

# The Economic Performance of Slovak Companies with Direct Ownership Links to Tax Havens

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**Abstract:** This paper aims to analyse the impact of transferring the registered offices of Slovak companies to tax havens at the level of the reported indicators of total assets turnover and EBITDA per total assets. A tax haven is generally defined as an offshore territory that imposes low or zero taxes with insufficient or low transparency, relatively low participation in multilateral exchanges of financial account information and with the possibility to use different and harmful tax structures. We divide tax havens into three categories, onshore, midshore and offshore jurisdictions. In our analysis, we use two databases. The first is the Bisnode database, which lists Slovak companies with the owner in selected tax havens. The second database is the datasets of the financial statements of Slovak companies for individual years prepared and provided by Finstat. As for the investigated period, we selected the year 2015 as it has the highest number of available data. Our results suggest that Slovak companies with direct ownership links to tax havens disclose statistically significant differences of median values in both total assets turnover and EBITDA per assets compared to those companies without links. Our output partially confirms the hypothesis that Slovak companies linked to tax havens report worse economic performances than that of their counterparts.

**Keywords:** EBITDA; foreign ownership; Slovak companies; tax havens; total assets turnover

**JEL Classification:** G30; H21; H26

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## 1. Introduction and Literature Overview

In 2019, the number of Slovak companies that have their headquarters in a tax haven (equity linkage) reached a new record since these particular statistics started to be tracked. In the first half of the year, up to 4,914 Slovak companies were connected to companies from selected jurisdictions via direct ownership links (Bisnode 2019a). The use of tax havens is considered controversial and is mainly associated with aggressive tax planning internationally and the anonymity of the ultimate beneficial owner (UBO). We have seen, not just individual states, but also international groups and organizations have responded to the artificial transfer of taxable profits to tax havens since the outbreak of the last financial crisis. Since 2014, new rules have gradually been implemented including the Slovak Income Tax Act against the artificial transfer of taxable profit to jurisdictions with little or no taxation, e. g. exit tax, CFC rules, thin-capitalization rules or the obligation to follow the arm's length principles among the associated parties (both on a domestic and international level). At international level, the automatic exchange of bank information (FATCA or GATCA) is implemented. The individual actions of the BEPS project and many proposed EU directives focused on new approaches on how companies operating in selected sectors will pay corporate income taxes (e.g. a proposal for a council directive laying down rules relating to the corporate taxation of a significant digital presence and a proposal for a council directive on a common system of taxation for digital services, European Commission 2018a and 2018b). All of these measures are being taken with a clear goal, namely, to avoid the artificial transfer of taxable profits and money laundering. Given the trends in this area, it is surprising that the number of Slovak companies based in tax havens continues to grow. The same statistics in the Czech Republic indicate that the number of Czech companies based in tax havens has reached its lowest level since 2011 and this trend can be expected to continue (decreasing number since 2015) (Bisnode 2019b). Nevertheless Moravec, Rohan, and Hinke (2019) declared that the research outputs might be highly

influenced by the data source used as there are huge differences among numbers different sources provide. While the available tax optimization analysis in relation to tax havens is quite a lot, studies focusing on the economic performance of such companies are relatively low, even if their increased numbers are recorded.

This paper focuses on analysing the selected indicators of economic performance of Slovak companies with direct ownership links to tax havens compared with their counterparts. The formation company and its use of tax havens itself is not illegal and companies doing so can still find benefits resulting in a better economic performance.

The attitudes to and perception of tax havens have changed dramatically over the last few years. On one side there is no generally accepted definition of a tax haven, on the other side, more and more authors are providing characteristics or common indicators to mark a jurisdiction as a tax haven. According to Mara (2015), low taxation is not enough for a country to be a tax haven even though corporate income tax rate is indeed a significant indicator. Moravec and Kukalová (2014) show the influence of tax environment (personal, corporate, income and profit taxes) on the foreign direct investments' allocation. In our opinion, the most accurate measure of tax havens currently is the Financial Secrecy Index (FSI) (Tax Justice Network, 2018). The methodology is comprised of 20 so called secrecy indicators, which are divided into 4 main areas: ownership registration, legal entity transparency, integrity of tax and financial regulation and international standards and cooperation. The findings of Omar and Zolkafli (2015) confirm that multinational companies with a tax haven advantage engage in profit shifting more extensively than multinational companies without a tax haven link.

Su and Than (2018) consider the setting up of affiliated companies in tax havens as legitimate, but an ethically dubious business practice. Salaudeen and Ejeh (2018) have analysed ownership concentration and its effect on tax aggressiveness. According to their research (focused on Nigerian data), they uncovered that tax aggressiveness is insignificantly affected by the ownership concentration. Furthermore, their research suggests that managerial ownership has a significantly negative impact. This research indicates that tax aggressive strategies are linked to profitability. According to Desai and Dharmapala (2006), managers can use tax planning in the international environment to draw private interests and to increase the company's earnings. Chen et al. (2010) outline the extent of potential benefits and related costs that can affect tax aggressiveness of a company. The costs of a tax aggressive strategy primarily include the time and effort spent on aggressive tax planning activities, transaction costs of profit-shifting techniques and lower reported revenues.

In 2001, Shackelford and Shevlin (2001) already pointed out direct ownership structures (through equity) as an important determinant of aggressive tax planning. According to Boussaidi and Hamed (2015), ownership concentration strengthens tax aggressiveness. Driffield, Sun, and Temouri (2018) showed that there is an increasing but non-linear relationship between foreign equity ownership and productivity. They find that companies with larger foreign shares have better productivity. Durnev, TieMei, and Magnan (2016) examined how a firms' reliance on Offshore Financial Centres (OFSs - primarily jurisdictions located in small tropical islands/often marked as offshore tax havens) (either by registering or setting up subsidiaries in OFCs) affects their financial performance. They find that companies that are directly registered in an offshore jurisdiction are valued at 14% lower than onshore companies, while companies with subsidiaries in OFCs report an 11% higher valuation compared with companies that have the parent companies located onshore. Ozili (2018) investigated the potential association between tax evasion and financial instability. He found tax evasion can impact tax revenues. Therefore, Ozili found that tax evasion reduces the sources available for a state to manage its economy. Additionally, companies benefitting from tax evasion can use these sources to improve their own economic performance and financial stability. With the empirical results of research from Desai and Dharmapala (2009), we can see that tax avoidance has no significant impact on a company's value. However, the opposite situation could be observed for well-governed companies. They are also of the opinion that a simplified view on tax avoidance cannot be complete due to the problems identifying the relationship between shareholders and managers. Prochazka (2019) analysed the financial performance of Czech firms with different parent companies and found that the location of

the parent company together with the operating sector of the subsidiary had a significant impact on the economic performance and taxation level (effective tax rate).

## 2. Methodology

This article aims to assess the economic performance of Slovak companies with ownership links to tax havens based on selected ratios. As investigated indicators we chose total assets turnover and EBITDA per total assets. Total assets turnover ratio measures the company's revenue per total assets and can be used as an indicator of the company's efficiency in using assets to generate sales. The value of this indicator shall be at least 1 and we understand that the higher the value of the indicator, the more efficient the company is. When comparing this indicator between companies, it is advisable to take into account the depreciation rate of the assets and the depreciation method. Due to this fact we extend our analyses by EBITDA/total assets ratio. Since in this ratio finance and depreciation costs are added back to the net profit (EBITDA) it allows a more comparable analysis between companies with varying capital structures, tax rates and capital expenditures.

For this analysis, data was available for 179,299 Slovak companies since we have excluded companies that reported a missing or a zero value of total assets (the denominator of a chosen ratio). In addition, we have also excluded companies where at least one of the indicators was showing an outlier (1.1%), which could distort the results of statistical tests. We have data available for 2,107 Slovak companies with links to tax havens for 2015. As there is a relatively large difference between the tested number of companies due to matching the data provided by Bisnode with the data available from the database of Finstat (financial statements), we have reduced this large number (175,220 vs. 2,107) by randomly selecting 5% of the companies without links to tax havens. Thus, in our analysis we compare two samples of Slovak companies: 8,761 companies without links to tax havens available in the Finstat database and 2,107 companies with links to tax havens provided by Bisnode.

We have divided jurisdictions marked by Bisnode as tax havens into three categories:

1. ONSHORE COUNTRIES (ON): Liechtenstein, Latvia, Luxembourg, Monaco and the Netherlands;
2. MIDSHORE COUNTRIES (MID): Hong Kong, Cyprus, Malta, United Arab Emirates, United States of America; and
3. OFFSHORE COUNTRIES (OFF): Bahamas, Belize, Bermuda, British Virgin Islands, Gibraltar, Guernsey (United Kingdom), Jersey (United Kingdom), Cayman Islands, Marshall Islands, the Netherlands Antilles, Panama, Man Island, and Seychelles.

The categorization of the jurisdiction was made based on additional sources and reasons: a) on our previous investigations (e.g. Ištók and Kanderová 2018; Ištók and Kanderová 2019), b) academic attitude (e.g. Durnev, TieMei and Magnan, 2016) and c) we categorised the jurisdictions by primarily using the potential benefits and often utilising the foreign company on the first ownership level. The offshore jurisdictions are mainly used to secure the anonymity of the ultimate beneficial owner (UBO). Midshore jurisdictions are used mainly in aggressive tax planning strategies due to the many possibilities how firms can shift taxable profit to offshore jurisdictions and avoid or minimize the withholding taxes (existence of double taxation treaties and possibility to use the EU directives). Onshore jurisdictions are used mainly for the purpose of asset and investment protection and asset management. Corporate income tax optimization is also possible, but not so aggressive compared to the past (impossible to reach the effective tax rate (ETR) in somewhere around 2-5% like in case of midshore companies). The specificity of this category is the relative high costs needed to establish and manage the company compared to midshore and offshore categories.

## 3. Results

In the first part of the analysis we analysed whether the differences between median values of selected ratios are statistically significant from the point of view of companies' ownership jurisdiction through the Mann-Whitney test. We opted for the statistically significance level of 5%. The results of this test are shown in Table 1.

**Table 1.** Mann-Whitney test (sales and performance ratios).

		N	Mean Rank	Sum of Ranks
<b>Total assets turnover</b>	With links	2,107	4,415.340	9,303,120.500
	With no links	8,761	5,679.610	49,759,025.500
	Total	10,868		
<b>EBITDA per total assets</b>	With links	2,107	4,666.040	9,831,345.000
	With no links	8,761	5,619.310	49,230,801.000
	Total	10,868		
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<b>Test statistics<sup>a</sup></b>			<b>Total assets turnover</b>	<b>EBITDA per total assets</b>
	Mann-Whitney U		7,082,342.500	7,610,567.000
	Wilcoxon W		9,303,120.500	9,831,345.000
	Z		-16.643	-12.521
	Asymp. Sig. (2-tailed)		0.000	0.000

a. Grouping variable: company links to tax havens

Nonparametric Mann-Whitney test confirmed a statistically significant difference in median values of both ratios since the p-value is 0.000. The basic descriptive statistics of given indicators is provided in Table 2.

**Table 2.** Descriptive statistics (sales and performance ratios).

		<b>Total assets turnover</b>		<b>EBITDA/total assets</b>	
		With links	With no links	With links	With no links
N	Valid	2,107	8,761	2,107	8,761
	Missing	0	0	0	0
Mean		1.144	1.03	-0.0462	-0.5085
Median		0.2328	0.9978	0.0177	0.0769
Std. deviation		2.0708	4.78832	1.1618	25.49547

The arithmetic average has lower reporting ability compared to the mean since the variability of the ratios is relatively high, particularly within companies with no links to tax havens.

The total assets turnover ratio should be at least level 1. Based on our analysis, the median value of companies with no links to tax havens almost meets this condition. However, the median value of companies with links to tax havens reaches a value of 76.67% lower. Thus, companies with links to tax havens achieve significantly lower efficiency in using total assets to generate revenues.

According to Ištók and Kanderová (2019), Slovak companies that moved their headquarters to tax havens achieve a 41% higher median value of interest expenses per assets than businesses with no links to tax havens. Therefore, we assumed a less significant difference when comparing the medians of EBITDA per total assets. This assumption was not confirmed. In the case of this indicator, they achieve better results with no links to tax havens, namely 76.98%. Based on the analysis, it is clear that companies with links to tax havens use their assets less efficiently with respect to the depreciation rate of assets and the depreciation method, varying capital structures, tax rates and capital expenditures.

Subsequently, we analysed the impact of transferring the company to an individual type of tax haven (offshore, onshore and midshore) on the values of indicators of a companies' revenue and performance.

Results of Kruskal-Wallis test are shown in Table 3.

**Table 3.** Descriptive statistics (sales and performance ratios).

Ranks		N	Mean Rank
<b>Total assets turnover</b>	With no links	8,761	5,679.61
	OFF	368	3,575.4
	MID	862	3,986.73
	ON	877	5,189.07
<b>EBITDA per total assets</b>	With no links	8,761	5,619.31
	OFF	368	4,145.07
	MID	862	4,414.22
	ON	877	5,132.16
<b>Test statistics<sup>a</sup></b>		<b>Total assets turnover</b>	<b>EBITDA/total assets</b>
Chi-Square		373.195	191.912
Df		3	3
Asymp. Sig. (2-tailed)		0.000	0.000

a. Kruskal-Wallis test

b. Grouping Variable: company jurisdiction

On the basis of the Kruskal-Wallis test, there are statistically significant differences between individual groups of enterprises in both of the indicators examined. This is also partly confirmed by the different objectives, respectively first-class ownership among different categories of tax havens. Subsequently, we carried out a post hoc test to determine specifically where there are statistically significant differences between the lower tax jurisdictions compared with companies with no links to tax havens. In the implementation of the Mann-Whitney test, there is often a first-class error, a condition where we reject the null hypothesis of equality of mean values in a set, even if it is true. Therefore, according to Field (2015), the Bonferroni correction is needed. Using this correction, the original significance level of 0.05 has been reduced to 0.0083, as businesses are divided into four groups in this analysis.

**Table 4.** Mann-Whitney test (sales and performance ratios) – individual categories.

Jurisdiction		Total asset turnover	EBITDA/total assets
With no links - OFF	Mann-Whitney U	988,432	1,104.64
	Wilcoxon W	1,056,328	12,483.6
	Z	-12.614	- 8.75
	Asymp. Sig. (2-tailed)	0.000	0.000
With no links - MID	Mann-Whitney U	25,968.49	2,947,681.5
	Wilcoxon W	29,688.02	3,319,634.5
	Z	-15.181	-10.645
	Asymp. Sig. (2-tailed)	0.000	0.000
With no links - ON	Mann-Whitney U	34,970.61	3,482,421.5
	Wilcoxon W	38,820.64	3,867,424.5

Z	-4,394	-4,574
Asymp. Sig. (2-tailed)	0.000	0.000

Based on the test results, it is clear that statistically significant differences exist in all three tax havens compared with those with no links to tax havens. At the same time, based on indicator Z, we can say that the smallest differences are achieved by companies in onshore jurisdictions.

**Table 5.** Descriptive statistics (sales and performance ratios) - individual categories.

Jurisdiction		Total asset turnover	EBITDA/total assets
ON	Valid	877	877
	Missing	0	0
	Mean	1.4713	0.0183
	Median	0.6268	0.0558
	St. Deviation	2.24077	0.71184
MID	Valid	862	862
	Missing	0	0
	Mean	0.9297	-0.0775
	Median	0.1596	0.0041
	St. Deviation	1.88731	1.49317
OFF	Valid	368	368
	Missing	0	0
	Mean	0.866	-0.1262
	Median	0.0794	0
	St. Deviation	1.95574	1.1343

Descriptive statistics of individual performance indicators in given categories of jurisdictions are shown in Table 6. A significantly larger number of enterprises are located in onshore and midshore jurisdictions, with only 17.46% of the companies surveyed having a direct owner in offshore jurisdictions. At the same time, the median value of the ratios examined by us in offshore jurisdictions have the greatest differences in businesses with no links to tax havens. Specifically, for total assets turnover ratio, up to 92% worse and 100% for total assets in EBITDA.

The obtained results may be due to the purpose for which the companies choose their owners from the offshore category at the first ownership level. With a direct link to an offshore jurisdiction, tax optimization options are relatively limited given the existence of withheld taxes. The main benefit of using an offshore company is UBO (ultimate beneficial owner) anonymity. At the same time, if we look at the calculation of performance indicators examined by us, it is clear that in the denominator both are total assets. The value of total assets affects the resulting median values.

According to Ištók and Kanderová (2018), the Slovak companies after the transfer of the registered office to a tax haven report statistically significant lower median values of land and structures per assets (they are getting rid of these types of assets).

Enterprises in midshore jurisdictions are 84.2% inferior in total assets turnover ratio and 94.7% worse off in EBITDA per total assets. Enterprises in onshore jurisdictions are 37.2% worse off in total assets turnover and 27.4% in EBITDA per total assets ratio. Therefore, our assumption has been fulfilled at least to a certain point, as onshore jurisdictions are also used to increase investment protection, which is expected to help generate revenue in the future and increase the company's revenue.

Subsequently, we compared selected performance ratios in selected sectors. We focused on selected sectors where the number of companies in the given sector exceeded 5% of the total number of firms.

The results of total asset turnover analysis are shown in Table 6.

**Table 6.** Median value differences in total asset turnover by sectors.

Sector	With links	With no links	Z	Asymp. Sig. (2-tailed)
Real Estate	0.2698	0.8154	-6.148	0,000
Law, consultancy and acc.	0.8713	1.7546	-5.087	0,000
Mediation	1,3112	4.3774	-1.897	0.058
Wholesale	1,7598	-1.886	-1.339	0.181

Significant differences between companies with and without links to tax havens exist for real estate and law sectors, counselling and accounting. Conversely, in the mediation and wholesale sectors, the differences are statistically insignificant. The difference in the median values of this indicator in the given sectors is quite large, but the fact is due to the variability of data and the different number of companies in each file. In particular, in the real estate sector, companies with a link to tax havens achieved a 66.9% lower median of total assets turnover and 50.3% in the law, consulting and accounting sector. Interestingly, companies with no links to tax havens in the wholesale sector have achieved lower median values of total asset turnover, while even being negative. Table 7 shows the analysis of selected sectors of EBITDA per total assets.

**Table 7.** Median value differences in EBITDA/total assets by sectors.

Sector	With links	With no links	Z	Asymp. Sig. (2-tailed)
Real Estate	0.0296	-1.2907	-3.612	0,000
Law, consultancy and acc.	-0.0769	-0.1098	-7.238	0,000
Mediation	0,0096	-0.06	-1.949	0.051
Wholesale	-0,1338	-3.0301	-1.523	0.128

Analysis of EBITDA per total assets pointed to statistically significant differences between the real estate sector and the law, consulting and accounting sector. Interestingly, in both of these sectors, the medians of the indicator reach lower values for companies with no links to tax havens than those with links to tax havens. On the contrary, for the mediation and wholesale sectors, the differences are not statistically significant, but it is clear that companies with no links to tax havens achieve better values for the indicator.

#### 4. Discussion

To the best of our knowledge we provided the first empirical study focused on the comparison of economic performance among Slovak companies with ownership links to tax havens compared to those companies without these links. The main limitation of our results is that we only investigated the year 2015 and therefore, the database Bisnode contains only a few jurisdictions specified as tax havens. On the other hand, the results are so significant that we can surmise some tendencies in the behaviour of selected Slovak companies regarding the selected area of economic performance. From one point of view we have tested only one year. However, this year is very important from the perspective of international taxation of Slovak companies. Since 2014 and 2015, many changes were implemented on both a national (mainly amendments of the Income Tax Act and Tax Procedure Code) and international level (e.g. introduction of BEPS project). Therefore, the use of aggressive profit-shifting channels became partially or even at times significantly limited. We examined available data

from companies already following the new "substance over form" conditions. We can therefore assume that from the investigated year there are many Slovak companies using tax havens not only for aggressive tax planning purposes, but also in order to support their economic performance. This has also been indicated by various authors. We are of the opinion that tax havens should also be investigated from the perspective that there may potentially exist benefits not only to the taxpayers but also to the governments and it is important to investigate any direct links between tax havens and unethical or illegal activities. While most studies related to the benefits of tax havens primarily focus on foreign direct investments (FDIs), the economic performance of companies often remains unnoticed.

Our results are essentially in line with Driffield, Sun and Temouri (2018), who showed there is an increasing but non-linear relationship between foreign ownership and productivity. Our findings are further similar to those of Durnev, TieMei and Magnan (2016), who confirmed that the financial performance of a company is based on the registering or setting up of subsidiaries and parent companies in Offshore Financial Centres (OFCs). What is also interesting is the comparison between our results and that conducted by Prochazka (2019) on Czech data due to the similar economic conditions in both the Czech and Slovak republics. Both our study and Prochazka's provide evidence that the domicile of the parent company and the operating sector of the subsidiary have a significant impact on the economic performance of the subsidiaries located in both Slovakia and the Czech Republic.

In our opinion, we partially contributed to the discussion raised by Ozili (2018), that of the link between tax evasion and financial instability. Our results confirmed that companies operating in certain sectors can potentially use the saved taxes (costs, sources) to improve their financial stability or economic performance (e.g. wholesale sector). Our assumptions were also confirmed in the breakdown of tax havens into the three selected categories. The best results were observed in the onshore category. As was already mentioned, these jurisdictions are used to protect assets and investments and improve asset management (partially with some tax planning incentives). Clearly the worst results were observed in offshore jurisdictions. Offshore jurisdictions on the first ownership link are mainly used to obtain the anonymity of the UBO, which according to our results is most likely linked with activities not supporting a higher economic performance. In our opinion, future research (not only focused on Slovakia and the conditions there) should be focused on a more detailed analysis of the relationship between ownership links to tax havens, potential investments or use of saved taxes (costs) and companies' productivity and performance. The selected economic performance indicators belong to often used when assessing also the financial health of the companies.

## 5. Conclusions

Our analysis of the selected ratios showed that Slovak companies with ownership links to tax havens demonstrated a worse economic performance compared with Slovak companies without links to selected foreign owners. Our analysis for 2015 showed that Slovak companies with direct ownership links to tax havens reported lower median values of total assets turnover by 76.67% and lower median values of EBITDA per total assets by 76.98% compared with their counterparts. The differences in the median values have been proven by the Mann-Whitney test. Our results further confirmed that the statistically significant differences are amongst all three selected types of tax havens compared with those without the link to tax havens. The smallest differences were observed in the onshore category. On the other side, Slovak companies with foreign owners from the offshore category reported worse median values of total assets turnover ratio by 92% and in the case of EBITDA per total assets ratio worse still, by even 100%. On the contrary, we find the obtained results differ among the tested sectors. The median values of selected performance ratios are not automatically worse for all sectors. For example, Slovak companies with ownership links to tax havens operating in the wholesale sector report higher median values of total assets turnover compared to their counterparts.

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