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tax justice network

Devising Fair Rules for Multi-Level Games: Limitations of the OECD's Harmful Tax Practices Initiative

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Recent Initiatives against Havens & OFCs

“globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices.”

G7 Summit Meeting, Lyon June 1996

Loose Coordination

“We remain concerned about offshore financial centers and tax havens which undermine international standards of financial regulation and which are shelters to avoid or evade payment of tax. We strongly support the work being done by the FSF and the OECD's Forum on Harmful Tax Practices, as well as the cooperative efforts of the OECD's Committee on Fiscal Affairs (CFA) and the FATF. We urge the OECD's CFA to bring a rapid conclusion to its work on bank secrecy.”

G7 Finance Ministers and Central Bank Governors
Tokyo, January 2000

Emphasis on Information Exchange

We urge the OECD to give particular attention to the development of a comprehensive programme to improve the availability of information to tax authorities to curb international tax evasion and avoidance through tax havens, and through preferential tax regimes …by the negotiation of effective information exchange arrangements. …

In addition we encourage international action to enhance the capacity of anti- money laundering systems to deal effectively with tax related crimes. … Money laundering authorities should be permitted to the greatest extent possible to pass information to their tax authorities to support the investigation of tax related crimes, and such information should be communicated to other jurisdictions in ways which would allow its use by their tax authorities. Such information should be used in a way which does not undermine the effectiveness of anti-money laundering systems.

G7 Summit, Birmingham, May 1999

Fundamental Flaws

- Rich Country Initiative
  G7-OECD policies, IMF-WB implementation
- Targeting small states/jurisdictions
  some (relatively) rich, some (mainly) poor
- Imbalance - no reciprocity
  small required to assist big states
- No shared global welfare aims
  national OECD country tax enforcement,
  not common effort e.g. against capital flight
- No common drive against international tax avoidance
  needs agreed principles to define & allocate tax base

Income/profits (direct) taxation

- Fairness/legitimacy
  Proportionate, progressive
- Prone to avoidance
  `income' is an abstract concept
  income from capital especially indeterminate
  most effective by deduction at source (PAYE, interest, dividends)
  i.e. on employees, individual savers/pensioners
- Avoidance (planning) strategies
  (i) altering timing of payments;
  (ii) recharacterising nature of payments;
  (iii) changing the recipient.

Fair Taxation of International Investment Income

Home State

Residence/nationality

where recipient located

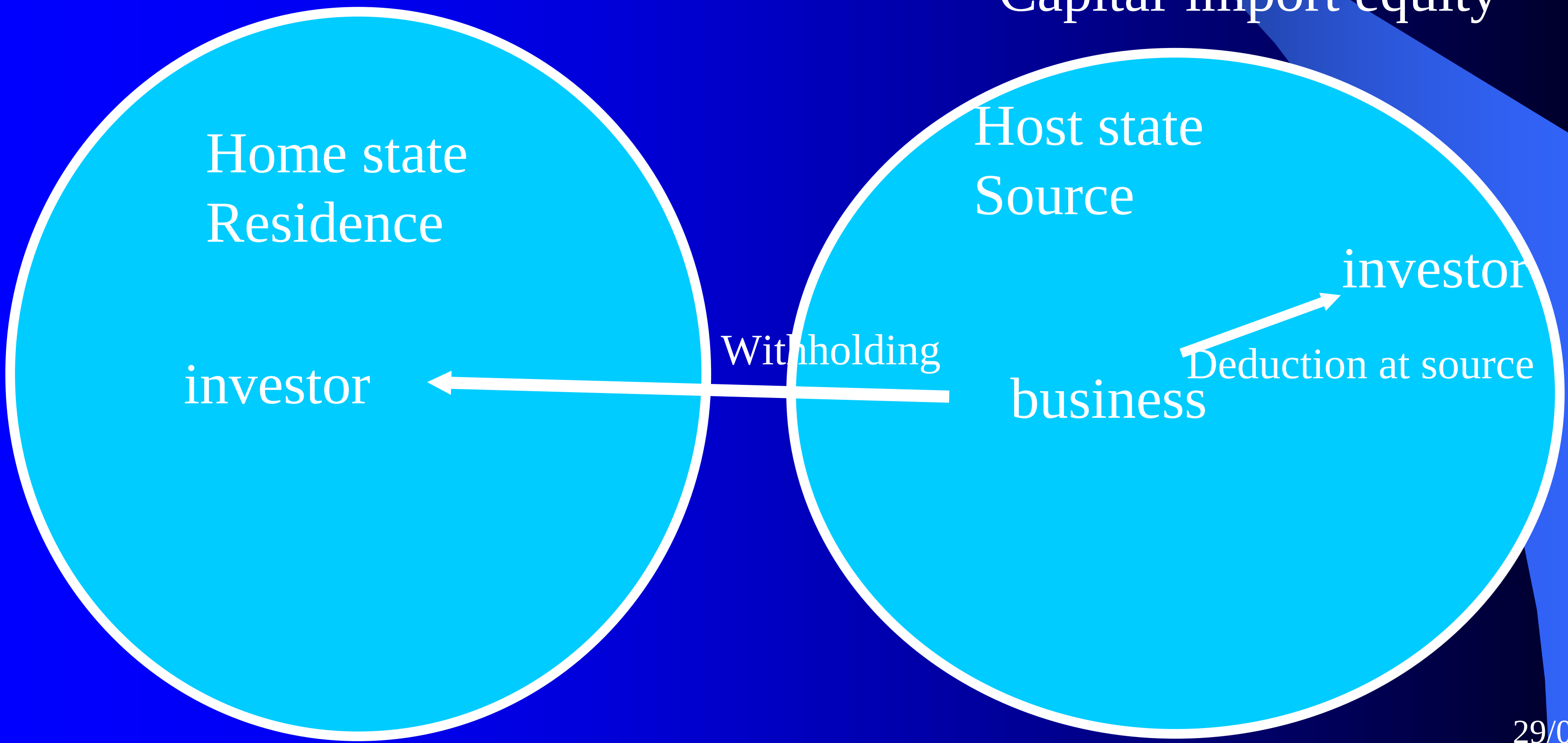
Capital-export equity

Host State

Source:

where income earned

Capital-import equity



International Double Taxation

Taxing Residents on all income
(residents in the territory)

capital-export equity

equal tax on investments at home/abroad

Taxing Income from All Sources
(income earned in the territory)

capital-import equity

same taxes on all local business whoever the investor

Juridical Double Taxation

same person's income taxed twice if earned abroad

Economic Double Taxation

same income stream (intra-firm payments) taxed twice

A Global Approach?

"In a business of this nature you cannot say how much is made in this country and how much in another. You kill an animal and the product of that animal is sold in 50 different countries. You cannot say how much is made in England and how much is made abroad. That is why I suggest that you should pay a turnover tax on what is brought into this country. … It is not my object to escape payment of tax. My object is to get equality of taxation with the foreigner and nothing else."

(Sir William Vestey, to Royal Commission on Taxation, 1915)

Tax Treaties

League of Nations: Finance Committee

studies 1923, 1925-27, conference 1928 - Model treaties for:

Direct Taxes

Succession Duties

Administrative Assistance in Assessment

Assistance in Collection of Taxes

Mexico drafts 1943, London 1946: single Direct Tax model treaty:
Avoidance of Double Taxation [and Prevention of Fiscal Evasion]
assistance >> exchange of information (article 26)

UN: Commission(to 1954)
Group of Experts 1968-2004
Committee 2005-

OECD Fiscal Affairs Committee 1956-

Model Treaties + Commentaries + Reports

Network of Bilateral Tax Treaties > c.2, 200

Multilateral: Nordic, Andean
OECD/Council of Europe: *Mutual Administrative Assistance 1995*

Tax Treaties' Allocation of Tax Jurisdiction

Residence state
- place of incorporation/
- centre of vital interests

Business Profits - art.7
- **subsidiary taxable by Host state**

Associated Enterprises - art.9
- profits = Arm's Length

Foreign Investment Income
- remittances from subsidiaries
- dividends
- interest on loans
- fees and royalties

Source State

income from immovable property

income attributable to a Permanent Establishment (PE)

attributable = sales/other activities effected through PE

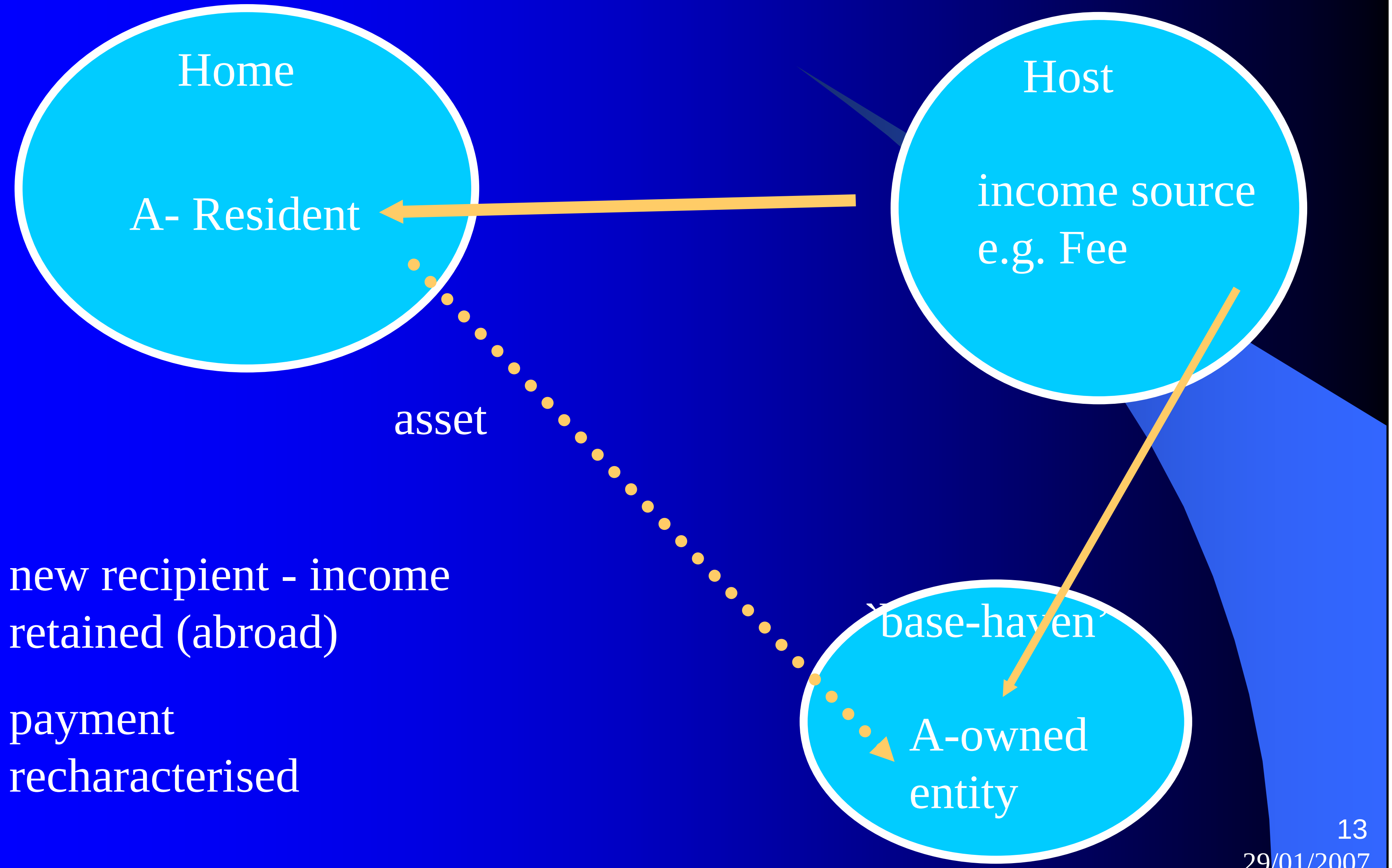
PE = fixed place of business, e.g.
- branch, factory, office
- mine, oil/gas well
- ?building site / oil rig
- if > 6/12 months

Basic Problems of Tax Treaty System

- Priority to Residence State of Investor
- Based on Portfolio Model of Investment
  Associated enterprises: separate taxation
  Transfer Pricing rules: Arm’s Length
- Little Basis for Joint Approach
  Income as defined in each state’s law
- Limited Exchange of Information
  information `necessary’ for carrying out the treaty
  (i.e. to prevent double taxation, or also avoidance?)

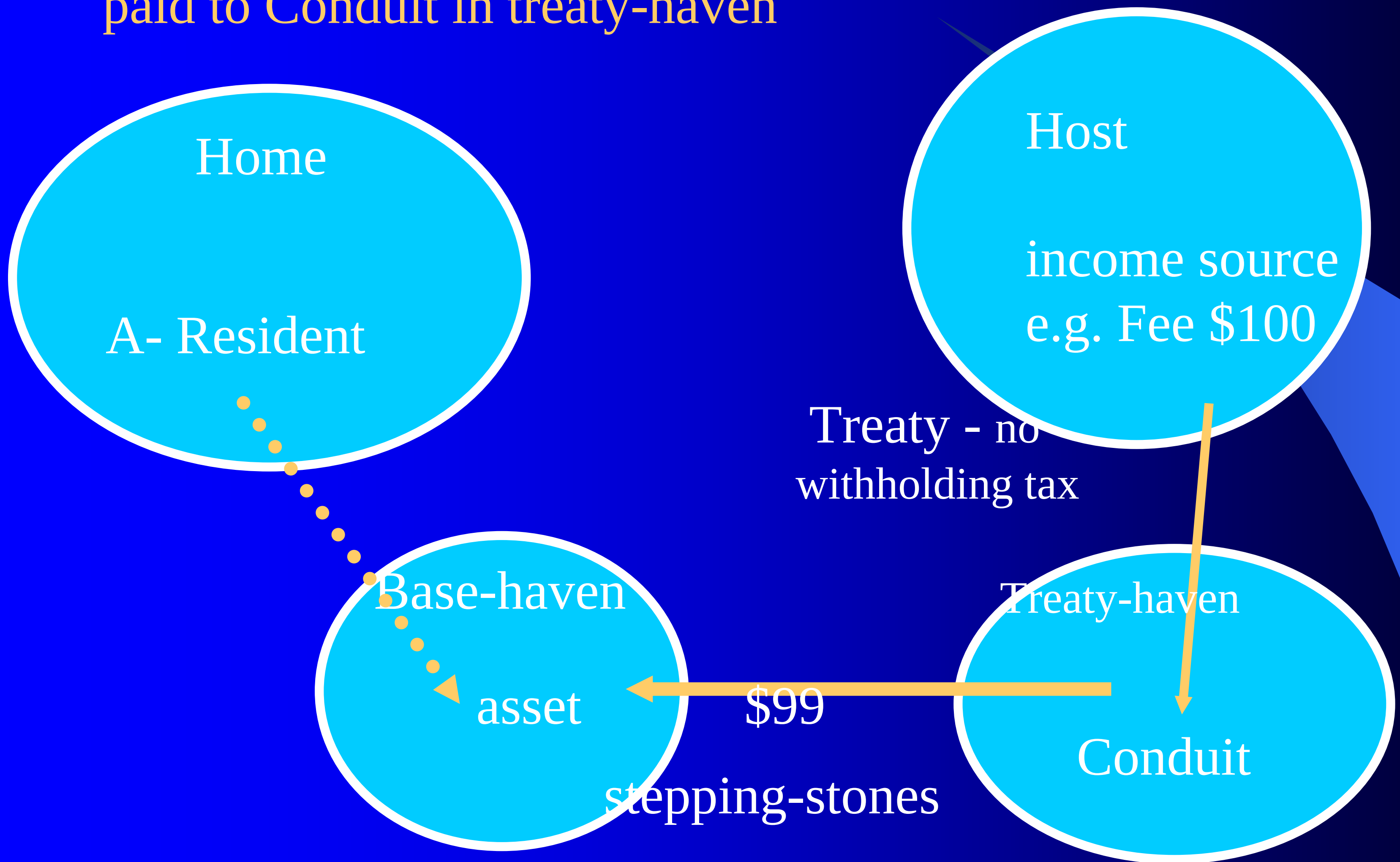
International Avoidance (Double Non-Taxation): 1.Residence

deferral of Home taxes on unremitted income



International Avoidance: 2. Source Taxes

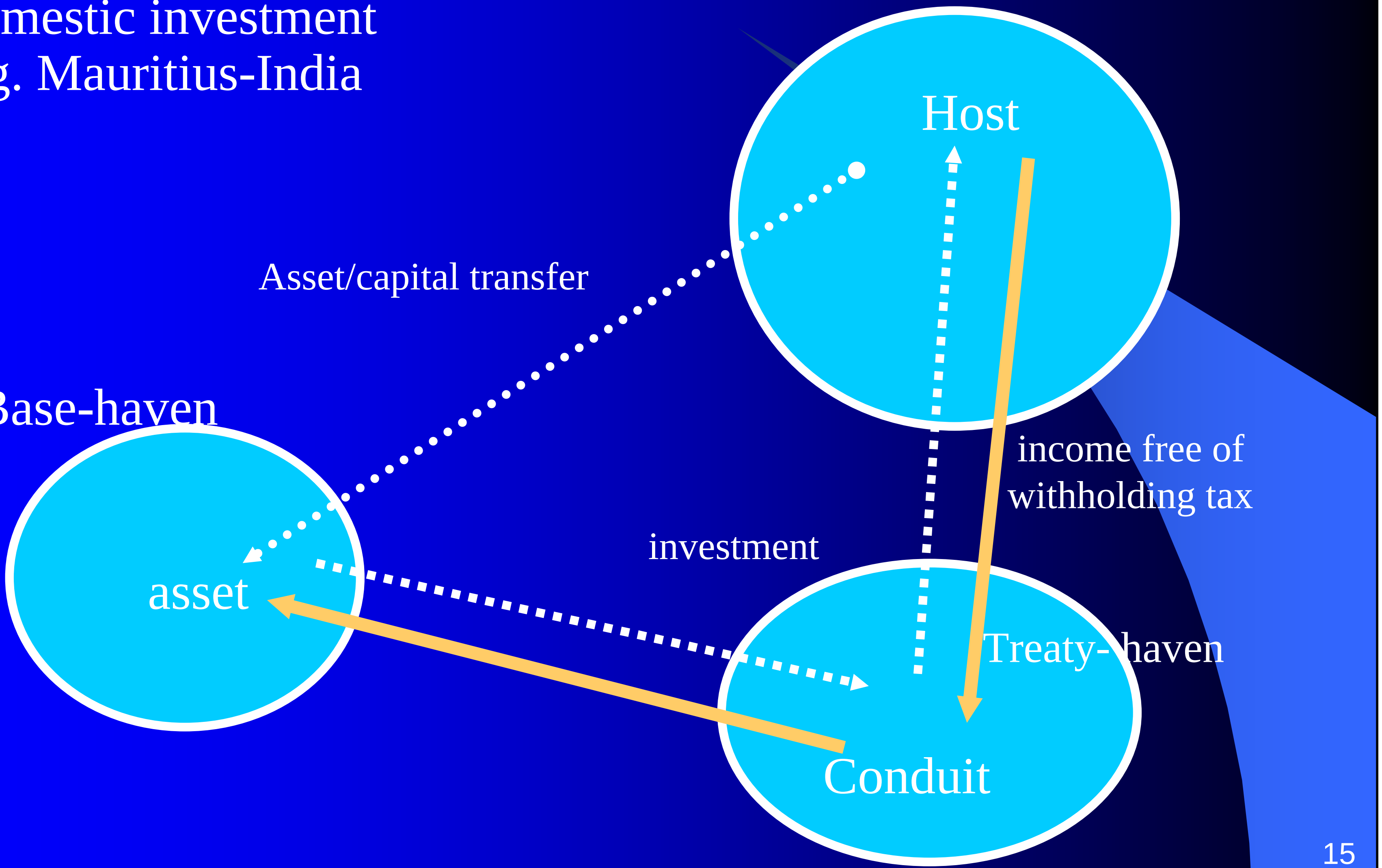
intra-affiliate payments deductible as costs by operating company, paid to Conduit in treaty-haven



International Avoidance: 3. Round-Tripping

Host country residents use `offshore' entities as vehicles for domestic investment

e.g. Mauritius-India



Globalization & Tax Competition

Emergence of tax havens 1920s

family wealth & business, e.g. Vesteys

Postwar direct capital flows & finance

exploitation of tax deferral on retained earnings by TNCs

current account convertibility 1958-

`offshore' banking & international capital markets

deposits in havens $11b 1968, $368b 1978

Liberalization of investment flows & capital flight

complete convertibility 1979-

1984 US & UK end WT on interest to non-resident portfolio investors

1988 German WT on interest abandoned

Competition for investment

103 states offer investment incentives by 1988

Types of Haven

Base-Haven

- no/low (income/profits) tax, OR
- exemption for non-residents, e.g. "International Business Company"

Treaty-Haven

- Tax treaty limiting Source state withholding allowing Conduit (no effective denial-of-benefits provisions)

Secrecy

- Bank records: no disclosure to (foreign) fisc
- fiduciary accounts - beneficial owner concealed
- company ownership - bearer shares, owners not registered
- company accounts: limited filings, not enforced
- professional-client confidentiality

Any state may be a haven for another's taxes

Anti-Haven Measures (by OECD countries)

Anti-Base Measures

Controlled Foreign Corporation - CFC

`passive' income deemed that of owners in Residence state

CFC must be in `low-tax' jurisdiction: what is `low'?

definition of `owners'?

definition of `passive' income - no `real' activity (Finance? Services?)

Anti-Conduit

denial of treaty benefits if recipient not bona fide resident

need for cooperation from Conduit state

denial of WT exemption to payments

e.g. interest re-categorised as dividend if subsidiary thinly capitalised

Regulated Investment Companies?

Information Exchange

Treaty-partner should obtain information even if not needed for itself:

i.e. help to collect another state's taxes

(only accepted by all OECD in 2005)

Harmful Tax Practices

- Harmful Tax Practices 1998 Report: Haven criteria:
  No/nominal taxation (low <u>effective</u> tax rate)
  tax holidays; exemption of foreign source income?
  Lack of transparency
  secret rulings, negotiated tax privileges
  Lack of (effective) exchange of information
  only information already obtained for its own enforcement?
  No Substantial Activities / Ring-Fencing
  now dropped?
- Action:
  listing & commitments: now 33 cooperative, 5 non-coop
  coordinated defensive measures?
- Parity of treatment?
  with OECD (Switzerland, US, etc), others (Singapore, Dubai)
  Global Forum, Towards a Level Playing Field

`Effective' Information Exchange?

- Not (yet) automatic
  EC Interest Directive: only individuals, WT alternative
  OECD optional; automation still pending (STF agreed 1997)
  US: reporting of payments to non-residents only in 16 states
- Extension of scope slow
  needs (i) obligation to obtain, (ii) override secrecy
  OECD Model TIEA 2002, Revised art.26 OECD 2005, UN ?
- Uneven Spread & Gaps
  from Havens to OECD
  to developing countries? UN Model: capacity problems
  Singapore, Dubai?
- Secrecy Blocks
  bank secrecy: Switzerland, Austria, Luxembourg, etc
  information unavailable: bearer shares/securities (US)

Tax Avoidance & International Finance

- Secrecy still prevalent in OFCs
  `level playing-field' campaign has stalled information exchange
  money-laundering reports unavailable to tax authorities
  IMF Surveillance does not include tax transparency
- Competition to Attract Investment
  deterred by ensuring non-residents are taxed
  even OECD countries exempt reporting of payments to NR: US
- Competition to Host & Control Financial Services
  `offshore' & `onshore' FCs linked

A Truly Global Approach?

- A Global Transparency Standard for Finance
  TJN support for UN Code of Conduct
  Multilateral Convention on Tax Cooperation?
  Information sharing between AML/CTF and Tax authorities
- Worldwide Taxation of International Business
  Unitary Assessment & Formula Apportionment
  (e.g. US; EU proposals for CCTB)
  agreement on definition of tax base, apportionment formula
  (including income attributable to financial services)
  tax rates and collection still national