

**APPLICATION OF OECD HARMFUL TAX PRACTICES CRITERIA TO THE OECD  
COUNTRIES SHOWS POTENTIAL DANGERS TO THE U.S. SOVEREIGNTY**

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by Bruce Zagaris

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## 1. INTRODUCTION

A cursory application of the Organization of Economic Cooperation and Development criteria of harmful tax practices (HTP) to some of its own members shows the hypocrisy of its own report. Most importantly, it shows that, if the initiative proceeds, the laws and practices of many countries, especially those of the United States, will be in jeopardy. Until now, many of these countries are sleeping giants insofar as these laws and practices go, because their laws have not been singled out. If the international trade law and the World Trade Organization demonstrate, these practices will soon become controversial and are likely to be brought before an international body to determine whether they comply with the very criteria by which the OECD is proposing that other countries be subject to countermeasures.

It will not matter that Assistant Secretary of Treasury Mark Weinberger wants to ensure that the OECD harmful tax competition (HTC) “does not have the unintended consequence of making the OECD an extraterritorial tax authority that imposes tax laws and tax rates on independent countries.”<sup>1</sup> In fact, the OECD HTC is fundamentally an effort first to prescribe the parameters for making tax policy and law by defining “bad” or “harmful” tax policy and then requiring countries to change their laws and agree to a stand-still or face economic sanctions. Once the U.S. through the OECD drags the so called “tax havens” down the HTC road, the U.S. laws and practices will be fair game, especially considering the enormous value of those U.S. laws and practices. Many of the rest of the OECD countries will be right behind.

In fact, modern day commercial diplomacy combined with international financial enforcement regimes has countries making cross accusations against one another over the extent to which they are complying with international tax and anti-money laundering enforcement. In addition to the case brought by the European Community against the U.S. over the foreign sales corporation, the French and Swiss governments are skirmishing over whether each is properly complying with anti-money laundering standards.<sup>2</sup> Similarly, the EU brought a case against Austria in the European Court of Justice when Austria did not abolish anonymous savings accounts and hence was allegedly in violation of the 1991 anti-money laundering directive. The FATF notified Austria of its suspension from membership unless it abolished savings accounts.

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<sup>1</sup> Paul Craig Roberts, *OECD Fiscal Ambush*, WASH. TIMES, Apr. 23, 2001, quoting Mark Weinberger.

<sup>2</sup> *E.g., French and Swiss Clash Over Money Laundering*, 17 INT’L ENFORCEMENT L. REP. 185 (May 2001).

This article discusses the obligations contained in the OECD Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices (hereafter OECD HTC MOU).<sup>3</sup>

## 2. TRANSPARENCY

The OECD HTC MOU has two separate provisions on transparency: one requires expanded access to beneficial ownership; and the other requires ensuring that financial accounts will be prepared in accord with generally accepted accounting standards and have such accounts either audited or filed for all entities.

### 1. Access to Beneficial Ownership Information

The OECD HTC MOU requires that “(e)ach Party will ensure that its regulatory or tax authorities have access to information regarding beneficial owners of companies, partnerships and other entities organized in its jurisdiction, including collective investment funds, and to information on the identify of the principal (as opposed to agent or nominee) of those establishing trusts (settlors) and foundations under their laws and those benefiting from trusts and foundations.”

The OECD countries have enormous gaps in their laws pertaining to access to beneficial ownership information. The U.S. is in serious violation of the OECD MOU on this issue. Most of the control over access to beneficial ownership information is through the states. The company formation and registry laws do not require the publication of information. The majority of it is held by the beneficial owners themselves or their professional advisers. Obtaining it would be very difficult. For instance, the U.S. General Accounting Office has reported that Russian entities have exploited the ease and economy of incorporating Delaware companies for Russian money brokers and then have opened bank accounts and entered banking relationships with Citibank of New York and Commercial Bank of San Francisco.<sup>4</sup> During 1991 through January 2000, more than \$1.4 billion in wire transfer transactions was deposited into 236 accounts opened at these two U.S. banks. Indeed, Delaware’s Division of Corporation advertises that only in Delaware can filings be completed within two hours, certificates of existence issued within minutes, and tax clearances obtained immediately.<sup>5</sup> Hence, Delaware tries to attract investment based on regulatory and tax arbitrage. As the GAO report shows, it has been very

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<sup>3</sup> OECD, Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices, OECD website ([www.oecd.org](http://www.oecd.org)).

<sup>4</sup> U.S. General Accounting Office, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*, GA-01-120 (Oct. 2000).

<sup>5</sup> William J. Reif, *Delaware Service*, THE CORPORATE EDGE (Summer 1996) (<http://www.state.de.us/corp/s96wkcm.htm>).

successful attracting questionable investment. While the OECD and FATF rail about small island jurisdictions, the major problem in terms of volume and access to the major capital center is all the U.S. states that offer ease of registration and operation, but do not provide gateways to information.

Some U.S. states, such as Alaska, Delaware, and Nevada, have enacted asset protection laws to attract persons, especially foreigners, seeking protection from creditors. For instance, Alaska's offshore trust laws offer secrecy and confidentiality to protect the client's affairs from disclosure.<sup>6</sup> The State of Delaware has advertised that its new trust law ensures "confidentiality of information and records".<sup>7</sup>

At least two states, Montana<sup>8</sup> and Colorado,<sup>9</sup> have offshore banking laws, designed to attract foreign investors by offering no taxes, confidentiality,<sup>10</sup> and ease of establishing accounts and doing

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<sup>6</sup> For a critical analysis of the Alaska and Delaware laws, see Amy Lynn Wagenfeld, *Note, Law for Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth that Flows*, 32 VAND. J. OF TRANSNAT'L L. 831-75 (1999); See Douglas J. Blattmachr & Jonathan G. Blattmachr, *A New Direction in Estate Planning: North to Alaska*, TR. & EST., Sept. 1997, at 48; Jonathan G. Blattmachr, *Unique Protection Under Alaska Law: Americans in All States Can Benefit*, N.Y.L.J., Sept. 2, 1997, at 1.

<sup>7</sup> Eric A. Mazie, *The Delaware Business Trust Act: Paving the Way Towards the 21<sup>st</sup> Century*, Delaware Division of Corporation, The Corporate Edge Newsletter, <http://www.state.de.us/corp/de-trust.htm>, accessed Feb. 19, 2001.

<sup>8</sup> For the Montana offshore banking law, see 1997 Mont. Laws 382 (codified in scattered sections of Montana Code Annotated); see also David Aronofsky, *Montana's Foreign Capital Depository Act: A Financial Pie in the Rocky Mountain Sky or a Sensible New Assets Attraction Approach*, 32 VANDERBILT J. OF TRANSNAT'L L. 712-61 (1999), on whose account this section relies heavily. Mr. Aronofsky practiced law in Washington, D.C. before joining the Law Faculty of the Univ. of Montana. He participated in the drafting of the law.

<sup>9</sup> For the Colorado Foreign Capital Depository Act, see *USA & Colorado as IFCs*, First Colorado Depository Corp. (FCDC), website ([http://www.fcdc.net/maxpagesUSA\\_Colorado\\_as\\_IFC](http://www.fcdc.net/maxpagesUSA_Colorado_as_IFC)) (accessed March 31, 2001). CFDC, Colorado Statutes 11-27-4-201 (Legislative declaration - purpose -financial privacy (<http://64.78.178.125/cgi-dos/standspp.ex>) (accessed Mar. 31, 2001). Interestingly, Secretary of the Interior Gale Norton was active in the enactment and implementation of the legislation when she was in private practice in Colorado. See *Benefits, News, and Services First Colorado Depository Corp. (FCDC)*, website <http://www.fcdc.net/maxpages/Benefits> accessed March 31, 2001).

<sup>10</sup> E.g., CFDC, Colorado Statutes 11-27-4-201 (Legislative declaration - purpose -

business. They complement the exemption from tax on interest earned by non-resident aliens on deposits in U.S. banks and freedom from reporting on the same by offering freedom from tax on the state level and confidentiality. The combination of the U.S. and states' laws, especially the fact that Colorado was enacted in 1999 – after the release in May 1998 of the OECD's initial report on harmful tax practices – illustrates the utter contempt with which the federal and state governments have for the OECD exercise and little wonder since the OECD's report failed to mention any of these harmful tax preferences despite the enormous amounts invested in U.S. banks by nonresident aliens.

The state of Delaware is trying to attract business based on its laws and reputation as a domicile where corporate debtors can quickly obtain bankruptcy.<sup>11</sup>

Virtually no OECD country requires corporations to keep ownership information on file with a central or other governmental authority beneficial on a routine basis, except for certain types of corporations, although the OECD HTC Framework Memorandum of Understanding would require the targeted countries to do so immediately.

## 2. Financial Books and Records

According to the OECD HTC MOU, “(e)ach Party will require that financial accounts be drawn up in accordance with generally accepted accounting standards, and will ensure that such accounts be either audited or filed for all entities (banks, insurance companies, collective investment funds and managers, trusts, foundations, etc.) Organized or operating in the jurisdiction (subject to possible de minimis exceptions or exceptions for entities that are not engaged in offshore activities and do not have foreign ownership, beneficiaries, management, or other involvement). Each Party must ensure that there is access by its regulatory or tax authorities to such accounts.”

Few countries require financial accounts be prepared in accordance with generally accepted accounting standards with auditing or filing for all entities organized or operating in the jurisdiction.<sup>12</sup>

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financial privacy (<http://64.78.178.125/cgi-dos/standspg.ex> (accessed Mar. 31, 2001). The confidential relationship between a foreign capital depository and its customers is to be protected by restrictions on the disclosure of financial records to supervisory agencies and a prohibition against disclosure of financial records to other state and local agencies and to private individuals except under specified conditions.

<sup>11</sup> Thomas L. Ambro and Mark D. Collins, *Why Delaware?*, CORPORATE EDGE (Spring 1998), <http://www.state.de.us/corp/bankrupt.htm>, accessed Feb. 19, 2001.

<sup>12</sup> In the U.S. this is a matter of state law, which follow to some extent the Model Business Corporation Act (1984), § 1602; *see e.g.*, Montana Code 35-1-1110.

The exceptions are those corporations or legal entities that have a large turnover, a large number of employees, or a large number of assets. Another exception is for those entities that conduct activities of public policy interest, such as banking, utilities, public transportation and those entities that are registered on stock exchanges. The most uniform and closest adherence to requiring the preparation of financial accounts is in the EU where directives require minimum standards.<sup>13</sup> Many countries have few laws on requiring the preparation of financial accounts. For instance, the states in the U.S. are quite lax on requiring the preparation of financial accounts.

### 3. TAX INFORMATION EXCHANGE

The OECD HTC MOU requires the targeted countries to engaged in effective exchange of information in criminal tax matters by December 31, 2003. The information eligible for exchange must include bank information and financial information as well as information on beneficial ownership. A requested state must provide information without the requirement that the conduct being investigated would constitute a crime under its own laws, if it occurred in its jurisdiction. A requested state must ensure that no impediment to the disclosure of any exchanged information exists, including courts and administrative bodies concerned with the enforcement or prosecution in respect of, or the determination of appeals in relation, to criminal matters. Each targeted country must have in place administrative practices so that the legal mechanism for exchange of information will function effectively and can be monitored, including having personnel responsible to ensure that the requests for information are answered promptly an efficiently, and that they have personnel trained or experienced in obtaining information.

Each targeted jurisdiction must have effective exchange of information for all tax (including civil) matters by December 31, 2005. Each jurisdiction must have a legal mechanism that permits information to be provided to the tax authorities of OECD countries upon request for the investigation and prosecution of criminal tax matters and for the determination, assessment, collection, and enforcement of all other tax matters (e.g., civil tax matters). The mechanism must include a means to ensure that information could be given to tax authorities of OECD countries in response to a request if the information may be relevant to a civil or criminal tax matter. In the case of information requested in the context of a civil tax matter, the jurisdiction must provide the information without regard to whether or

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<sup>13</sup> The EU does require preparation and auditing of financial statements for medium-sized and large corporations. The criteria include balance sheet, amount of sales, annual average number of employees, and balance sheet total. E.g., Diarmuid Murray, *Business Operations in the Republic of Ireland, Tax Management Portfolio* 965-2nd A-15-16 (Tax Mgmt. Inc., BNA 2000); Kees van Raad, *Business Operations in The Netherlands, Tax Management Portfolio* 973 A-17 (Tax Mgmt Inc., BNA, 2000).

not the jurisdiction has an interest in obtaining the information for its own domestic tax purposes. Administrative practices must exist so that the legal mechanism for exchange of information will function effectively and can be monitored, including having personnel responsible to ensure that the requests for information are answered promptly and efficiently, and that they have personnel trained or experienced in obtaining information.

Big differences exist in the ways in which OECD countries approach exchange of tax information. Most of them authorize such cooperation only pursuant to and in many cases strictly to enforce the provisions of an income tax treaty and on the basis of reciprocity. In contrast, the OECD HTC initiative has not suggested such exchanges as a part of an income tax treaty, but as a free standing mechanism as though such cooperation in tax matters was an international obligation. Indeed, to secure the agreement of Caribbean countries to conclude such agreements, the U.S. Government in the 1980s offered various types of economic preferences, including eligibility for U.S. persons to deduct expenses of attending conventions in such countries on a par with deductions for attending conventions in the U.S., eligibility for financing under Section 936 of the Internal Revenue Code (the so-called Puerto Rican possession tax financing), and eligibility to host foreign sales corporations. Even with these preferences, some of the jurisdictions offering international financial services and confidentiality refused to conclude TIEAs with the U.S. because they determined that concluding such agreements would not be in the best interest of their countries.<sup>14</sup>

Some OECD countries allow tax information exchange only to ensure that benefits conferred in the treaty are not misused.<sup>15</sup>

Some OECD countries will agree to provide information and judicial assistance on criminal tax matters only in the context of a Mutual Agreement in Criminal Matters Treaty (MLAT).<sup>16</sup>

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<sup>14</sup> For background on the CBI TIEA program, see B. Zagaris, *The Caribbean Basin Tax Information Exchange Agreements Program of the United States: Eat Softly and Carry a Big Stick*, INT'L BULL. OF FISCAL DOCUMENTATION 115-118 (Mar. 1989); B. Zagaris, *The Caribbean Basin Initiative*, TAX NOTES 1021 (Aug. 26, 1985).

<sup>15</sup> Bruno Gangemi, *General Report*, INTERNATIONAL MUTUAL ASSISTANCE THROUGH EXCHANGE OF INFORMATION, LXXVB CAHIERS DE DROIT FISCAL INT'L 19, 25-26 (1990).

<sup>16</sup> E.g., with Luxembourg and Austria the U.S. has had to conclude simultaneous with an income tax treaty a MLAT. For instance, the MOU to the U.S.-Luxembourg tax treaty explains that certain information of financial institutions may be obtained and provided to "certain U.S. authorities" only in accordance with the proposed U.S.-Luxembourg MLAT. The income tax treaty only took effect after the MLAT was signed by the two governments. See Bruce Zagaris, *Developments in Mutual Cooperation, COORDINATION AND ASSISTANCE BETWEEN THE U.S. AND OTHER COUNTRIES IN INTERNATIONAL TAX ENFORCEMENT*, 27 TAX MGMT. INT'L J. 506, 508-9 (Oct. 9, 1998);

Few OECD countries allow the exchange of information without regard to whether or not the requested jurisdiction has an interest in obtaining the information for its own domestic purposes. OECD countries rarely conclude such undertakings.<sup>17</sup>

The requirement to make information exchange function effectively and monitor such functions clearly does not occur as a general rule today. In fact, OECD countries, such as Canada, admit to not having sufficient resources to conduct exchanges of information and as a result, believe such exchanges are practically not reciprocal and hence they take a restrictive view of tax information exchanges (i.e., a requested state need not undertake administrative measures that would not be allowed under the laws of the requesting state).<sup>18</sup> Similarly, the requirement to give prompt service and have trained or experienced personnel would be an unrealistic imposition on small states and one not usually met by many OECD countries.

The proposed obligations in the OECD HTC MOU exceed significantly those called for in the OECD's *Improving Access to Bank Information for Tax Purposes*.<sup>19</sup> The latter was designed to obtain an agreement within the OECD on best practices in order to improve the current level of cooperation. Indeed, Paragraph 21 of the OECD Report on *Improving Access to Bank Information for Tax Purposes* shows the lack of agreement on efforts to provide bank information in the context of information exchange.<sup>20</sup> Paragraph 21 states that the Committee on Fiscal Affairs *encourages* Member countries to:

- (1) undertake the necessary measures to prevent financial institutions from maintaining anonymous accounts and to require the identification of their usual or occasional customers, as well as those persons to whose benefit a bank account is opened or a

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*Luxembourg and U.S. Conclude Tax Treaty Whose Ratification Process Awaits Conclusion of a MLAT*, INT'L ENFORCEMENT L. REP. 171 (May 1996).

<sup>17</sup> Gangemi, *supra*, at 25-26.

<sup>18</sup> Stephen S. Heller/Boris Stein, Canada, INTERNATIONAL MUTUAL ASSISTANCE THROUGH EXCHANGE OF INFORMATION, LXXVB CAHIERS DE DROIT FISCAL INT'L 259, 265 (1990).

<sup>19</sup> Committee on Fiscal Affairs, OECD, *Improving Access to Bank Information for Tax Purposes* (declassified Mar. 24, 2000).

<sup>20</sup> See, e.g., Richard J. Hay, *Offshore Financial Centres: Response to the Supranational Initiatives*, delivered to the IBC Conference, in mid-December, 2000.

transaction is carried out. The committee will rely on the work of the Financial Action Task Force in ensuring the implementation of these measures by Member countries;

- (2) re-examine any domestic tax interest requirement that prevents their tax authorities from obtaining and providing to a treaty partner, in the context of a specific request, information they are otherwise able to obtain for domestic tax purposes with a view to ensuring that such information can be exchanged by making changes, if necessary, to their laws, regulations and administrative practices. The Committee suggests that countries take action to implement these measures within three years of the date of approval of this Report;
- (3) re-examine policies and practices that do not permit tax authorities to have access to bank information, directly or indirectly, for purposes of exchanging such information in tax cases involving intentional conduct which is subject to criminal tax prosecution, with a view to making changes, if necessary, to their laws, regulations and administrative practices. The Committee acknowledges that implementation of these measures could raise fundamental issues in some countries and suggest that countries initiate a review of their practices with the aim of identifying appropriate measures for implementation. The Committee will initially review progress in this area at the end of 2002 and thereafter periodically.

The alternative options and the use of words, such as the Committee encourages its members to re-examine, indicate the lack of agreement among the countries. Nevertheless, the OECD Collective MOU leapfrogs to seemingly binding legal language: “Each party will ensure that its regulatory or tax authorities have access to bank information that may be relevant for the investigation or prosecution of criminal tax matters.” Solid legal and economic reasons exist behind the reluctance of countries, such as the Luxembourg and Switzerland, to go further. Hence, clearly there is lack of hard law basis, even within the elite cartel, let alone universal agreement. Therefore, the effort to impose economic sanctions or countermeasures is a brazen violation of international law, but one that may work, given the disproportionate balance of power. The OECD countries should make the same commitment in the OECD Collective MOU or allow the targeted countries to adhere to the more liberal language of Paragraph 21 of the OECD Report on *Improving Access to Bank Information for Tax Purposes* or better yet, a standard vetted by an international organization with universal standing and membership.

#### **IV. TAX PREFERENCES**

##### **1. Ring-Fencing**

Targeted jurisdictions must pledge to abolish tax preferences, which can include ring-fencing or giving tax or similar incentives to one group, normally foreign investors, over another group of investors,

normally domestic ones. Tax preferences include zero or comparatively low rates of tax or preference tax deductions or credits.

Notwithstanding the failure to identify tax preferences that, under the OECD HTC initiative provide preferences to foreign or international transactions, there is a veritable proliferation of laws that are worth trillions of dollars.

The new Polish harmful tax practices law has include the following OECD countries as violators: Belgium, The Netherlands, Iceland, Hungary, Luxembourg, Switzerland, Italy, Spain, and Ireland.<sup>21</sup>

In 1994, Hungary introduced an offshore financial regime, based on confidentiality laws, low withholding taxes, exempt withholding on interest and royalties in most tax treaties and 5 to 15% on dividends.<sup>22</sup> On January 1, 1999, the Hungarian legislation was amended (in violation of the stand-still provisions in the OECD HTC report in May 1998) in order to extend its status as an offshore financial center, including marketing this product internationally.<sup>23</sup>

In the U.S., examples include: interest earned by non-resident aliens and foreign corporations on U.S. bank deposits;<sup>24</sup> portfolio interest paid to foreign persons;<sup>25</sup> long-term capital gains paid to a

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<sup>21</sup> Michael Plachta, *Recent Polish Legislation on Tax Havens*, 17 INT'L ENFORCEMENT L. REP. 142-46 (April 2000).

<sup>22</sup> Dr. Grabor B. Szabo, *Hungary: Born to Be a Tiger?: Reflections on Hungary's Possible Role in the International Financial Services*, 1, 3 International Tax Planning Assoc. Website ([www://itpa.org](http://itpa.org))(accessed Mar. 25, 2001).

<sup>23</sup> *Id.* at 3-4. For a discussion of the utility of Hungarian preferences for international investments and tax planning, see Milton Grundy *Tax Competitive Jurisdictions Not Under Attack*, *supra*, at 2, 4 ([www://itpa.org](http://itpa.org))(accessed March 25, 2001).

<sup>24</sup> For background on the U.S. tax preferences, see Marshall J. Langer, Langer, *Harmful Tax Competition: Who Are the Real Tax Havens*, TAX NOTES INT'L 1 (Dec. 18, 2000); Bruce Zagaris, *How Foreigners Should Hold U.S. Bank Deposits and Money Market Funds*, FOREIGN INVESTMENT IN THE UNITED STATES 25-60 (PLI 1988), discussing IRC, § 861(a)(1)(A) and (c). There are proposed regulations to extend the information reporting requirement for bank interest paid to nonresident alien individuals who are residents of other foreign countries. Treasury is in the process of holding hearings and evaluating the comments.

<sup>25</sup> For a discussion of portfolio interest, see Langer, *id.*

foreign person;<sup>26</sup> international shipping provisions;<sup>27</sup> limited liability companies,<sup>28</sup> offshore investment funds,<sup>29</sup> and Tribal corporations.<sup>30</sup> The value of the U.S. tax preferences not discussed in the OECD HTC are so large that they are worth a much closer study, which undoubtedly will be forthcoming soon, given the amount in controversy if the OECD HTC employs countermeasures.

Luxembourg exempts dividends and liquidation proceeds from corporate taxation if a taxable Luxembourg company owns at least 10% of a taxable Luxembourg or foreign company for at minimum of 12 months, while capital gains are exempt from corporation tax if 25% or more owned by a taxable Luxembourg company.<sup>31</sup> Luxembourg is a base for holding companies and companies wanting to conduct conduit transactions for interest or royalties.<sup>32</sup>

Ireland has a number of tax preferences in violation of the non-discrimination provisions: interest received by a nonresident from Irish government securities is exempt from Irish tax;

a nonresident is only liable to tax in Ireland on income arising or derived from property in Ireland; an individual who is resident, or ordinarily resident, in Ireland during a year of assessment is generally subject to Irish income tax on income wherever it arises. There are other exceptions, such as for an individual who is not domiciled in Ireland or while being an Irish citizen, is not ordinarily resident in Ireland. Persons resident, or ordinarily resident, in Ireland but not domiciled in Ireland, are subject to tax with respect to assets located outside Ireland and the U.K. only if the gains realized on those assets

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.*, referring to IRC, §§ 883(a) and 872(b).

<sup>28</sup> *Langer, id. See also Graham Taylor, International Tax Planning Through the United States*, 1 ITPA Journal 75 (No. 2, New Orleans Nov. 20-21, 2000).

<sup>29</sup> See Rufus V. Rhoades and Marshall J. Langer, 2 U.S. INTERNATIONAL TAXATION AND TAX TREATIES, Chapter 30 (1999); Susan Klein, *Offshore Investment Companies in Light of the 1984 Deficit Reduction Act Changes*, 52 J. TAXN. 362 (1985).

<sup>30</sup> Taylor, *supra*, at 75 (referring to the use of an Indian Tribe corporation which can take advantage of the fact that an Indian Tribe and its entities are not-subject-to-tax entity, thereby giving rise to some creative international tax planning).

<sup>31</sup> *See Luxembourg*, OFFSHORE TRUST YEARBOOK 1998 45 (Int'l Money Marketing).

<sup>32</sup> Tom van deer Meer and Berglind Sigurdardottir, BUSINESS OPERATIONS IN LUXEMBOURG A-20-22 (Tax Mgmt. Foreign Income Portfolios 971-2d).

are remitted to Ireland. Persons not resident in Ireland also receive preferential treatment.<sup>33</sup> Ireland offers the thin trust mechanism that tax planners use in the U.K.<sup>34</sup> Many observers believe the Irish 12.5 % corporate tax rate violates the HTC rules and indeed most countries, in contrast to the HTC policy, haven identified Ireland as a tax have for the purposes of their Controlled Foreign Corporation rules.<sup>35</sup>

The U.K. legislation contains many preferential tax preferences due to ring-fencing. For instance, the U.K. does not tax the foreign income of U.K. residents who are not domiciled in the U.K., unless the person's income is remitted to the U.K. resident. Foreign income is generally taxable, except for the non-U.K. domiciliaries who remain taxable only a remittance basis. Thin trusts are useful tax preferences in violation of the HTC rules.<sup>36</sup> If the beneficiary who has an interest in possession is non-resident and the income arises outside the U.K., it does not matter that the trustee is resident or incorporated in the U.K. since it is not liable to tax. The U.K. accords capital gains exemption to trusts made by non-resident settlors. A U.K. tax preference exists to incorporate a company that acts the nominee or agent of a zero-tax vehicle.<sup>37</sup>

Belgium does not tax most capital gains and hence persons from neighboring high tax countries move to Belgium and remain in the country long enough to sell moveable property, such as securities and bonds, to avoid the capital gains tax.<sup>38</sup>

Canadian tax law allows its new landed immigrants to avoid tax on their foreign income for the

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<sup>33</sup> Diarmuid Murray, *Business Operations in the Republic of Ireland (Tax Management Portfolio 965 A-35* (2000).

<sup>34</sup> Milton Grundy, *Tax Competitive Jurisdictions Not Under Attack* 1, 5-6, Nov. 15-18, 2000, Shanghai, P.R.C. (accessed Mar. 15, 2001) (<http://www.itpa.org>).

<sup>35</sup> Brian J. Arnold, *Controlled Foreign Corporation Rules, Harmful Tax Competition, and International Taxation*, 2000 WORLD TAX CONFERENCE REPORT: REPORT OF PROCEEDINGS OF THE FIRST WORLD TAX CONFERENCE: TAXES WITHOUT BORDERS 17:1, 17:19 (Canadian Tax Foundation 2000).

<sup>36</sup> For more background on the ability of U.K. residents to arrange their affairs in a way that avoids tax on most of their income, see Marshall J. Langer, *Harmful Tax Competition: Who Are the Real Tax Havens?*, TAX NOTES INT'L 1, 7 (Dec. 18, 2000).

<sup>37</sup> Milton Grundy, *Tax Competitive Jurisdictions Not Under Attack*, *supra*, at 5-6 (Int'l Tax Planning Assoc. website).

<sup>38</sup> Langer, *Harmful Tax Competition: Who Are the Real Tax Havens?*, TAX NOTES INT'L 1, at 8.

first five years they are resident in Canada by establishing a pre-immigration offshore trust.<sup>39</sup>

Some Korean laws accord tax preference to investments by foreigners over other investors, i.e., investments in certain high technology sectors, the Foreign Invested Enterprise, and foreign nationals working under a Technology Inducement Agreement.<sup>40</sup>

The New Zealand trust enables persons to benefit from the exemption of trusts from tax on income derived from outside New Zealand, thereby serving as a base to hold and make various investments outside New Zealand and qualifying for New Zealand's rich tax treaty network.<sup>41</sup>

Switzerland offers tax preferences for holding companies, domiciliary companies and service companies. Some cantons offer preferential rates and facilities for the administration of trusts and companies established under the laws of other jurisdiction.<sup>42</sup>

Denmark is useful for holding companies and companies wanting to conduct conduit transactions for interest or royalties.<sup>43</sup>

## 2. Attracting Business in the Absence of Substantial Domestic Activity

For any preferential tax treatment provided to financial and other services activities, each targeted jurisdiction must remove any restrictions that deny the benefits of that preferential tax treatment to resident taxpayers, to entities owned by resident taxpayers, or to income derived from doing the same type of business in the domestic market

The Polish harmful tax competition legislation sanctions many OECD countries for their regimes that attract business without substantial business activity.

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<sup>39</sup> Id. Julie Y. Lee, *Canada's Taxpayer Migration Rules, in Taxation of Migrating Individuals*, 2000 WORLD TAX CONFERENCE REPORT 27:1, 27:20 (2000 Canadian Tax Foundation).

<sup>40</sup> Robert A. Baskerville and Woo Taik Kim, *Business Operations in the Republic of Korea, Tax Management Portfolio A-32* (Tax Mgmt Inc., BNA 2000).

<sup>41</sup> Milton Grundy, *Tax Competitive Jurisdictions Not Under Attack, supra*, at 5 ([www://itpa.org](http://www://itpa.org))(accessed March 25, 2001).

<sup>42</sup> *Id.* at 8.

<sup>43</sup> *Id.* at 7.

Both on a federal (i.e., the exemption and non-reporting of interest earned by non-resident aliens and foreign corporations on U.S. bank deposits) and a state (i.e., South Dakota “backoffice services” regime) level, the U.S. attracts investments without substantial business activity.

Korea, Belgium, Cyprus, France, Greece, The Netherlands, Germany, Switzerland, Spain, Portugal, Hungary, Ireland, and Turkey, many of such laws being named by the Polish HTC legislation.<sup>44</sup>

## V. TRANSPARENCY

The OECD HTC MOU requires that each targeted jurisdiction will ensure that no non-transparent features of its tax systems exist, such as rules that depart from accepted laws and practices, secret rulings, or the ability of investors to “elect” or “negotiate” the rate of tax to be applied.

In the category of Transparency the states in the U.S., such as South Dakota, has discretion to provide tax incentives.<sup>45</sup> The state of South Dakota allows its county commissioners, at their discretion to forgive from 0 to 100 percent of the property taxes for up to five years on a new structure or an addition to an existing one. This abatement may be available on all industrial, commercial and/or non-residential agricultural structures with a value of more than \$30,000.<sup>46</sup> The discretionary abatement is in addition to its other tax incentives, such as “no corporate income tax, no personal income tax, no personal property tax, no business inventory tax, and no inheritance tax.”

Ireland allows Irish residents to apply for tax benefits in the case of income earned from an

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<sup>44</sup> See Michael Plachta, *Recent Polish Legislation on Tax Havens*, 17 INT’L ENFORCEMENT L. REP. 143-45 (Apr. 2001).

<sup>45</sup> South Dakota, International Business Institute, State of South Dakota - *International Business Recruitment* (<http://sdibi.northern.edu/articles.html>). Some states have regimes designed to attract business with minimal business activity, very similar to the “back office services” that some of the targeted jurisdictions attract. For instance, South Dakota has successfully marketed back office services. It offers “no corporate income tax, no personal income tax, no personal property tax, no business inventory tax, and no inheritance tax.” In addition, its unemployment insurance costs are said to be the sixth lowest in the U.S. and its state sales tax is only 4 percent. Its marketing material highlights that South Dakota is first or third lowest in cost of doing business (depending on the source of the information), and the second lowest tax state. Hence, South Dakota is engaging in just the type of tax arbitrage that the OECD harmful tax practices report says is bad.

<sup>46</sup> South Dakota International Business Institute, *Profile, South Dakota Business Climate*, [www.wysiwyg://384http://sdibi.northern.edu/ibrclimate.html](http://www.wysiwyg://384http://sdibi.northern.edu/ibrclimate.html), accessed Feb. 19, 2001.

employment outside Ireland when the individual is abroad temporarily.<sup>47</sup>

Canada and the U.S. have had discretionary immigration incentives tied to investment. Canada's program is linked to tax incentives for qualified high-net worth individuals who do not reside for more than sixty months in Canada.

## VI. STAND-STILL PROVISIONS

The OECD HTC MOU requires each targeted jurisdiction to refrain from (i) introducing any new regime that would constitute a HTP under the OECD 1998 Report on HTC; (ii) modifying any existing regime related to financial and other services that currently do not constitute a HTC in such a way that, after the modification, it would be a HTP; and (iii) strengthening or extending the scope of any existing measure that current constitutes a HTP under the OECD report. In other words, notwithstanding the controversies about the entire concept of the HTP, the vagueness of the HTP concept, and the inability of the targeted countries to participate in the making or implementation of the policy, the targeted countries must both dismantle existing HTPs and pledge to refrain from any new HTPs. Effectively they give the OECD the right to override their power over tax and revenue matters.

The U.S., Hungary, and Germany have conspicuously ignored and violated the stand-still provisions. Indeed, the constitutional provisions of most countries preclude their surrender of the sovereign power to tax to an international organization, especially one of limited membership and authority such as the OECD.<sup>48</sup>

As a general matter the stand-still provisions raise problems of potential violations of a signatory's sovereignty and constitutional obligations.

For instance in the European Union the most intractable area insofar as harmonization of law in the context of the single market has been tax policy. The intended removal of border controls and restrictions is believed to be connected to tax harmonization. In fact, lack of sufficient harmonization may even preclude or greatly delay completion of the single internal market. Progress toward formal unification or convergence of fiscal, including taxation policy and instruments has been much slower than the removal of regulatory restrictions for two reasons. First, these policies are by nature often politically contentious since they may indicate profound differences in social and economic philosophy

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<sup>47</sup> Murray, *supra* at A-35.

<sup>48</sup> U. S. Const., Art. I, § 8, cl. 1 (exclusive power to levy and collect taxes) and Art. I, § 7, cl. 1 (House of Representative's exclusive power to originate all bills for raising revenue under the origination clause).

and can be perceived to limit national sovereignty and discretionary policymaking. In particular, the agreement in Maastricht on the Economic and Monetary Union (EMU) Amendments to the treaty implies fiscal policy convergence with some transfer of decision-making to a supranational level. Second, unlike most Community-idea regulatory changes, which can be adopted by a qualified majority of member governments, enactment of provisions in monetary, fiscal, and certain social policy areas requires unanimous consent.<sup>49</sup> The inability and unwillingness due to constitutional, political and legal constraints to surrender power over fiscal policy has resulted in the need to obtain a unanimous decision on tax matters, including the savings tax directive.

Not surprisingly the effort to compel sovereign states, which have not agreed to international obligations in the context of an international agreement let alone a customs union or single market, to surrender the power their citizens have strictly transmitted to the sovereigns and in most cases the duly elected parliaments raises fundamental issues of governance and constitutional law of the highest magnitude

## VII. SUMMARY AND CONCLUSION

Clearly the preparation of the list of tax havens and tax preferences reflects the geopolitics of the body that is the source of the policy. Hence, the laws and practices mentioned in this article that violate the HTP are not found in the report.<sup>50</sup> Some of the laws and practices mentioned in this article are clearly in violation of the HTP while others seem in violation and may eventually be subject to the type of litigation the U.S. has experienced first with respect to the Domestic International Sales Corporation and more recently with its successor the Foreign Sales Corporation.

The OECD HTC initiative does have good news. It is a windfall for litigators and dispute resolution specialists steeped in public international law, international trade law, and knowledgeable about tax. It will spin out multiple lawsuits. Mark Warner, Esq., Hughes Hubbard & Reed, who specializes in international trade and anti-trust work, discussed on April 23, 2001 during a speech on Capitol Hill on this subject that the Fiscal Affairs Committee only consulted lawyers in the legal department of the OECD, where he worked for four years, about the legality of the OECD HTC initiative. In October 2000, an OECD official told me the same in an informal conversation. The size of the U.S. tax preferences not discussed by the OECD HTC report makes the U.S. a major target of

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<sup>49</sup> George Kopits, *Overview*, TAX HARMONIZATION IN THE EUROPEAN COMMUNITY: POLICY ISSUES AND ANALYSIS (George Kopits, ed.) 1 (IMF 1992).

<sup>50</sup> For a critical review of the initiative see Bruce Zagaris *The Assault on Low Tax Jurisdictions: A Call for Balance and Debate*, 28 TAX MGMT INT'L J. 474-500 (Aug. 13, 1999); Bruce Zagaris, 9. *Issues Low-Tax Regimes Should Raise When Negotiating with the OECD*, 22 TAX NOTES INT'L 523-32 (Jan. 29, 2001).

dispute resolution. Someone should inform Mark Weinberger about the real game of the OECD HTC so that he and his colleagues can make an informed decision. In the meantime, international tax lawyers may want to join the American Society of International Law's new interest group on international taxation and start acquainting themselves with transnational litigation.

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