott, 2010:3, Euromoney Institutional Investor PLC, 2015:3).	
It will combat base erosion, profit shifting and offshore non-compliance (Owens & Moore, 2013:2, M2 Equity Bites, 2013:3, Houlder, 2016:2, Pross et al., 2016:1).	

It will encourage local and international tax fairness (International Tax Review, 2013:3, Owens & Moore, 2013:1, M2 Equity Bites, 2013:2).

The above findings were deduced from the sixty-one articles reviewed and these studies had the following country perspective.

**Table 6: Countries perspective of articles**

Countries	1993	2000	2001	2003	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
African									2				1		1	2		3	9
Anguilla														1					1
Argentina					1														1
Asia			1										1						2
Australia									1				2						3
Belize												1							1
Brazil												1	1						2
Cayman Islands												1							1
China												1					1		2
Developing countries		1	1					1	2	1		2	2	1	2	1	1	1	16
Europe			1										1	1	2			1	6
France								1	1										2
Germany								1					1					1	3
Gibraltar														1					1
Group of countries				1		1					1		1						4
India								1			1				1				3
Ireland								1						1					2
Isle of man							1												1
Kenya																		1	1
Malawi																1			1
Monaco												1							1
Netherlands							1						1	1					3
Panama								1						1					2
Russia											1	1							2
South Africa									1		1	1					2	1	6
Spain								1											1
Switzerland														1	1			1	3
United Kingdom								1			2	2	1	1				1	8
United State of America	1		1					1			1	2			1				7
<b>Total</b>	<b>1</b>	<b>1</b>	<b>3</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>1</b>	<b>13</b>	<b>3</b>	<b>1</b>	<b>13</b>	<b>17</b>	<b>8</b>	<b>9</b>	<b>6</b>	<b>5</b>	<b>8</b>	<b>94</b>

A total of sixty-one articles were tagged based on country perspective and twenty-nine countries have been written about. The articles provide a general overview of tax transparency and the impact that tax havens have on countries mentioned and also on developing countries. The articles included are between 1993 and 2018.

#### 4.2.1 The current status of literature relating to the impact of tax transparency on developing countries.

#### **4.2.1.1 *The impact of tax transparency on developing countries***

It is estimated that developing countries lose R160 billion annually as a result of transfer pricing that is not at arms-length standard (Grocott & Stevenson, 2010:3). It is further estimated that 11.5 trillion dollars is placed in other jurisdictions (Anonymous, 2008:4). The estimations provide an overview of losses encountered by countries. According to Radu (2012:3), companies manipulate transfer pricing by buying products from offshore centres without profit and resell in open markets without paying fees and taxes. Companies also reduce tax contributions by exploiting tax rulings and this is as a result of a lack of transparency. Of course, the ultimate impact is on revenue collections and tax base.

The banks have also been accused of facilitating capital flight by their secrecy operations and the effect of these operations, are that investors and depositors do not report interest income in their respective countries (Spencer, 2005:3). Tanzi (2000:13) declares that it is difficult for developing countries to tax interest income derived by their residents, he adds that if interest income is at all taxed, it is through the withholding tax mechanism. According to Thaçi and Gërzhaliu (2018:3), firms use banks to avoid taxes when tax rates are high. They are willing to give up the economic benefits in order to avoid taxes. Capital flight also affects developing countries negatively. According to Spencer (2005:4), capital flight affects developing countries the same way that it affects other countries. This amounts to non-compliance to tax declarations and automatically affects the ability of countries to collect revenue and to increase the tax base. Hence, organisations such as the OECD, IMF and World Bank are committed to assisting developing countries in improving their tax administration in an attempt to fight capital flight.

The UN International Conference also encouraged developing countries to strengthen international cooperation (amongst other things) and they have pledged their support to developing countries (Spencer, 2005:4). Grocott and Stevenson (2010:8) add that to improve international cooperation, tax authorities must work together. It was also observed that countries are working together to address cooperation on economic challenges that are common to them (Shaheen, 2012:1). It appears that cooperation is key to ensuring successful implementation of tax transparency. It is also an added benefit that organisations are committing to assisting developing countries in dealing with their problems.



It is believed that ensuring more openness between states will encourage more cooperation between tax administration authorities (Cunningham, 2015:2). It appears that cooperation is key as enhancing the transparency of multinational enterprises is expected to have a significant impact on boosting international cooperation specifically in relation to corporate tax and transfer pricing (Pross et al., 2016:4). Tax transparency is impactful to developing countries and through cooperation, developing countries can successfully implement it.

It is a fact that tax transparency will also impact tax audits. According to Grocott (2010:2), multinationals use legal tax avoidance to minimise tax liabilities; exchange of information will make things easier for tax authorities to verify disclosed information. It is believed that with regard to the audits, the impact will be huge as tax transparency will provide more information which would normally not be available. This will ensure efficiency and it is an added advantage as correct amounts of taxes will be collected. Euromoney Institutional Investor PLC (2015:3) added that tax transparency or information exchange will effectively govern audit processes and will ensure consistency in audits around the world.

As much as tax transparency has the potential to positively impact on developing countries, there are concerns associated to it. According to Shrivastav (2015:2), the OECD observed that developing countries rely heavily on revenues collected through Corporate Income Tax, hence Base Erosion and Profit Shifting (BEPS) is of significance to developing countries. The OECD launched the BEPS project, which consists of 15 action plans in key areas to tackle tax challenges and these actions are endorsed by the G20 (Shrivastav, 2015:1).

According to Ring (2016:50), Action 13 will have the master file, a local file and CbC report which countries will benefit from as they will receive better information and be able to self-report regarding transfer pricing and allocation of profits globally. There are concerns particularly for developing countries participating in this action. Ring (2016:50) stresses that multinationals have concerns regarding the use of information that developing countries will receive through participation in Action 13. She adds that developing countries may use the information for tax adjustment and will fail to engage in full transfer pricing analysis (Ring, 2016:50).

There is also a concern for developing countries on the usage of this information, that taxpayer privacy and confidentiality will be jeopardised; multinationals are concerned as to whether developing countries will adequately protect data received through this action (Ring, 2016:51). Developing countries must, therefore, assure multinationals that receipt of such information will be safeguarded and assist with proper implementation.

#### **4.2.1.2 *The benefits of tax transparency in developing countries***

According to (Owens, 2009:2), a seminar held by the African Tax Administration Forum (ATAF) reflected on the importance of adopting the international standards of transparency and exchange of information. This highlights the importance of tax transparency and the reason why it should be encouraged, especially in developing countries. Greater tax transparency will benefit both developing and developed countries (M2 Equity Bites, 2013:2). Developing countries depend more heavily on mechanisms of information exchange to secure relevant tax data regarding foreign multinationals operating in their jurisdictions (Ring, 2016:33); hence tax transparency is of high importance to them.

International forums such as G20 and Global Forum have indicated their commitment and support to encouraging and assisting developing countries to implement global standards of transparency and exchange of information to get a fair deal in the global tax environment, through the fight against tax avoidance and evasion (Owens, 2009:4, Grocott & Stevenson, 2010:8). The Global Forum has further committed to monitoring the impact that new tax transparency standards will have on developing countries (Owens, 2009:4).

Ring (2016:46) identified possible advantages for developing countries which are associated with the implementation of BEPS Action 13. It is believed that the benefits include developing countries having access to information directly from multinationals through this action (Ring, 2016:55). Whereas developing countries suffer from limited tax enforcement and audit resources, global tax administrators automatically receive information and that enables them to begin their analysis (Ring, 2016:54). In addition, Venter et al. (2017:8) suggest that tax transparency could benefit capital markets as investors view tax transparency as a sign of quality disclosure and they add that it could reduce the risks and costs of being subject to an audit.

It is believed that tax authorities must create a feeling of fairness towards taxpayers to avoid disadvantaging them (International Tax Review, 2013:3). Owens and Moore (2013:1) mention that the G8 organisation also launched a ten point action plan; it is believed that its implementation will improve tax transparency, multinationals will achieve fairer taxation and it will also help developing countries build their tax capacity. It proves that there is a significant benefit to developing countries by the mere implementation of tax transparency. This benefits both taxpayers and countries.

Former South African Minister of Finance, Pravin Gordhan also confirmed that the automation of exchanging tax information will contribute and add value to the establishment of effective, efficient and fair international tax systems (M2 Equity Bites, 2013:2). Transparency initiatives will have an impact on current tax procedures and systems and this could require legislative and organisational changes (Anonymous, 2013:4). It is strongly believed that tax transparency when paired with international tax reform may provide opportunities for a tax director to clean up all company tax strategies that does not serve a legitimate purpose (Alexander, 2013:6). Developing countries have to invest in the tax system to effectively maximise collection of taxes.

Christian Aid is an organisation that also advocates that developing countries should be included in initiatives such as information exchange agreements through country-by-country reporting standards, which will to a certain extent prevent companies from shifting profits to tax havens (Anonymous, 2010:1). According to Grocott and Stevenson (2010:4) if developing countries are informed via the automatic sharing of tax information, then they would not fall a foul of abusive tax arrangements. The international community is also fighting tax evasion through information sharing (Alexander, 2013:4). Developing countries should learn from such communities as tax evasion and capital flight in developing countries are enabled by lack of transparency in onshore and offshore financial centres. (Anonymous, 2008:3-4).

It is expected that automated exchange of information can reduce the mobility of capital and this will assist governments to tax the wealth and capital income as required by legislation (Houlder, 2016:3); this will effectively reduce non-compliance. Houlder (2016:2) reports that

global tax transparency has a significant strategic shift from offshore to onshore wealth management. This proves that tax transparency indeed adds value. The enhancement of tax transparency is believed to fight against tax evasion and corporate tax avoidance (Cunningham, 2015:2). According to Pross *et al.* (2016:3), taxpayers are already moving quickly to comply with their offshore tax affairs as a result of tax transparency implementations. However, Haines (2017:2) seems to share a different view, as he believes that tax transparency will not likely impact tax behaviour or compliance of taxpayers particularly with regard to the utilisation of exchange of information.

Tax transparency is a crucial weapon in fighting offshore tax evasion (Pross *et al.*, 2016:1). Certain companies artificially reduce their tax contribution, this is as a result of the lack of tax transparency on tax rulings (M2 Equity Bites, 2013:1). The implementation of BEPS initiatives was with the view that tax planning that utilises gaps to artificially reduce taxable income or shifting profits to tax havens will be dealt with (Russell, 2015:1). He believes that this provides countries with tools that ensure that profits are taxed where economic activities are generated and performed. Developing countries received attention in the UN Financing for Development (FfD) conference, where tax transparency was addressed as a key theme (African Business, 2015:2). It was agreed that disclosure practices and transparency must be enhanced in both source and destination countries (African Business, 2015:2); this will ensure that the right country collects what is due to it.

Anonymous (2010:1) stated that Christian Aid believes that tax revenues have the potential to transform poor people's lives in developing countries, also confirmed by (M2 Equity Bites, 2013:2). It was highlighted earlier that developing countries rely heavily on the collection of revenue. The OECD estimated that developing countries lose three times more in revenue collections to tax havens than they receive in international aid (Ring, 2016:30); also according to Christian Aid and Action Aid, developing countries lose more than they receive through tax evasion (Anonymous, 2010:2). This explains why authors (Grocott & Stevenson, 2010:3, Anonymous, 2010:2) believe that if tax information was effectively used, developing countries will have more access to tax revenues. It is hoped that sharing detailed taxpayer information will reduce tax avoidance, minimise tax evasion and improve offshore tax compliance (Grocott, 2010:1).

This explains why Christian Aid also confirms that it believes greater transparency will assist developing countries to generate revenue (Grocott & Stevenson, 2010:3). Tax administrators have reported increased revenue statistics by adopting the advice provided by OECD initiatives (Euromoney Institutional Investor PLC, 2015:1). In the past seven years, the impact of tax transparency has already been witnessed as it is reported that 30 countries identified additional revenue of around EUR 50 billion, which is translated to be \$54 billion (Pross et al., 2016:3). These revenues were retrieved through voluntary disclosures and other similar initiatives which targeted offshore tax evasion (Pross et al., 2016:3). It appears there is unity in the fight against offshore tax evasion being facilitated through tax havens.

Various countries and supranational organisations such as the OECD have also implemented several initiatives against tax havens and this process is often referred to as the fight against tax havens. Some countries become compliant with this initiative and others continue operating as tax havens and provide tax sheltering services (Konrad & Stolper, 2016:1). However, the success of tax transparency has already been reported as companies and individuals now avoid using low-tax jurisdictions that have signed a number of tax exchange agreements (Grocott & Stevenson, 2010:6). They further confirm that tax transparency will assist in dealing with uncooperative tax havens (Grocott & Stevenson, 2010:8).

Owens (2009:2) highlighted the importance of African countries to understand the role of transfer pricing in raising revenues, encouraging investments and discouraging tax avoidance. He believes that this will ensure that multinational enterprises do not artificially shift taxable profits to tax havens and in so doing it will reflect the real economic activity undertaken (Owens, 2009:2). Shaheen (2012:4) concludes that national problems need national solutions and global problems also need global solutions; tax avoidance affects everyone and therefore countries should help each other.

Reliable statistics assist in producing policy measures that combat the problem (Cunningham, 2015:3). According to Ring (2016:46), another benefit that developing countries will have as a result of Action 13 is the impact it will have on domestic legislation. Due to increased information exchange, rules requiring specific reporting by multinationals may get a boost from the combination of an available international framework that can be

adopted (Ring, 2016:57). Action 13 brings benefits to developing countries as it will provide assistance to domestic tax policy conversations and allocation of resources as a result of possible useful tax information received (Ring, 2016:46).

It was indicated earlier in the study how important data is to policy implementation. Owens and Moore (2013:2) confirms the importance of data to developing countries with their statement that it assists them to effectively implement their transfer pricing provisions. G8 committed that they might create a pan-African database for tax administrators in developing countries to effectively assist them (Owens & Moore, 2013:2). Euromoney Institutional Investor PLC (2015:3) also confirms that it will impact proposed tax legislation. Friezer (2013:1) adds that increased tax transparency has a positive impact as it encourages policy debates and also discourages aggressive tax minimisation practices. Generally, it can be concluded that tax transparency will impact tax policies and its changes.

It was discussed earlier in the study that the lack of tax transparency facilitates BEPS; it is confirmed that all the initiatives have more benefits which include combating base erosion, profit shifting and generally fighting offshore non-compliance (Owens & Moore, 2013:2, M2 Equity Bites, 2013:3). Pross et al. (2016:1) believe that greater transparency is key in fighting base erosion and profit shifting and it plays a role in closing tax loopholes. Tax transparency is, therefore, an added advantage for developing countries. It will assist in the fight against corruption as it has also been reported as a problem, Grocott and Stevenson (2010:4) confirm that above-mentioned implementation of transparency and exchange of information will also help with this challenge.

International tax competition plays a crucial role as it encourages economic growth and efficient delivery of public services (Gilleard, 2014:2). It is believed that this has to be done to show honest taxpayers that non-compliance will no longer be tolerated and also to promote competition between financial centres based on service, not secrecy (Grocott and Stevenson, 2010:6). In fact, the European Commission promotes tax transparency as a tool for healthier tax competition and a tool in identifying abusive tax practices (Cunningham, 2015:1, Dewar et al., 2015:1, M2 Equity Bites, 2013:1). However, Faith (2007:1) seems to disagree with this view as she believes that, in fact, tax havens are a necessary part of tax competition.

It is further stressed that developing countries having access to this information will enable them to identify areas of training for staff (Ring, 2016:45), and through automatic exchange of information between countries, developing countries will have access to the same information that the taxpayer would have provided which will enable accuracy in collecting revenue (Ring, 2016:45).

It is believed that through all tax transparency initiatives, countries will enhance communication amongst each other and best practices will be established (Grocott, 2010:3). Euromoney Institutional Investor PLC (2015:3) agrees that it will assist tax administrators in adopting best practices. Revenue authorities in different countries will also be more consistent and transparent in the treatment of similar issues, as added by (Grocott, 2010:4). To avoid double taxation and to maintain consistency, the application of tax transparency by jurisdictions must be the same in the sense that different application criteria for tax matters must be avoided (Hinnekens, 2003:2). Therefore, communication and consistency will provide best practices.

## **4.2.2 The current status of literature relating to the impact that tax havens have on developing countries**

### **4.2.2.1 *The impact of tax havens on developing countries***

The most significant impact that tax havens have through tax avoidance is on emerging (developing) countries as they do not have the necessary tools to enforce an exchange of information (Radu, 2012:2). According to the literature reviewed, many countries are facing challenges in revenue collection and tax havens are partly to be blamed (Radu, 2012:1, Slemrod & Wilson, 2009:2). In 2007, 5.6% trillion dollars were estimated to be held in tax havens globally (Alstadsæter et al., 2018:4) and 90-95% of the wealth that is in tax havens is not declared in their respective countries (Alstadsæter et al., 2018:9). This already indicates a problem and the impact on the non-haven countries becomes clear – lower revenue collections and reduction of the tax base are the result.

According to Bucovetsky (2014:2) and Alstadsæter *et al.* (2018:9), companies use tax havens to reduce the tax liability and they hide assets through the use of subsidiaries in haven countries. Tax practitioners often use hybrid entities to assist investors to reduce final tax liability (Hinneken, 2003:2). As a result of the use of tax havens, reallocation of income from high-tax jurisdictions to low-tax jurisdictions is effected (Desai *et al.*, 2006a:2). This is done by combining trusts, foundations and holding companies with the purpose of disconnecting assets from their owners (Alstadsæter *et al.*, 2018:9). They are also used to facilitate legal tax avoidance and illegal tax evasion (Slemrod & Wilson, 2009:2).

Karp (1993:1) confirms that it is difficult for the US to trace money once wired to tax havens and upon return in the name of a foreign entity. According to him, it is even more difficult to establish if “lost” assets are generating taxable income for the benefit of the citizens and it is not easy to determine if the original money was reported and taxed in the first place. This is how tax liabilities are reduced through the use of tax havens. It is reported that several US bills fight offshore secrecy through the utilisation of information reporting (Alexander, 2013:3). On a positive note, literature reveals that Switzerland is adopting the international tax transparency standard (Kapalle, 2015:4); this remains a grey area as to whether other tax havens will follow or they will maintain their status as tax havens.

It is reported that tax havens affect tax competition as Haines (2017:1) suggests that the efforts to fight aggressive tax practices will eliminate unfair tax competition. It is believed that countries are faced with tax competition problems, which are caused by tax havens as they force countries to reduce their tax rates below efficient levels (Slemrod & Wilson, 2009:2).

On the other hand, the use of tax havens by companies shifting income to their subsidiaries held in low-tax jurisdiction comes with increased reputational risks (Franco, 2013:2). So too, is the use of aggressive tax planning and non-compliance of companies, which will raise reputational and legal tax risks (Franco, 2013:2, M2 Equity Bites, 2013:1). It is added that the exchange of information and transparency of taxpayers’ information one way or the other may cause taxpayers’ reputations to be damaged (Grocott, 2010:2, Franco, 2013:2, Venter *et al.*, 2017:2, Manzano & Pinamont, 2014:2). However, Alexander (2013:4) believes that through formal and informal programs, reputational risk arising from tax controversies can



be reduced. Venter et al. (2017:2) also add that the EU suggested that managing reputational risk and regaining the trust of society is essential to tax transparency. There is a lack of trust between taxpayers and tax authorities (International Tax Review, 2013:3). It is believed that companies trade-off between the benefits of tax transparency such as being a good citizen, creating trust, avoiding reputational damage and enhancing public perception, in exchange for obligations to shareholders to minimise costs (Gilleard, 2012:3). Hence, reputational risk is directly linked to tax transparency.

Tax havens can be classified as a problem for countries but definitely not for the companies and individuals utilising them. According to Radu (2012:5), tax havens benefit them by providing freedom of foreign exchange control, which enables them to have freedom to build reserves, freedom not to disclose information and the freedom not to pay heavy taxes and fees. It also offers services such as global custody, investment fund management and administration of offshore companies and trusts, legal and accounting services and stock transactions (Radu, 2012:5). It is a fact that these companies and individuals utilise tax havens for their own benefit, regardless of the impact it has on their respective countries.

It is further emphasised that the use of tax havens have a positive association with multinationals, transfer pricing, aggressiveness, thin capitalisation and intangible assets (Richardson & Taylor, 2015:24). Desai et al. (2006a:18) demonstrated in their study that tax haven operations benefit and assist firms to avoid taxes; that the use of tax havens provide trading opportunities and have the ability to reduce taxes. In fact, Johannesen (2010:1) presents a model of tax competition for real investment and profits, and the results provide that the presence of tax havens in some cases increases tax revenues of countries. Tax havens are therefore not as bad as they are painted, as they carry with them benefits for taxpayers and companies.

#### **4.2.3 Possible identified solutions so far**

There is no problem without a possible solution; there are possible solutions that literature provides. It is suggested that bank secrecy in tax matters whether through *de jure* or *de facto* must be abolished and the automatic exchange of tax-relevant information be implemented internationally (Spencer, 2005:3). This will mean that every country will be

transparent regarding their tax status and providing an exchange of information. It remains a mystery whether all countries will agree. According to Spencer (2005:3), the solution to capital flight and tax havens (which in turn cause tax evasion and tax avoidance) is to abolish bank secrecy altogether. The revised Article 26 of the OECD Model Income Tax Treaty overrides bank secrecy and confidentiality in international tax matters (Spencer, 2005:4). This is an indication that more work is being done to implement tax transparency so that countries can benefit.

It is added that countries should instead concentrate on increasing tax rates and invest minimal resources on enforcement. They believe that if countries adopt this conclusion, the demand for tax havens' services will rise and that will ultimately raise effective prices of their services which will eventually discourage their use (Slemrod and Wilson, 2009:2). This is an interesting analogy if indeed it can be proven, nevertheless, Stiglitz and Pieth (2016:3) add that tax havens should be cut off from the global financial community as they serve as centres for tax avoidance and evasion, which facilitate corruption or illicit activities. Slemrod and Wilson (2009:1) went further to demonstrate that the elimination of tax havens will improve welfare in non-haven countries. This is indirectly affirmed by Konrad and Stolper (2016:9), who suggest that chances of elimination of offshore tax evasion are better if countries that impose high tax rates can impose lower tax rates and severe penalties for disclosed tax evasion.

Johannesen (2010:9) does not seem to agree with this analogy; his study strongly suggests that eliminating tax havens will not stop aggressive tax competition. However, Gilleard (2014:7) still maintains that it is better for governments to be two-faced about tax policy and rhetoric and strike the balance between the need to attract investment with the need to be seen as strictly enforcing compliance. Reports by the Central of the Bahamas indicated that there is already a significant strategic shift from offshore to onshore wealth management caused by the pressure for global tax transparency (Houlder, 2016:2).

The Horizontal Monitoring programme was also highly recommended as a solution, as it was believed that its implementation brings greater convergence (it already impacted Russia's tax system) (International Tax Review, 2013:4). It might be able to benefit developing countries as well.



## CHAPTER FIVE

### CONCLUSION

#### 5.1 INTRODUCTION

The purpose of this chapter is to reflect on the journey that was taken throughout the study in addressing the research question as well as to report on limitations experienced and make recommendations for future study. This chapter also provides brief concluding remarks on the study in general.

#### 5.2 REFLECTION ON ADDRESSING THE RESEARCH QUESTION AND OBJECTIVES

This section discusses and concludes on whether the research question and objectives stated in Chapter One were achieved and answered. The research study followed a systematic review approach which reviewed literature currently available on the topic of interest. The literature used to conduct this study was peer-reviewed academic journal articles, which were found on databases as mentioned earlier. The purpose of this study was to answer the research question “*What is the current status of literature regarding the impact that tax transparency and tax havens have on developing countries?*” This research question birthed two research objectives. The first research objective for this study was:

- To identify and analyse peer-reviewed academic journal articles in order to determine the current status of literature relating to the impact that tax transparency has on developing countries.

The research objectives were addressed through the literature and it was found that tax transparency has a direct impact on countries, particularly developing countries. According to the findings, tax transparency has more benefits than disadvantages to (developing) countries if implemented. Tax transparency impacts developing countries by positively enhancing and boosting revenue collections and their tax base. There is, however, another view which discourages the implementation of tax transparency, as it is believed it will not impact taxpayers' behaviour and tax compliance in anyway, and ultimately it will not impact

revenues and tax bases of said countries. These articles discouraged the idea of tax transparency for reasons such as confidentiality, rights of taxpayer information and reputational risks associated with this tax transparency. However, the majority of literature from articles reviewed are supportive of the idea of tax transparency.

Even though the study did not determine the complete extent of the benefits associated with the implementation of tax transparency, particularly in developing countries, it can be concluded that the implementation of tax transparency might result in partial or complete elimination of tax havens that have a direct impact on the countries' abilities to maximise collection of revenue and extend their tax base. This might enable the right country to collect revenues due as opposed to revenues being wired to tax havens instead. It is a fact that more studies have to be conducted to prove the impact of tax transparency to its full potential as it is believed that the findings of this study may change, pending progression and technological changes.

The second research question was:

- To further identify and analyse high-quality academic research articles in order to determine the current status of literature relating to the impact that tax havens have on developing countries.

The findings on the impact that tax havens have on developing countries are more negative than positive. One article indicated that tax havens affect countries positively, particularly with regard to transfer pricing and thin capitalisation to name a few. Another article also highlighted opportunities and benefits that tax havens provide to countries and individuals utilising them as they provide freedom to build reserves and not to disclose information and reduce tax liabilities.

However, the majority of articles and literature revealed that tax havens are posing many problems to (developing) countries. These problems include, amongst other things, facilitation of loss of revenues by developing countries through tax havens assisting residents to avoid taxes in their respective countries. The impact of this problem directly

affects developing countries' ability to maximise collection of revenues and extend their tax base. A general view is that tax havens create more problems than benefits for developing countries. Hence it can be concluded that indeed tax havens impact developing countries negatively.

In conclusion, the systematic review revealed that tax transparency impacts developing countries positively and brings more benefits than disadvantages, whereas tax havens impact them negatively as they create more problems and disadvantages than benefits.

### **5.3 LIMITATIONS**

During the course of this study, a number of limitations were experienced. The study was mainly focused on reviewing the literature that is currently available on the topic of interest. This was as a result of the fact that the study was limited to acquiring literature from certain databases which were available on the online library of the University of Pretoria. This resulted in limitations of extending the search and acquiring literature from other sources, such as books, newspapers and websites.

In addition to this, there were certain articles which were relevant to the study based on the title of the article and the abstract found on mentioned databases, however, the articles will require a purchase in order for the articles to be retrieved or they will require certain credentials in order to access them. It will clearly state that the article is restricted, therefore cannot be obtained. Hence this was a limitation to the study.

### **5.4 RECOMMENDATIONS AND FUTURE RESEARCH**

The literature reveals the benefits associated with tax transparency for (developing) countries. It is recommended therefore that future research explores whether implementation of tax transparency might result in the partial or complete elimination of tax havens and in turn benefit developing countries. One study has already determined that the elimination of tax havens improves the welfare of non-haven countries, however, it cannot be concluded that it applies to developing countries, hence it is recommended that research

is conducted on developing countries or African countries to determine the extent to which they can benefit.

It is noted that many countries and different organisations invest funds and resources in an attempt to fight offshore tax compliance. It is also noted that countries should rather concentrate on increasing tax rates and invest minimal resources on enforcement. They believe that if countries adopt this conclusion, the demand for tax havens' services will rise and that will ultimately raise effective prices of their services, which will eventually discourage their use. This is an interesting analogy if it can be proven. Other countries have already indicated a significant strategic shift from offshore to onshore wealth management, caused by the pressure for global tax transparency. It is recommended that research such as this be conducted on developing countries to determine if the results will be the same.

## **5.5 CONCLUDING REMARKS**

This study was conducted to determine the impact that tax transparency and tax havens have on developing countries. Analysis of the literature reviewed revealed that there is a relationship between tax transparency and secrecy. It is also a fact that secrecy is associated with tax havens as they were described as such (secretive). It almost appears as though one cannot talk about tax transparency without mentioning tax havens with regard to loss of revenues and tax base and other problems experienced by countries. It can, therefore, be concluded that there might be a direct influence between tax transparency and tax havens, particularly on non-haven countries. Lack of transparency is almost a confirmation as the direct link between tax havens resulting in tax evasion and tax avoidance.

Based on the above analysis and findings, it is concluded that tax transparency has a positive impact on developing countries while tax havens have a negative impact on developing countries; therefore, the study has achieved its objectives as it answered the research questions and fulfilled research objectives as planned. This study is therefore complete.

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