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OECD Project on Harmful Tax Practices

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CENTRE FOR TAX POLICY AND ADMINISTRATION

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OECD Project on Harmful Tax Practices

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Background of OECD Work

- International solutions to international tax problems in areas where unilateral domestic action is not effective
- Co-ordination (NOT harmonization) of substantive international tax rules
- International guidelines, benchmarks, best practices

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Current examples of OECD worl

- Tax treaties
  - Over 2000 treaties based on OECD Model
  - Business profits Tag
  - Taxation of stock options
    - Avoiding double taxation and double non-taxation
  - Cross border pension issues
  - Dispute resolution: MAP and Arbitration

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Current examples of OECD worl

- Transfer Pricing
  - Application of TP concepts to branches
  - Multilateral MAP
  - Taxation of Global Trading
  - Improving MAP procedures in TP controversies

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Why Have An HTP Project

- Basic Tension: global economy and national tax systems
- Global Economy
  - Reduction of trade and investment barriers
  - Technological advances increase capital mobility
  - Global business strategies

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Why Have An HTP Project

- National Tax Systems
  - Legal limits to taxing jurisdiction
  - Practical limits to taxing jurisdiction
- Lack of an agreed framework for developing national tax principles

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Why Have An HTP Project

- Positive and Negative Effects of Basic Tension
- Positive
  - Differences in tax systems and rates put pressure on gov'ts to reduce taxes and make tax system more efficient
  - More discipline in gov't spending
  - Re-assess fiscal climate for investment

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Why Have An HTP Project

- Negative
  - Tax evasion easier
  - Shifting tax base to less mobile factors (e.g., wages and consumption)
  - Increase cost/complexity for gov'ts and taxpayers
  - General loss of sovereignty: domestic policy driven by external forces

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Why Have An HTP Project

- Harmful Tax Practices:
  - make it hard to detect non compliance with domestic laws.e.g. non declaration of foreign income
  - put pressure on domestic anti-abuse rules
  - increase compliance costs for all taxpayers

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Why Have An HTP Project

- What To Do
  - Preserve positive benefits of tax competition
  - Limit factors that encourage harmful tax competition (i.e., harmful tax practices)
  - Prisoner's dilemma: Need for co-operative solution
- Paradox: Gain sovereignty by agreeing to restrictions

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Why Have An HTP Project

- Competing models
- Race to the bottom
  - Compete with measures that lack transparency, secrecy provisions, no exchange of information, ring-fencing
- Race to the top:
  - Compete on overall level of taxes, balance of taxes, general structure of tax systems, efficiency of administration
  - Structured within agreed principles

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Why Have An HTP Project

- HTP project addresses this by:
  - providing a framework for international co-operation
  - eliminating features that encourage evasion/avoidance such as lack of transparency and lack of effective exchange of information
  - analysis of externalities and agree to eliminate

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What OECD Approach Is

- Narrow approach:
  - Geographically mobile activities such as financial and other service activities
  - Investment in plant and equipment excluded

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What OECD Approach Is

- Narrow approach:
  - One gateway criterion: no or low effective rate (member countries and NOEs) or no or nominal taxation (tax havens)
    - Low schedule rate or way tax base defined
  - NO/LOW TAX NEVER HARMFUL
    - Used only to determine where consideration of operative criteria is warranted

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What OECD Approach Is

- 3 operative criteria

1) Lack of transparency
   - Rules should be applied openly and consistently
   - Information should be available to determine taxpayer's situation (e.g., beneficial owner information, accounts)

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What OECD Approach Is

- 3 operative criteria

2) Lack of effective exchange of information
   - Legal mechanism (April 2002 Agreement on Exchange of Information on Tax Matters)
   - Administrative means
   - Lack of impediments

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What OECD Approach Is

- 3 operative criteria

3) Ring fencing (member countries and non-OECD economies)

or

no substantial activities (tax havens) (subsequently modified)

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What OECD Approach Is Not

- No harmonisation of rates
- No harmonisation of tax base
- No harmonisation of tax systems
- In sum: project is about process, not outcomes

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Advantages For Business

- A level playing field (e.g., no secret deals for competitors)
- Long-run -- lower compliance costs
- Less conflict between tax authorities
- Removes barriers to extending treaty networks

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Process

- Three Parts To Project
  - Tax Havens
  - Member Country Work
  - Non-OECD Economy Work

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Tax Haven Work

- June 2000 35 jurisdictions identified as tax havens
  - 6 jurisdictions make advance commitment
- By April 2002, 25 of the 35 jurisdictions make commitments (for a total of 31 commitments)
- Three jurisdictions found not to cause concern under criteria (Barbados, Maldives, Tonga)

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Tax Haven Work

- Seek commitments on transparency and effective exchange of information
- Phased implementation: transparency and effective exchange by 2006
- Welcome removal of practices implicated by no substantial activities insofar as they inhibit fair competition

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Tax Haven Work

- 7 jurisdiction's on OECD list of unco-operative tax havens issued last spring

Andorra	Marshall Island
Liechtenstein	Nauru
Liberia	Vanuatu
Monaco	

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Tax Haven Work

31 offshore jurisdictions committed to transparency and effective exchange of information

Aruba	Dominica	Panama.
Anguilla	Gibraltar	St. Vincent
Antigua	Guernsey	St. Lucia
Bermuda	Grenada	San Marino
Bahrain	Isle of Man	Seychelles
Bahamas	Jersey	Turks & Caicos
British V.I.	Malta	St. Kitts & Nevis
Belize	Montserrat	Samoa
Cayman Islands	Mauritius	US Virgin Islands
Cooks Islands	Neth. Antilles	
Cyprus	Niue	

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Member Country Work

- June 2000 identification of 47 potentially harmful preferential regimes
  - Preferential does not equal harmful
- Remove actually harmful features by April 2003
  - Grandfather provision for taxpayers benefiting from existing regimes

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Member Country Work

- 47 regimes fall into 9 categories
  - Insurance; Financing and Leasing; Fund; Managers; Banking; Headquarters Regimes; Distribution Centre Regimes; Service Centre Regimes; Shipping; Miscellaneous (e.g., informal capital rulings, foreign sales corporations)
- Holding companies required further work and separate analysis

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Member Country Work

- Application notes to provide guidance in applying the criteria
- Purpose: illustrate what features of a preferential regimes are problematic under the 4 key criteria
- Circulated to 59 non-OECD jurisdictions
- Business input
- Will likely be unclassified in June

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Necessity of NOE Work

- The broader the association with the harmful tax practices work, the greater the effectiveness of the solutions
- Minimise tax induced distortions
- It is in the interest of NOE to associate themselves with this work.

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Points of Interest

- Ring Fencing
  - Narrow focus: regimes covering geographically mobile activities
  - Key: is domestic economy isolated from benefits of regime (i.e., is sponsoring country protected from the effects of regime)
  - Not aimed at eliminating preferential tax rates in general
  - General features of tax system not implicated, for example, elimination of double taxation

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Points of Interest

- Holding Companies
  - 2000 Report said further study required
  - Subject of application note
  - HCs serve legitimate purposes, including repatriating income without additional levels of tax
  - Countries free to choose exemption or credit systems

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Points of Interest

- Coordinated framework for the application of defensive measures where harmful features not removed
  - Denial of deduction for payments to other jurisdiction
  - CFC/FIF rules
  - Modification of exemption system/credit system
  - Terminating/modifying tax treaties

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How OECD and EU Projects Differ

- EU tax package aimed at supporting single market and EU employment policy
- OECD project "seeks to encourage an environment in which free and fair tax competition can take place"

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How OECD and EU Projects Differ

- EU -- scope "those measures which affect, or may affect, in a significant way the location of business activity in the community."
- OECD -- scope narrow: geographically mobile activities such as financial and other service activities

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How OECD and EU Projects Differ

- EU -- benchmark concept: significantly lower effective level of taxation than generally applies is potentially harmful
- OECD -- no or low tax never harmful

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How OECD and EU Projects Differ

- EU - includes transparency element
- Information exchange not a prominent element except for proposed savings directive.
- Savings directive: limited to interest paid to individuals; would require automatic exchange ultimately

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How OECD and EU Projects Differ

- OECD project - transparency (open/consistent administration and information to identify taxpayer's situation);
- Effective exchange of information key
- Exchange would relate to all types of income paid to entity and individual recipients
- Exchange only "upon request"

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Where do we go from here?

- Many member country regimes have been changed already to eliminate harmful features.
- Havens (now know as Participating Partners) working on implementation plans
- Intensified dialogue with NOE's

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Where do we go from here?

- OECD Global Forum on Taxation
  - Annual meeting of over 70 jurisdictions to deal with common issues
- International Tax Dialogue
  - Joint effort of OECD, IMF, World Bank
  - Dialogue and technical assistance
  - ITD Website
- Partnership relations with other regional tax organizations