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The Level Playing Field: Misguided and Non-Existent

For all intents and purposes, the Organization for Economic Cooperation and Development's attempt to undermine tax competition has collapsed. Many low-tax jurisdictions had made "commitments" to weaken their attractive tax and privacy laws after being threatened by the OECD with financial protectionism – but explicitly stated that those commitments were binding only if all OECD nations agreed to the same flawed rules (the famous "level playing field" requirement). The European Union's Savings Tax Directive might have satisfied that condition, but that tax harmonization scheme collapsed when the United States, the United Kingdom, Switzerland, and Luxembourg refused to agree to share confidential information about nonresident investors with foreign tax authorities. This is a positive development for the world economy. Tax competition is a liberalizing force in the world economy. Fiscal rivalry helps lower tax rates and helps reduce discriminatory taxes on income that is saved and invested, and even OECD economists have widely written that lower tax rates and neutral treatment of capital are important contributors to economic growth.

By Daniel J. Mitchell

Background

Acting at the behest of Europe's welfare states, the Organization for Economic Cooperation and Development (OECD) has been fighting to undermine fiscal competition. Concerned that jobs and capital are leaving high-tax nations, the Paris-based bureaucracy wants low-tax jurisdictions to help enforce the bad tax laws of OECD member nations by collecting private financial information about nonresident investors and sharing that information with the tax authorities from high-tax nations.

The OECD calls this policy "information sharing" or "information exchange," but such a system would be a one-way street because low-tax nations generally have better tax law than high-tax nations. This means, for instance, that they usually do not try to tax income earned outside their borders. Not that this matters very much, since residents of low-tax jurisdictions have little reason to invest in uncompetitive, high-tax nations like France and Germany.

Needless to say, low-tax jurisdictions would have nothing to gain from participating in a scheme that imposes heavy costs and offers no benefits. Acting as vassal tax collectors for other nations would undermine their competitiveness, and the resulting loss of jobs and capital would be significant. The damage would be especially severe for developing nations, many of which are using market-based tax policy in an effort to improve living standards.

Hoping to “encourage” obedience, the OECD in 2000 created a “tax haven” blacklist and called for financial protectionism against low-tax jurisdictions unless they agreed to emasculate their attractive tax and privacy laws so that high-tax nations could track – and tax – flight capital. Notwithstanding this threat, the OECD’s attempt to create a tax cartel has not had much success. Many blacklisted jurisdictions made commitments to share information – but explicitly stated that those commitments are binding only if all OECD nations agree to the same flawed rules. This is the famous “level playing field” requirement, and it creates immense problems for the OECD since the United States, the United Kingdom, Switzerland, and Luxembourg are tax havens.

High-tax nations wanted to solve this problem by getting OECD tax havens to participate in a European Union proposal known as the Savings Tax Directive. At one point, this scheme would have required all EU member nations – as well as six non-EU nations including the United States and Switzerland – to collect private financial information about nonresident investors and automatically share that information with foreign tax authorities.

As discussed in greater detail below, however, the EU Directive has been eviscerated. Indeed, it is quite possible that the proposal will never be implemented. And even if it does go into effect, OECD nations such as Switzerland, Luxembourg, Austria, and Belgium are explicitly exempted from any requirement to collect and share private financial data about nonresident investors. The United States, meanwhile, has been completely excused from any requirement to participate in the EU scheme.

These developments are a major setback for the OECD. Indeed, the Paris-based bureaucracy even admitted at its recent “Global Forum” that the level playing field does not exist.¹ As a result, it is difficult to imagine how the OECD might resuscitate its tax harmonization agenda. Indeed, a number of jurisdictions have officially withdrawn their “commitment” letters to the Paris-based bureaucracy.² Other jurisdictions, meanwhile, have made clear that they have no intention of emasculating their tax and privacy laws so long as OECD member nations are permitted to retain pro-growth policies.³

But this does not mean the battle is over. The level playing field argument has given low-tax jurisdictions a good reason to withstand OECD bullying, but this is a stalling tactic, not a strategy for victory. Supporters of economic liberalization need to go on the offensive and explain that the OECD’s proposed tax cartel is fundamentally

¹ Organization for Economic Cooperation and Development, “Closing Statement by the Co-Chairs,” OECD Global Forum on Taxation, Ottawa, Canada, October 14-15. Available at http://www.oecd.org/document/0/0,2340,en_2649_201185_16643264_1_1_1_1,00.html.

² Cordia Scott, “Two Tax Havens Suspend Commitment Letters to OECD,” *Tax Notes International*, October 20, 2003.

³ In the post-forum communiqué, most low-tax jurisdictions “reaffirmed their commitments,” realizing that this was a meaningless gesture since there is no possibility that a “level playing field” could be achieved.

inconsistent with good tax policy.⁴ It also has adverse consequences for civil society, undermining principles of privacy for law-abiding people,⁵ and it damages sovereignty, leading to a lowest-common-denominator approach to decision-making.⁶

The History of the Level Playing Field

The OECD uses several criteria to define a tax haven. First on the list is the presence of low – or zero – tax rates.⁷ There are three other criteria, but the OECD is most fixated on information exchange, which is why the OECD is so opposed to laws that protect the privacy of investors. According to the Paris-based bureaucracy, “bank secrecy” hinders the ability of high-tax nations to enforce their punitive tax laws.

The OECD is demanding that low-tax jurisdictions provide foreign tax authorities with private financial information about nonresident investors. The OECD would like the provision of such information to be automatic.⁸ As an interim step, however, the OECD is seeking to compel “tax havens” to provide information on request, regardless of any constitutional, legal, or procedural protections that exist in non-OECD nations.⁹

Low-tax jurisdictions have never been happy with OECD demands – and they complained about discriminatory treatment from the outset, but faced with the threat of financial protectionism, a handful of “tax havens” quickly capitulated and sent “advance commitment letters.” These were letters that had been drafted by the OECD, and low-tax

⁴ Eric Engen and Kevin Hassett, “Does the Corporate Tax Have a Future?” *Tax Notes* 30th Anniversary Issue, Spring 2003. Available at http://www.aei.org/docLib/20021222_raengehass0212.pdf.

⁵ Richard W. Rahn and Veronique de Rugy, “Threats to Financial Privacy and Tax Competition,” Policy Analysis No. 491, The Cato Institute, October 2, 2003. Available at <http://www.cato.org/pubs/pas/pa491.pdf>.

⁶ John O. McGinnis, “The Political Economy of Global Multilateralism,” *Chicago Journal of International Law*, Vol. 1, No. 2, Fall 2000. Available at <http://cjlil.uchicago.edu/contents/v1n2/>.

⁷ The complete definition of “tax haven,” along with the OECD’s tortured explanation of why tax competition is bad, can be found at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

⁸ The OECD openly admits its desire for automatic information “exchange” in the preface of its 2000 report, “Improving Access to Bank Information for Tax Purposes,” which can be accessed at <http://www.oecd.org/dataoecd/3/7/2497487.pdf>.

⁹ The OECD’s model “Agreement on Exchange of Information on Tax Matters” can be found at <http://www.oecd.org/dataoecd/15/43/2082215.pdf>. In this “model” treaty, the OECD clearly reveals its contempt for individual rights. Among the provisions:

- “Rights can not [sic] form the basis for declining a request.”
- “...information shall be exchanged without regard to whether the conduct being investigated would constitute a crime under the laws of the requested party if such conduct occurred in the requested party.”
- Procedural rights only apply “to the extent they do not unduly prevent of delay effective exchange of information.”
- The OECD model treaty is designed “...to provide for exchange of information in tax matters to the widest possible extent”
- The aim is to cover all possible organizational structures.”
- “Information must be exchanged for both civil and criminal tax matters.”
- A low-tax jurisdiction “must take all relevant information gathering measures.”
- “An information gathering measure is relevant if it is capable of obtaining the information requested by the applicant party.”

jurisdictions signed them under duress – much as “defendants” signed confessions during the Soviet purges in the 1930s.

Most so-called tax havens, however, were reluctant to surrender their fiscal sovereignty to the OECD. But they were caught between the proverbial “rock and a hard place.” These jurisdictions understood that they would suffer if OECD nations subjected them to fiscal protectionism, but they also recognized that acquiescing would cause severe economic damage since capital would quickly flow to countries that were not part of the OECD tax cartel.

The desire to escape this no-win situation eventually led low-tax jurisdictions to unofficially embrace a “level playing field” strategy. The Isle of Man was the first “tax haven” to implement the strategy, sending a commitment letter that stated it would only emasculate its laws if, “...those jurisdictions, including OECD member countries, that fail either to make equivalent commitments or to satisfy the standards of the 1998 Tax Competition Report, will be the subject of a common framework of defensive countermeasures.”¹⁰

Following the Isle of Man’s lead, every jurisdiction to send a commitment letter included a “level playing field” clause. Most copied the text used by the Isle of Man, but some chose to use even stronger language. The Bahamas, for instance, wrote that it would only comply with OECD demands if “...those jurisdictions, including OECD member countries *and other countries and jurisdictions yet to be identified*, that fail either to make equivalent commitments or to satisfy the standards of the 1998 Tax Competition Report, will be the subject of a common framework of defensive countermeasures. [emphasis added]”¹¹ This language was designed to make sure that the tax havens on the OECD blacklist did not lose business to non-OECD tax havens – such as Hong Kong and Singapore – that were not on the blacklist.

Not all “Level Playing Fields” are Created Equal

The level playing field strategy is a double-edged sword. On the positive side, it has given low-tax jurisdictions an effective means of resisting the OECD’s fiscal imperialism. On the negative side, however, the level playing field argument inadvertently suggests that OECD policies would be desirable and acceptable if only every nation would abide by those rules.¹²

¹⁰ “Defensive countermeasures” is the OECD’s term for the sanctions that it wants imposed on “uncooperative” low-tax jurisdictions. The Isle of Man’s commitment letter can be found at <http://www.oecd.org/dataoecd/12/53/1903624.pdf>.

¹¹ <http://www.oecd.org/dataoecd/44/59/2075870.pdf>.

¹² This misguided view even creeps into an otherwise excellent paper by Richard Hay. See “A Level Playing Field for Tax Information Exchange?,” *Review*, Tax Planning International, September 2003.

This is manifestly untrue. The OECD vision is completely contrary to good tax policy. The academic literature clearly shows that low-rate, consumption-based, territorial tax systems maximize economic growth. The OECD's agenda, by contrast, is designed to help nations impose double-taxation on capital – even when economic activity occurs in other jurisdictions. One of the desirable features of tax competition is that nations are driven to lower tax rates and reduce the discriminatory tax treatment of income that is saved and invested. Indeed, scholarly papers have shown that tax competition is having this beneficial effect (which, of course, is why Europe's welfare states are so determined to create a fiscal cartel).

Several Nobel Prize winners have commented on tax competition. James Buchanan points out that "...tax competition ...is an objective to be sought in its own right."¹³ Milton Friedman writes, "Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them."¹⁴ And Gary Becker observed that "...competition among nations tends to produce a race to the top rather than to the bottom by limiting the ability of powerful and voracious groups and politicians in each nation to impose their will at the expense of the interests of the vast majority of their populations."¹⁵

These level playing field clauses mean that "tax havens" are not obliged to obey OECD demands unless all other jurisdictions agree to abide by the same misguided rules. This creates a bit of a problem for the OECD since the world's biggest tax havens are all members of the Paris-based bureaucracy.¹⁶ Indeed, "onshore" jurisdictions that belong to the OECD may control as much as 80 percent of the world's offshore business.¹⁷ And this doesn't even count jurisdictions such as Hong Kong and Singapore, which are active competitors for offshore business, yet were conveniently omitted from the OECD's blacklist.

This is why proposals affecting OECD member nations – such as the EU Savings Tax Directive and the Internal Revenue Service's nonresident alien interest reporting regulation in the United States – are so important. Unfortunately for the OECD (but

¹³ Geoffrey Brennan and James Buchanan (1980), *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press: Cambridge).

¹⁴ Letter to Center for Freedom and Prosperity, TK

¹⁵ Gary Becker, "What's Wrong with a Centralized Europe? Plenty," *Business Week*, June 29, 1998.

¹⁶ See Marshall Langer, "Harmful Tax Competition: Who are the real tax havens?," *Tax Notes International*, December 18, 2000. Available at <http://www.freedomandprosperity.org/Articles/tni12-18-00.pdf>.

¹⁷ Richard J. Hay, "A Level Playing Field for Tax Information Exchange?," *Review, Tax Planning International*, September 2003.

fortunately for the global economy), the status of these initiatives demonstrates there is no level playing field.

The EU's "Loophole Tax Directive"

This June, the European Union announced agreement on a compromise Savings Tax Directive. This proposal does not require participant nations to share information and thus clearly is not consistent with a level playing field – though this may not even be relevant since it is far from clear that this initiative will ever be implemented. The history of this constantly evolving scheme, which dates back to the 1990s, shows that the EU has continuously misrepresented the status of its proposal.

At every stage of the process, EU officials and representatives of high-tax nations have tried to imply that the Directive was a foregone conclusion.¹⁸ Yet in every case, the supposed deal has fallen apart. The EU has tried to get a withholding tax. They have proposed "co-existence" models (nations choosing either to impose a withholding tax or divulge information). They then shifted to proposals requiring automatic information sharing, only to then gravitate back to the current proposal, which is a form of the co-existence model (though the EU does not use that term in order to maintain the fiction that automatic information-sharing is imminent).

The current Directive is both laughable and dangerous. It is laughable because it contains so many loopholes. It is designed to tax the capital income of individuals, but only the least competent Germans, Greeks, or Swedes would allow themselves to get swept into the net. The vast majority of people seeking a safe haven for their money will set up companies, trusts, and foundations.

And if that does not work, they will move their funds someplace outside of Europe. According to the *International Herald Tribune*, "An agreement by European Union countries to crack down on tax cheats is likely to encourage some wealthy Europeans to park their money in tax havens in Asia and elsewhere outside the Union, tax lawyers and bankers said Wednesday."¹⁹ Banks in Singapore already are positioning themselves to capture a share of the \$1 trillion that is expected to leave Europe if the Directive is implemented.²⁰ This view was echoed in another news report, which quoted a banker as stating, "There will probably be more funds raised from Europe for Far East private equity funds [as a result of the new EU tax deal]. Money always flows away from places with higher taxation."²¹

¹⁸ James Neuger, "EU Nears Agreement on Savings Tax as Luxembourg Backs Down," Bloomberg, November 27, 2000.

¹⁹ Thomas Fuller and Eric Pfanner, "Crackdown on tax cheats could backfire on the EU," *International Herald Tribune*, January 23, 2003.

²⁰ Gulf Daily News, "Singapore set to welcome Europe's wealth," Vol. XXVI, No. 156, Bahrain, August 23, 2003.

²¹ Thomas Crampton, "EU tax deal shouldn't flood Asia with cash," *International Herald Tribune*, January 25, 2003.

In other words, years of EU negotiations have borne bitter fruit. To paraphrase Winston Churchill, “Never have so many labored so long to produce so little.”

Yet the Directive also is dangerous because it is a first step. If nothing else, the EU has been honest about long-term objectives. The bureaucrats in Brussels and the politicians in high-tax nations ultimately want complete tax harmonization, and they are willing to accept every incremental step. As such, the moment the ink is dry on the current Directive (assuming it eventually does get implemented), there will be immediate calls for a new and expanded proposal.²² Indeed, Romano Prodi, President of the European Commission, already has endorsed the idea of a bigger tax cartel. Responding to a letter from Congressman Pete Sessions (R-TX), Prodi admitted the weaknesses in current tax harmonization proposals and stated that, “This should of course not prevent us from trying to establish an even broader international coalition by engaging other countries.”²³

Deciphering the Directive²⁴

Does the EU Savings Tax Directive create a level playing field? The answer is emphatically no. The EU Directive unambiguously protects a number of jurisdictions from information sharing. Clause 17 of the preface, for instance, states, “...Austria, Belgium and Luxembourg cannot apply the automatic exchange of information...” Clause 18 states, “In order to avoid differences in treatment, Austria, Belgium and Luxembourg should not be obliged to apply automatic exchange of information...” The Directive also acknowledges that the non-EU nations control the fate of the proposal. According to Clause 24:

“So long as the United States of America, Switzerland, Andorra, Liechtenstein, Monaco, San Marino and the relevant dependent or associated territories of the Member States do not all apply measures equivalent to, or the same as, those provided by this Directive, capital flight towards these countries and territories could imperil the attainment of its objectives. Therefore, it is necessary for the Directive to apply from the same date as that on which all these countries and territories apply such measures.”

²² This excerpt from a news article paints a chilling picture: “Speaking at a recent Euromoney seminar in London, Mattias Levin, a research fellow at the Centre, told delegates: ‘Taxation increasingly stands out as a major obstacle to a full realisation of internal markets in the EU. Therefore the little tax action that we have seen so far- mainly in the form of the tax package- is only the start.’ Levin continued: ‘More will come. Whether it will be in the form of extending the scope of the savings tax directive or whether it will be some form of corporate tax harmonisation, remains to be seen. But I think it's fairly safe to say that more tax measures are likely to emanate from the EU.’” For the full story, see Jason Gorringer, “EU Savings Tax Directive Just the Start Warns Academic,” Tax-News.com, July 17, 2003. Available at <http://www.tax-news.com/asp/story/story.asp?storyname=12646>

²³ Letter from Romano Prodi to Cong. Pete Sessions, March 13, 2002.

²⁴ The text of the directive can be found at:

http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=32003L0048&model=guichett.

The EU pretends that full information exchange is just around the corner, but the Directive language belies that claim. Paragraph 1 of Article 10 refers to a “transitional period” for Belgium, Luxembourg and Austria, but Paragraph 2 admits that:

“The transitional period shall end at the end of the first full fiscal year following the ... date of entry into force of an agreement between the European Community, following a *unanimous decision* of the Council, and the *last* of the Swiss Confederation, the Principality of Liechtenstein, the Republic of San Marino, the Principality of Monaco and the Principality of Andorra, providing for the exchange of information...[emphasis added]”

The most important parts of this paragraph are the italicized provisions, which demonstrate that the EU needs tax treaties with all of the listed nations and that all EU member nations – especially Austria, Luxembourg and Belgium – will have to agree that the treaties do not put them at a competitive disadvantage.

More Evidence of EU’s Pro-Tax Harmonization Bias

While the purpose of this paper is to expose the absence of a level playing field, it is worth noting the ideological blinders that guide EU thinking. The following items all come from the preface to the Savings Tax Directive:

1. The opening clause includes the statement, “Articles 56 to 60 of the Treaty [creating the European Union] guarantee the free movement of capital.” This certainly is a noble aspiration, but the entire purpose of the Directive is to hinder the flow of capital from high-tax jurisdictions to low-tax jurisdictions.
2. Revealing the bias – and ultimate objective of the EU, the Directive twice bemoans the “absence” and “lack” of “coordination of national tax systems.”
3. The Directive also states that tax competition, “...is creating distortions in the capital movements between Member States, which are incompatible with the internal market.” This is a rather odd assertion, since a market does not exist in the absence of competition.

The EU also makes a bold claim that the Directive will become effective January 1, 2005, but Paragraph 2 in Article 17 shows that this also is a hollow claim. The Directive language states that enforcement of the scheme inside the EU is explicitly contingent on the non-EU member nations adopting “...measures equivalent to those contained in Directive, in accordance with agreements entered into by them with the European Community, following unanimous decisions of the Council.” Moreover, the Directive also is explicitly contingent on the imposition of “automatic exchange of information” or a “withholding tax” by “...all the relevant dependent or associated territories...” of the United Kingdom.

These conditions almost surely will not be met. The Cayman Islands and other territories have stated that they have no interest in participating in the EU tax cartel.²⁵ Liechtenstein also has refused to cooperate with the Brussels-based bureaucrats.²⁶ The outlook for the Directive is so grim that Swiss bankers already have warned their government not to impose any withholding tax because other jurisdictions are not going to comply with the EU scheme.²⁷ Even EU officials are being forced to recognize that the house of cards is in danger of tumbling down. A Commission spokesman acknowledged that, "If there is a belief by member states that the legislation is not in compliance they could delay the implementation."²⁸

Pretending the United States does not exist: The Case of the Moving Goal Posts

The EU has had an even harder time getting the United States to participate in an information-sharing cartel. Last year, two senior level Bush Administration officials announced that the American government was opposed to the Savings Tax Directive.²⁹ The Chairman of the Council of Economic Advisers stated that, "We are not for the European savings initiative,"³⁰ and the Chairman of the National Economic Counsel remarked that, "The Administration does not support the EU Savings Directive. There is zero interest in it."³¹ And while some bureaucrats in the US Treasury Department are sympathetic to the EU's tax harmonization plan, the White House has repeatedly provided assurances that the Administration has no intention of reconsidering its position.

In a desperate effort to keep the Directive alive, the EU has repeatedly adjusted its goals with regards to US participation. In 2001, the EU expected official negotiations with the United States, leading to a formal information-sharing arrangement, similar to the agreements it was seeking with European jurisdictions. As the EU stated:

"On the basis of this text, *the Commission will conduct negotiations* with key non-EU countries (*United States, Switzerland, Liechtenstein, Monaco, Andorra, San Marino*) *to ensure the adoption of equivalent measures* in those countries in order

²⁵ Carl Mortished, "OECD chief protests against EU compromise on savings tax," *The Times*, London, January 21, 2003. See also, Caribbean Media Corporation News Agency, "Caribbean states appeal to the OECD for level playing field on tax," March 1, 2003.

²⁶ Joe Kirwin, "EU calls on member states to pressure Liechtenstein for savings tax agreement," Bureau of National Affairs, September 16, 2003. See also, Agence Europe, "Liechtenstein stands firm on banking secrecy," September 27, 2003.

²⁷ Jacob Greber, "Bankers attack EU and OECD over tax," Swissinfo, September 18, 2003. Available at <http://www.swissinfo.org/sen/Swissinfo.html?siteSect=105&sid=4250670>.

²⁸ Joe Kirwin, "European Commission Says No Exemption for Withholding Taxes in Channel Islands," Daily Report for Executives, BNA, September 29, 2003.

²⁹ <http://www.freedomandprosperity.org/press/p10-29-02/p10-29-02.shtml>.

³⁰ Edward Alden, Francesco Guererra, and Amity Shlaes, "US opposes sharing information on savings taxation: White House advisers come out against European request for data on foreign-held accounts," *Financial Times*, September 26, 2002.

³¹ International Money Management, "EU threatens Swiss again over information exchange," November 8, 2002.

to allow effective taxation of savings income paid to EU residents. The Commission received a mandate from the Council to conduct these negotiations from the 16th October 2001 Finance Council [emphasis added].”³²

Notwithstanding explicit US opposition, the EU kept pretending that an agreement was imminent. In July 2002, a news report stated, “The European Commission said July 24 that it was in regular contact with the Bush administration on the savings taxation issue and that it was confident an agreement on information exchange of cross-border savings incomes would be reached.”³³ In September 2002, the Financial Times reported that, “Mr Bolkestein believes that if Switzerland agreed to exchange information on the savings of EU citizens other third countries, including the US, would follow suit.”³⁴ Later that month, another report stated, “Bolkestein said an agreement with the United States was all but agreed and that only some details needed to be worked out.”³⁵

Treasury Department Bureaucrats vs. the Bush Administration

Representatives from many low-tax jurisdictions ask whether the U.S. genuinely favors tax competition. On the positive side, they see that the Bush Administration has rejected the EU Savings Tax Directive. They see that the IRS regulation has been shelved. They see that the U.S. has backed away from the OECD anti-tax competition project. They see an Administration that has endorsed tax reform policies that eliminate the need for information sharing between governments.³⁶ And they see a President who has pushed through three tax cuts in three years – two of which were significant and will dramatically improve U.S. competitiveness.

But these positive signs are partially offset by the behavior of bureaucrats – and even some low-level political appointees – at the Treasury Department. Perhaps because they feel some affinity or comradeship with tax collectors in other nations, some Treasury Department employees support tax harmonization policies and allow their ideological biases to affect their actions. At an OECD meeting in July, for instance, the Treasury Department’s International Tax Counsel sided with the French and disregarded the Bush Administration’s position on tax competition issues.³⁷

³² European Union, “Results of Council of Economics and Finance Ministers, Brussels, 13 December 2001 (tax and financial services),” MEMO/01/439, Brussels, 14th December 2001

³³ Alison Bennett, “Thomas Mulls Hearing on EU Savings Tax, Nonresident Alien Interest Reporting Rules,” Bureau of National Affairs, July 31, 2002.

³⁴ George Parker, “Swiss may face EU action over banking laws,” Financial Times, September 6, 2002.

³⁵ Joe Kirwin, “EU Confident of Reaching Accord with US for Information Exchange on Savings Income,” Bureau of National Affairs, September 27, 2002.

³⁶ Council of Economic Advisers, 2003 Economic Report of the President, Washington, DC, 2003. Available at http://w3.access.gpo.gov/usbudget/fy2004/pdf/2003_erp.pdf.

³⁷ The OECD refuses to hold open meetings, but minutes of the July 3, 2003 meeting of the “Informal Contact Group” were made available to the Center for Freedom and Prosperity.

Another example is Rocco Femia, a holdover from the Clinton years who works in the International Tax Counsel office. Mr. Femia is committed to a left-wing agenda of higher tax rates and income redistribution. He also is very supportive of the OECD's tax harmonization work, and his ideological fervor is so pronounced that he even made unspecified threats against supporters of tax competition during the OECD conference held in Barbados in January 2001. Amazingly, even though Mr. Femia has behaved in an intemperate fashion and expressed views that are diametrically opposed to those held by the White House, the Treasury Department sent him to Ottawa to represent the U.S. position.

So how should representatives from low-tax regimes interpret the U.S. position? When dealing with Treasury Department officials, the best strategy may be to force them to choose between loyalty to the White House and their own ideological biases. For instance, they should be asked the following two questions:

1. Senior White House officials announced the U.S. was opposed to the EU Directive. Can you provide any evidence that the White House has changed that view?
2. The White House has blocked the IRS interest-reporting regulation. Can you provide any evidence that the White House has changed that view?

These two questions are important because Treasury officials may be willing to pursue a private, ideological agenda, but they presumably will be reluctant to deliberately misrepresent the Administration's position – especially since it is highly unlikely that such behavior would remain confidential.

The EU's claims, of course, were groundless. Bolkestein's assertion was especially interesting since it came just one day after the Chairman of President Bush's Council of Economic Advisers had announced the United States was opposed to the scheme. But rather than admit defeat, the EU moved the goal posts. In a December 2002 report to the ECOFIN Council,³⁸ the European Commission admitted that, "The U.S. is not prepared at this stage to give a formal statement in relation to the savings directive." Not surprisingly, the Commission chose not to acknowledge the official statements of opposition from senior Bush Administration officials. Instead, the report claimed that the U.S. was in favor of "full and effective administration of taxes based on information exchange." The report did admit, however, that there were "important exceptions" to U.S. reporting rules, and specifically referenced "bank deposit interest" and "non-U.S. source income."

³⁸ The ECOFIN Council comprises Finance Ministers from EU nations. The report was entitled "Communication from the Commission to the Council: Report Concerning Negotiations with Third Countries on Taxation of Savings Income," ECOFIN Council, December 3, 2002.

In an effort to create a sense of positive momentum, the December 2002 Commission Report specifically highlighted a proposed Clinton-era IRS regulation that would force U.S. banks to report deposit interest paid to nonresident aliens. The Report asserted that the regulation was “due to become effective from 31st December [2002].” The EU clearly wanted to imply that enactment of the regulation was a big step toward and would be an “equivalent measure” for purposes of the Directive (the IRS regulation would not have put the US in compliance with the Directive, but that is a separate issue).

Once again, the EU was guilty of misrepresentation. The IRS regulation was not implemented at the end of 2002. Indeed, it still has not been implemented, and White House officials say it will never be implemented. This presumably should have been the death knell of the Directive, and news reports have raised this issue. According to one report: “... if the US fails to authorize the 'non-resident alien' interest reporting measures which are currently being fought over by Treasury staffers and more liberal [in the pro-freedom European sense of the word] administration officials, then there isn't an agreement ...”³⁹

It does not require genius-level IQ to guess the EU's response. We know that they originally wanted an official agreement from the United States, but moved the goal posts when the Bush Administration rejected the EU cartel. So what happened when the United States refused to comply with the EU's new requirement based in part on the interest-reporting regulation? Simple, the EU moved the goal posts yet again. Actually, they tore down the goal posts, completely excusing the United States from any obligation to participate in the Directive. According to a Commission publication from earlier this year:

*"The Council recalls the conclusions of the Feira European Council that sufficient reassurances should be obtained from certain third countries on the application of "equivalent measures" to those provided for in the draft directive. Based on the Commission's report, as submitted to the ECOFIN of 3 December, the Council considers that this condition is effectively satisfied in the case of the United States of America and that it would be satisfied in the cases of Switzerland, Liechtenstein, Monaco, Andorra and San Marino if these countries offered to enter into agreements as outlined below. [emphasis added]"*⁴⁰

In other words, the EU has decided to pretend that the United States is in compliance. In reality, however, foreigners can still receive capital gains and interest income in the US, secure in the knowledge that they will generally be free of US tax and that they will not be reported to their home governments.⁴¹ Many of those foreigners, of

³⁹ Ulrika Lomas, “EU/Swiss Savings Tax Agreement Hangs in the Balance,” Tax-News.com, March 27, 2003. Available at <http://www.tax-news.com/asp/story/story.asp?storyname=11320>.

⁴⁰ European Union, “Results of Council of Economics and Finance Ministers,” Brussels, January 22, 2003. Available at http://europa.eu.int/comm/taxation_customs/taxation/information_notes/taxation_package/taxpack_4.htm.

⁴¹ For more information on the use of the United States as a safe haven for flight capital, see, Daniel J. Mitchell, “The Adverse Impact of Tax Harmonization and Information Exchange on the U.S. Economy,”

course, will utilize some of the world's best tax-planning vehicles – corporations from Delaware, Nevada, and other American States.⁴²

The EU Directive and the OECD anti-competition initiative would both benefit the US economy if they were implemented. Capital would flow into American financial institutions and further boost US competitiveness. But public policy should not be designed to make America richer at the expense of other jurisdictions. Instead, all nations and territories should have the right to enact market-based reforms that boost growth and attract capital. This is the level playing field – based on competition – that deserves support.

Does the EU Directive Create a Level Playing Field? Ask the OECD and the Media

There is no level playing field, at least as measured by what the OECD is demanding from persecuted jurisdictions. The EU Directive has numerous loopholes, the biggest of which is the United States. These loopholes are good for the global economy since double-taxation of capital will not be as pervasive, but they are bad news for the OECD. The bureaucrats from Paris traditionally have maintained a dismissive attitude toward officials from low-tax jurisdictions, treating them like backward colonials. But arrogance is no substitute for truth, and the OECD will have a hard time convincing low-tax jurisdictions that a level playing field exists – particularly when the head of the OECD has admitted that the EU Directive makes a mockery of that principle. According to one news report:

“The Organisation for Economic Cooperation and Development last night accused the European Union of going soft on tax cheats after EU finance ministers agreed a watered down deal on taxing cross-border savings which left loopholes for high rolling investors.... In a letter to EU governments, [OECD Secretary-General Johnston] warned that the compromise deal would damage the OECD's own efforts to promote greater openness about financial affairs.”⁴³

Indeed, the OECD's Secretary-General confesses that the Directive destroys the level playing field and gives low-tax jurisdictions the right to disavow the so-called commitment letters. According to the *International Herald Tribune*, Johnston wrote, “If some OECD countries were to receive more favorable treatment [than blacklisted low-tax jurisdictions] as a result of the EU negotiations, this could lead them to withdraw their commitments.”⁴⁴ Even the *Financial Times*, which has demonstrated a strong bias against

Prosperitas, Vol. 1, No. 4, Center for Freedom and Prosperity, November 2001. Available at <http://www.freedomandprosperity.org/Papers/taxharm/taxharm.shtml>.

⁴² For more information on tax-efficient US corporate vehicles, see, Richard Hay, *Towards a Level Playing Field*, International Tax and Investment Organisation September 2002. Available at www.itio.org/documents/TowardsaLevel.pdf.

⁴³ Charlotte Denny and Andrew Osborn, “EU deal on tax dodging leaves loopholes,” *The Guardian*, January 22, 2003.

⁴⁴ Thomas Fuller and Eric Pfanner, “Crackdown on tax cheats could backfire on the EU,” *International Herald Tribune*, January 23, 2003.

tax competition, felt compelled to ridicule the EU Directive, writing that, “The loophole-riddled compromise was a shoddy enough deal that did little to advance wider efforts to end global tax evasion. The price paid to achieve it diminishes still further the integrity of the EU's decision-making and its moral authority.”⁴⁵

Winning the End Game and Seizing the Moral High Ground

Advocates of tax harmonization policies such as information exchange have no legitimacy. They are pursuing policies that will diminish global economic growth and reduce individual opportunity. Developing nations would suffer most, since they would be effectively prohibited from using good tax law to attract economic development – much as Western nations experienced their growth spurts during the 1800s prior to the enactment of income taxes.

Defending tax competition is not just a matter of promoting good tax policy. For blacklisted jurisdictions, it may mean the difference between poverty and economic development. This is why the “tax havens” must stand united and reject the OECD’s tax harmonization demands. Some jurisdictions already have courageously announced that they have no intention of becoming fiscal colonies for Europe’s welfare states, including Antigua,⁴⁶ Panama,⁴⁷ and the Cayman Islands.⁴⁸ All other persecuted jurisdictions should withdraw (or at least suspend) their commitment letters as well. Fortunately, this seems to be happening. Low-tax jurisdictions generally linked arms and stood united at the OECD’s Global Forum in Ottawa.⁴⁹

The OECD cleverly has played a game of divide-and-conquer, making private deals with some jurisdictions and applying discriminatory pressure against others. If the OECD is allowed to continue this game, the Paris-based bureaucracy will prevail. Low-tax regimes should adopt a common strategy if they hope to preserve their sovereignty. Fortunately, the EU has created a perfect opening by proposing a Savings Tax Directive that makes a mockery of the level playing field.

But while the death of the level playing field gives low-tax jurisdictions a perfect excuse to resist OECD pressure, this issue does not guarantee long-term victory. The OECD, after all, could demand that blacklisted governments impose a withholding tax – akin to the latest version of the Savings Tax Directive. Or the EU Directive might be expanded in the future to make information exchange the norm, potentially emasculating the level playing field argument.

This is why low-tax regimes must aggressively defend tax competition as a liberalizing force in the world economy. They should argue that tax competition has

⁴⁵ Financial Times, “Monti’s cave-in,” February 14, 2003.

⁴⁶ <http://www.tax-news.com/asp/story/story.asp?storyname=10660>.

⁴⁷ <http://www.freedomandprosperity.org/ltr/latorraca/latorraca.shtml>.

⁴⁸ <http://www.tax-news.com/asp/story/story.asp?storyname=9848> and <http://www.tax-news.com/asp/story/story.asp?storyname=10033>.

⁴⁹ Mike Godfrey, “Level Playing Field Not Yet Achieved, OECD Meeting Concludes, Tax-News.com, October 17, 2003. Available at <http://www.tax-news.com/asp/story/story.asp?storyname=13714>.

helped lower tax rates and reduce discriminatory taxes on income that is saved and invested. And since even OECD economists have widely written that lower tax rates and proper treatment of capital are important contributors to economic growth, the time has come to seize the moral high ground.

For too long, low-tax jurisdictions have been defensive, acting as if there was something wrong with pro-market tax and privacy laws. The time has come to point the finger of blame at the real culprits – the uncompetitive European welfare states whose bad tax laws have hobbled economic growth and caused a flight of jobs and capital.⁵⁰ These are the nations that are harming the world economy.

Conclusion

A couple of years ago, it seemed that tax competition was going to be dramatically curtailed. Backed by the threat of financial protectionism and a left-wing Clinton Treasury Department, the OECD was able to bully low-tax jurisdictions. Combined with the EU Savings Tax Directive, it seemed that high-tax governments were going to impose barriers to the free flow of capital – which likely would have the same disastrous effects as the capital controls that helped cripple the world economy in the 1970s.

Today, the OECD anti-competition effort is stalled and the EU Directive is a hollow shell. These positive developments can be turned into permanent victories if low-tax jurisdictions defend their interests. This means saying no to the OECD and aggressively promoting tax competition as a positive force for worldwide economic growth.

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⁵⁰ Amity Shlaes, “The musical discord of the marketplace,” *The Financial Times*, October 20, 2003.

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5) January 2002, *Prosperitas Vol. II, Issue I*, “U.S. Government Agencies Confirm That Low-Tax Jurisdictions Are Not Money Laundering Havens,” by Daniel J. Mitchell. Web page link below:

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4) November 2001, *Prosperitas, Vol. I, Issue IV*, “The Adverse Impact of Tax Harmonization and Information Exchange on the U.S. Economy,” by Daniel J. Mitchell. Web page link below:

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3) October 2001, *Prosperitas, Vol. I, Issue III*, “Money Laundering Legislation Would Discourage International Cooperation in the Fight Against Crime,” by Andrew F. Quinlan. Web page link below:

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2) August 2001, *Prosperitas, Vol. I, Issue II*, “United Nations Seeks Global Tax Authority,” by Daniel J. Mitchell. Web page link below:

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