May 2003

OECD Project on Harmful Tax Practices

Hugh J. Ault
Boston College Law School, hugh.ault@bc.edu

Follow this and additional works at: https://lawdigitalcommons.bc.edu/lslp
Part of the Taxation-Transnational Commons

Digital Commons Citation
https://lawdigitalcommons.bc.edu/lslp/5

This Article is brought to you for free and open access by Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College Law School Lectures and Presentations by an authorized administrator of Digital Commons @ Boston College Law School. For more information, please contact nick.szydlowski@bc.edu.
OECD Project on Harmful Tax Practices
Professor Hugh J. Ault
Tilburg, May 15, 2003

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

Current examples of OECD work
- 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

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

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

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

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

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

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

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

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
What OECD Approach Is

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

• 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

• 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)
  2) Lack of effective exchange of information
     • Legal mechanism (April 2002 Agreement on Exchange of Information on Tax Matters)
     • Administrative means
     • Lack of impediments
  3) Ring fencing (member countries and non-OECD economies) or no substantial activities (tax havens) (subsequently modified)

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
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

Process

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

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)

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

Tax Haven Work

- 7 jurisdictions on OECD list of unco-operative tax havens issued last spring
  - Andorra
  - Marshall Island
  - Liechtenstein
  - Nauru
  - Liberia
  - Vanuatu
  - Monaco

Tax Haven Work

- 31 offshore jurisdictions committed to transparency and effective exchange of information
  - Andorra
  - Anguilla
  - Antigua
  - Barbados
  - Bahrain
  - Bahamas
  - British Virgin Islands
  - Belize
  - Cayman Islands
  - Cook Islands
  - Cyprus
  - Dominica
  - Gibraltar
  - Grenada
  - Guernsey
  - Isle of Man
  - Jersey
  - Malta
  - Montserrat
  - Mauritius
  - Nauru
  - Niue
  - Panama
  - St. Kitts & Nevis
  - Samoa
  - San Marino
  - Seychelles
  - St. Vincent
  - St. Lucia
  - Turks & Caicos
  - US Virgin Islands
  - Vanuatu
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

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

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

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.

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

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
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

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”

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

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

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

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”
Where do we go from here?

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

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