THE OECD TAX COMPETITION INITIATIVE: A CRITIQUE OF ITS MERITS IN THE GLOBAL MARKETPLACE

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I. INTRODUCTION

One policy-based principle within the area of international tax law is the promotion of worldwide efficiency and growth.[1] The means to accomplish this principle is to remove tax rates from the factors considered in selecting the country in which to locate business operations or other investments.[2] The United States, in furtherance of this principle, generally pursues a system applying capital export neutrality which maintains that, if tax rates are immaterial, a business enterprise will locate where it will potentially have the greatest return on capital.[3] To this end, the United States taxes the worldwide income of domestic entities, but allows a credit against U.S. tax liability for foreign taxes paid.[4]

Despite widespread application of the capital export neutrality principle among many industrialized nations, tax considerations continue to strongly influence the behavior of individuals and multinational corporations.[5] The United States and other developed nations invest based on tax considerations, which maintain or improve the competitive position of their multinationals in the world economy.[6] These considerations may include investment in developing nations as a means of tax reduction.[7]

Developing nations create attractive tax incentives, causing an influx of foreign investment capital from individuals and business enterprises.[8] In response, the Organisation for

1. Karen B. Brown, *Harmful Tax Competition: The OECD View*, 32 GEO. WASH. J. INT'L L. & ECON. 311, 311 (1999) (book review).

2. *See id.* (stating that statutory and treaty rules result from various economic and political choices).

3. *See id.*; Donald J. Rousslang, *Deferral and the Optimal Taxation of International Investment Income*, 53 NAT'L TAX J. 589, 590 (2000) (discussing the theory behind capital export neutrality).

4. Brown, *supra* note 1, at 311; *see also* 26 U.S.C. §§ 901(a), 904(a) (1994) (granting a credit for foreign taxes paid to avoid double taxation).

5. Brown, *supra* note 1, at 314 (arguing that capital export neutrality does not preclude contemplation of tax considerations when making investment decisions).

6. *See id*. at 314–15 (stating that based on competitive positions in the world economy, many countries depart from purely neutral tax systems).

7. *Id*.

8. *See* discussion *infra* Part II (addressing the amount of tax revenue that

Economic Co-operation and Development (OECD) has prepared two reports targeting jurisdictions with nominal or no income tax in certain circumstances.[9] The reports identify those jurisdictions that the OECD believes engage in harmful preferential tax schemes and discuss the criteria for identifying a tax haven.[10]

This Article argues that the OECD findings are fundamentally flawed and that the lack of involvement of the OECD-deemed tax havens in any attempted tax harmonization deliberations undermines the credibility of the reports. Additionally, this Article suggests that the issues involved in a nation's system of taxation make competition the most favorable alternative. Though investment capital may be displaced, the notion of sovereignty dictates that a nation best determines the structure of its domestic affairs.[11] Competition will dictate the best location of investments for the greatest return on capital.[12]

II. THE MAKE-UP OF A TAX HAVEN

High taxation and increased regulation in developed nations have persuaded individuals and corporations to search for more favorable locations for depositing funds and transacting business.[13] Tax-haven governments recognized a niche that they

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developing nations have directed away from industrialized nations).

9. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES (2000), *available at* http://www.oecd.org/pdf/M000014000/M00014130.pdf [hereinafter 2000 OECD REPORT]; ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998), *available at* http://www.oecd.org/pdf/M00004000/M00004517.pdf [hereinafter 1998 OECD REPORT]; *see* discussion *infra* Part III (detailing the reports' recommendations to address the situation).

10. *See* Alexander Townsend, Jr., Comment, *The Global Schoolyard Bully: The Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition*, 25 FORDHAM INT'L L.J. 215, 238–39, 245–46 (2001).

11. Mortimer Sellers, *Republican Principles in International Law*, 11 CONN. J. INT'L L. 403, 410–11 (1996) (discussing ideas of sovereignty).

12. Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 CORNELL L. REV. 18, 55 (1993); Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1644 (2000) [hereinafter Avi-Yonah, *Globalization*].

13. Townsend, *supra* note 10, at 232.

were able to fill and attracted capital by providing favorable tax rates for non-resident monetary deposits.[14] Tax havens are generally characterized by stringent bank secrecy laws, a lack of information exchange, and a lack of transparency.[15]

One consequence of this arrangement has been extensive criticism surrounding tax-haven activities.[16] The criticism includes two major issues. The first concern is that bank secrecy obscures evidence of tax evasion and money laundering.[17] Secrecy makes these jurisdictions very attractive to drug dealers, terrorists, and individual tax cheats for the protection of their illicit activities.[18] The second concern is the steep rise in the transfer of funds to tax havens and the corresponding loss of revenue to high-tax jurisdictions.[19] Many opponents of tax-haven activities cite inequitable allocation of the world's investment dollars to tax-haven jurisdictions as a reason to protect against the displacement of investment dollars.[20]

A. *Information Exchange*

Information exchange refers to the willingness of different taxing authorities to share the data necessary for effective enforcement of residence-based taxation, especially data on tax-haven investments.[21] Typically, a tax-haven jurisdiction

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14. *Id*. at 232–33.

15. *Id*. at 238–39.

16. *See* Ben Seessel, Comment, *The Bermuda Reinsurance 'Loophole': A Case Study of Tax Shelters and Tax Havens in the Globalizing Economy*, 32 U. MIAMI INTER-AM. L. REV. 541, 565 (2001).

17. *Id.*

18. *See* Andrew Ayers, *The Financial Action Task Force: The War on Terrorism Will Not Be Fought on the Battlefield*, 18 N.Y.L. SCH. J. HUM. RTS. 449, 449–50 (2002) (stating that secrecy laws in tax havens frustrate the ability to discover transfers of illegal funds); Patti Mohr, *U.S. Senate Committee Approves Stricter Monitoring of Tax Havens*, 24 TAX NOTES INT'L 215, 215 (2001) (identifying tax havens as jurisdictions that further terrorism, money laundering, and criminal offenses).

19. Seessel, *supra* note 16, at 565.

20. *See* Taylor Morgan Hoffman, Developments, *The Future of Offshore Tax Havens*, 2 CHI. J. INT'L L. 511, 513 (2001) (discussing the growing investment in tax-haven jurisdictions, particularly Caribbean nations, since 1985).

21. Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1337 (1996) (discussing how information exchange between developed and developing nations would lead to more effective

maintains the confidentiality of depositors and investors within its territory and does not release information to foreign tax authorities.[22] Both individuals and corporations have benefited from this incentive by avoiding attempts by their domestic authorities to impose a tax on foreign-source or worldwide income.[23]

Proponents of information exchange agreements want banks (or tax authorities) to give notice of interest payments to the country where the beneficial owner of the interest resides.[24] Therefore, the home country could assess its domestic tax on the payment.[25] However, if a tax haven serves as intermediary for an investment, exchange of information is useless to tax authorities because bank secrecy laws will prevent them from identifying the owner of the funds.[26]

B. Bank Secrecy

Foreign tax authorities generally cannot accurately ascertain the identity of investors who invest through holding companies located in tax havens.[27] This impediment exists because "most tax havens have bank secrecy laws that prohibit giving out any confidential client information such as the identity of the individuals who own the shares in the holding company."[28] This aspect frustrates the efforts of foreign tax authorities to collect taxes according to their domestic revenue laws.[29] Additionally, bank secrecy laws attract investors with the prospect of shielding activities in the tax haven from review by home-country tax authorities.[30]

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enforcement of residence-based taxation).

22. *See* Avi-Yonah, *Globalization*, *supra* note 12, at 1584.

23. *Id.* at 1576.

24. *See id.* at 1654.

25. *See id.*

26. *See id.* at 1585, 1668–69.

27. Arthur J. Cockfield, *Transforming the Internet into a Taxable Forum: A Case Study in E-Commerce Taxation*, 85 MINN. L. REV. 1171, 1225 n.188 (2001).

28. *Id.*; *see also id*. at 1243 n.254 (discussing that most tax havens have criminalized disclosure of client information to third parties).

29. *See* Avi-Yonah, *Globalization*, *supra* note 12, at 1576.

30. *See* 1998 OECD REPORT, *supra* note 9, at 21–24.

Tax-haven jurisdictions resist abating their bank secrecy laws because their economies may collapse if they cannot provide investors with secrecy-leveraged tax advantages.[31] Many tax-haven nations, unlike most industrialized nations, do not have an abundance of natural resources with which to develop their economies.[32] This renders the tax-haven nations comparatively less capable of sustaining themselves through the more traditional methods found in industrialized nations.[33] These economic conditions require that nations arrange other means to generate revenue and provide for a sustainable economy.[34] In large part, the financial services industry has been the primary revenue source for these developing nations.[35] Therefore, removal of those aspects that make tax-haven economies attractive to foreign capital investment would devastate the financial services industry and cause the tax-haven jurisdictions to become heavily dependent on foreign aid.[36]

The notion of fiscal sovereignty also arises in characterizing a tax haven and contributes to making agreements on worldwide fiscal policy a formidable challenge.[37] A nation's right to determine its fiscal policies is an inherently domestic issue.[38] It is a basic principle that an individual nation most appropriately determines its own public policies and the structures necessary to implement them.[39] However, it is a misconception that low-tax jurisdictions establish their fiscal policies with the primary

31. Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543, 602 (2001) (discussing tax havens' arguments for maintaining their bank secrecy laws).

32. *See* Townsend, *supra* note 10, at 257.

33. *Id.*

34. *Id.*

35. *See* Hoffman, *supra* note 20, at 513 (describing Barbados, where one-third of government revenue is from financial services, as an example of such dependence).

36. *See id*. (discussing financial service-dependent economies).

37. *See* Townsend, *supra* note 10, at 223 (discussing that in the absence of international laws limiting nations' fiscal autonomy, governments are refusing to relinquish any authority).

38. *See id.* at 219–20 (explaining that a nation's taxing authority is fundamental to its governmental functions because the fiscal policies generate the necessary revenue to provide for its structural needs).

39. *See id.*

purpose of attracting foreign capital.[40] For example, the Cayman Islands traditionally employed a framework that relies on taxing consumption, rather than taxing the accrual of earned or unearned income.[41] The Cayman Islands never levied direct taxes on income, capital gains, or wealth, nor utilized other direct taxes that have been adopted by industrialized nations.[42] Nevertheless, globalization and global competition remove any distinction between competitive intent and non-competitive fiscal policy and raise concerns over future transnational tax bases and future government tax revenues.[43]

C. *Lack of Transparency*

A lack of transparency refers to the situation when details of a tax regime or the application of rules are not clear or when financial disclosure or supervision are not adequate.[44] This situation may occur when tax authorities issue favorable administrative rulings, thereby allowing a certain sector to operate with lower effective tax consequences compared to other sectors.[45] When administrative practices are consistent with statutory laws, they may have the appearance of a legitimate and necessary exercise of administrative authority; however, in effect, they benefit only particular taxpayers.[46] If administrative practices and enforcement do not have clear provisions indicating appropriate application, other countries may find it more difficult to enforce their tax laws.[47]

The OECD estimates that the amount of foreign direct investment flowing into Caribbean and South Pacific countries,

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40. *See* Robert Goulder, *Cayman Islands Urges Tax Havens to Cooperate with OECD*, 22 TAX NOTES INT'L 231, 232 (2001) [hereinafter Goulder, *Cayman Islands*] (indicating that the Cayman Islands did not create its fiscal regime specifically to attract business, despite that the regime is both simple and transparent).

41. *Id*. (citing comments of George McCarthy, financial secretary of the Cayman Islands).

42. *Id*.

43. *See* Roin, *supra* note 31, at 544.

44. *See* 1998 OECD REPORT, *supra* note 9, at 28.

45. *Id*. at 28–29 (describing qualities of a non-transparent regime).

46. *Id*.

47. *Id*.

which are generally considered low-tax jurisdictions, reached over two hundred billion dollars between 1985 and 1994.[48] In 2000, the OECD estimated that tax havens had more than one trillion dollars in investments and that the number of offshore funds had increased by more than fourteen hundred percent over the previous fifteen years.[49] The United States, an OECD member, estimates that it loses seventy billion dollars annually in tax revenue from American taxpayers who maintain offshore accounts.[50] As a result of the significant revenue loss, the OECD directs its efforts to countries with favorable tax regimes.[51]

III. THE OECD AND ITS INITIATIVE

The OECD is an international organization based in Paris, France.[52] The organization was established in 1961 to contribute to economic development and growth in its member countries.[53] The OECD seeks to promote this economic development through issuing publications and statistics on various topics including competition, corporate governance, electronic commerce, trade, and taxation.[54] Through its publications, the OECD chooses the

48. *Id*. at 17 (stating that the rate of growth of foreign direct investment in Caribbean and South Pacific countries exceeds that of total outbound foreign direct investment from industrialized nations).

49. Cockfield, *supra* note 27, at 1226.

50. Hoffman, *supra* note 20, at 513; *see also* John D. McKinnon, *IRS to View Offshore Credit-Card Records: U.S. Soon Will Gain Access to Account Information in Bid to Nab Scofflaws*, WALL ST. J., Mar. 8, 2002, at A3.

51. Townsend, *supra* note 10, at 234.

52. *See* OECD, Contact us, *available at* http://www.oecd.org/EN/contactus/0,,EN-contactus-0-nodirectorate-no-no-no-0,00.html (last visited Mar. 21, 2003).

53. History of the OECD*, available at* http://www.oecd.org/EN/document/0,,EN-document-0-nodirectorate-no-21-9347-0,00.html (last visited Mar. 21, 2003) (describing the history of the OECD); About: OECD*, available at* http://www.oecd.org/EN/about/0,,EN-about-0-nodirectorate-no-no-no-0,FF.html (last visited Mar. 21, 2003) (defining OECD and its purpose). Currently, the OECD has thirty member countries: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. OECD, Member Countries, *available at* http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-countrylist-0-nodirectorate-no-no-159-0,00.html (last visited Mar. 21, 2003).

54. About: OECD*, supra* note 53 (describing the mission and scope of the OECD).

tools of dialogue, consensus, peer review, and pressure to encourage economic development and change in the market economy.[55] Though the primary focus of the OECD is on member countries, its additional goals of contributing to the expansion of world trade and the development of the world economy affects non-members as well.[56]

A. The 1998 OECD Report

In 1998, the OECD released *Harmful Tax Competition: An Emerging Global Issue* (1998 OECD Report), a report addressing the harmful practices of tax havens and preferential tax regimes.[57] The 1998 OECD Report sought to develop a better understanding of how the "harmful tax practices" affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns, and generally undermine tax systems.[58]

According to the 1998 OECD Report, harmful tax practices may take the form of tax havens or preferential tax regimes.[59] The 1998 OECD Report distinguishes between the two classifications by identifying the factors that enable tax havens and harmful preferential tax regimes in OECD member and non-member countries to attract highly-mobile activities, such as financial and other service activities.[60]

The 1998 OECD Report specifies criteria for identifying tax havens. A jurisdiction is labeled a tax haven if it meets the following conditions: (1) it imposes no or only nominal taxes; (2) it lacks a policy of effective exchange of information;[61] (3) it lacks transparency;[62] and (4) it has no requirement of substantial

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55. *See id.*

56. *See* History of the OECD, *supra* note 53.

57. 1998 OECD REPORT, *supra* note 9, at 8.

58. *Id*.

59. *Id*. at 20.

60. *Id*. at 19.

61. *Id*. at 22–23 (noting that tax havens typically have laws or administrative practices through which depositors benefit from strict secrecy rules and other protections against scrutiny from home tax authorities); *see also* discussion *supra* Part II (describing characteristics of a tax haven).

62. 1998 OECD REPORT, *supra* note 9, at 22 (noting that tax havens typically

activities within the jurisdiction.[63] Permitting investment without substantial activities signals that there is no requirement that investors' activities add value to a jurisdiction and is indicative of a tax haven that allows purely tax-driven activity.[64] These jurisdictions provide non-resident taxpayers a place to hold passive investments, to book "paper" profits, and to conceal their financial affairs from their resident-country's taxing authorities.[65]

Harmful preferential tax regimes exist in non-tax-haven countries that receive significant revenue from their respective tax policies, but whose tax systems contain aspects that classify them as engaging in harmful tax competition.[66] According to the 1998 OECD Report, the following principal factors identify a harmful preferential tax regime: (1) no or low effective tax rates;[67] (2) ring-fencing;[68] (3) lack of transparency;[69] and (4) lack of effective exchange of information.[70]

Zero or low effective tax rates may arise "because the schedule rate itself is very low or because of the way in which a country defines the tax base to which the rate applies."[71] Because these identification factors fluctuate, and the factors themselves may vary among countries, it is enormously challenging to harmonize tax practices or equitably identify harmful regimes.[72]

Ring-fencing protects a country from the financial burden of its own incentive regime, while adversely affecting only foreign

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frustrate other countries' access to information on the operation of legislative, legal, or administrative provisions); *see also* discussion *supra* Part II (describing characteristics of a tax haven).

63. 1998 OECD REPORT, *supra* note 9, at 22.

64. *Id.*

65. *Id*.

66. Townsend, *supra* note 10, at 239.

67. 1998 OECD REPORT, *supra* note 9, at 25.

68. *Id*. at 26.

69. *Id*. at 27.

70. *Id*.

71. *Id.* at 26.

72. *See id.* at 8 (recognizing that there are limitations on unilateral or bilateral responses to a multilateral problem such as taxation rates and practices).

tax bases.[73] For example, assume Country A is a nation with an effective tax rate of forty percent. Country A is able to generate sufficient revenues from its domestic tax base. Country X has a tax rate competitive to that of Country A. Ring-fencing occurs when Country A, while maintaining its forty percent tax rate applicable to its residents, offers a significantly lower rate applicable to foreign investors or to investment by non-residents within certain industries.[74] This type of regime maintains or increases Country A's tax base and revenues, but negatively affects Country X's tax base by displacing a significant amount of investment funds.[75]

A lack of transparency involves unclear application of a tax regime to a taxpayer and the application is unavailable to the tax authorities of other concerned countries.[76] This situation harms tax bases of other countries by effectively disallowing the proper execution of their tax laws due to missing or undisclosed information[77] and by providing an invaluable component for money laundering activities.[78]

Ineffective exchange of information means secrecy laws or administrative policies may hinder the application of tax treaties and national legislation by preventing home-state tax authorities from obtaining information on taxpayers benefiting from a preferential tax regime.[79] In short, the 1998 OECD Report considers these activities in countries with preferential tax regimes to be as harmful as tax havens.[80]

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73. *Id.* at 26.

74. *See id.* at 28 (defining two forms of ring-fencing: (1) regimes that restrict benefits to non-residents and (2) investors who benefit from the tax regime are explicitly or implicitly denied access to domestic markets).

75. *See id.* at 26 (illustrating how ring-fencing shields the sponsoring country from harm and shields the taxpayer from bearing costs incurred to provide infrastructure).

76. *Id.* at 28.

77. *See id.* (explaining how some jurisdictions have enacted laws that prevent financial institutions from providing tax authorities with information about investors).

78. *Id.* at 24.

79. *Id.* at 29.

80. *See, e.g.*, *id.* at 24, 25, 29–30 (discussing the similarities between preferential tax regimes and traditional tax havens). Preferential tax regimes and tax havens share three identifying harmful tax practices. Both systems impose a low or zero

As evidenced by the 1998 OECD Report, the OECD seeks to curb what it considers harmful tax competition and counter the spread of harmful preferential tax regimes directed at financial and service activities.[81] The 1998 OECD Report lists nineteen recommendations (the Recommendations) that countries may adopt to counteract the negative effects of harmful tax regimes.[82]

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effective tax rate, operate in a manner that prevents or inhibits effective exchange of information with other countries, and lack transparency. *Id.* at 23, 27.

81. *Id*. at 70 (stating a collective and individual need for OECD member countries to take action to address and eradicate harmful tax practices in the world).

82. *Id*. at 67–71. The Recommendations are as follows:

I. Recommendations concerning domestic legislation and practices

1. Recommendation concerning Controlled Foreign Corporations (CFC) or equivalent rules: that countries that do not have such rules consider adopting them and that countries that have such rules ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices.
2. Recommendation concerning foreign investment fund or equivalent rules: that countries that do not have such rules consider adopting them and that countries that have such rules consider applying them to income and entities covered by practices considered to constitute harmful tax competition.
3. Recommendation concerning restrictions on participation exemption and other systems of exempting foreign income in the context of harmful tax competition: that countries that apply the exemption method to eliminate double taxation of foreign source income consider adopting rules that would ensure that foreign income that has benefited from tax practices deemed as constituting harmful tax competition do not qualify for the application of the exemption method.
4. Recommendation concerning foreign information reporting rules: that countries that do not have rules concerning reporting of international transactions and foreign operations of resident taxpayers consider adopting such rules and that countries exchange information obtained under these rules.
5. Recommendation concerning rulings: that countries, where administrative decisions concerning the particular position of a taxpayer may be obtained in advance of planned transactions, make public the conditions for granting, denying or revoking such decisions.
6. Recommendation concerning transfer pricing rules: that countries follow the principles set out in the OECD's 1995 Guidelines on Transfer Pricing and thereby refrain from applying or not applying their transfer pricing rules in a way that would constitute harmful tax competition.

7. Recommendation concerning access to banking information for tax purposes: in the context of counteracting harmful tax competition, countries should review their laws, regulations and practices which govern access to banking information with a view to removing impediments to the access to such information by tax authorities.

II. Recommendations concerning tax treaties

8. Recommendation concerning greater and more efficient use of exchanges of information: that countries should undertake programs to intensify exchange of relevant information concerning transactions in tax havens and preferential tax regimes constituting harmful tax competition.
9. Recommendation concerning the entitlement to treaty benefits: that countries consider including in their tax conventions provisions aimed at restricting the entitlement to treaty benefits for entities and income covered by measures constituting harmful tax practices and consider how the existing provisions of their tax conventions can be applied for the same purpose; that the Model Tax Convention be modified to include such provisions or clarifications as are needed in that respect.
10. Recommendation concerning the clarification of the status of domestic anti-abuse rules and doctrines in tax treaties: that the Commentary on the Model Tax Convention be clarified to remove any uncertainty or ambiguity regarding the compatibility of domestic anti-abuse measures with the Model Tax Convention.
11. Recommendation concerning a list of specific exclusion provisions found in treaties: that the Committee prepare and maintain a list of provisions used by countries to exclude from the benefits of tax conventions certain specific entities or types of income and that the list be used by Member countries as a reference point when negotiating tax conventions and as a basis for discussions in the Forum.
12. Recommendation concerning tax treaties with tax havens: that countries consider terminating their tax conventions with tax havens and consider not entering into tax treaties with such countries in the future.
13. Recommendation concerning co-ordinated enforcement regimes (joint audits; co-ordinated training programmes, etc.): that countries consider undertaking co-ordinated enforcement programs (such as simultaneous examinations, specific exchange of information projects or joint training activities) in relation to income or taxpayers benefiting from practices constituting harmful tax competition.
14. Recommendation concerning assistance in recovery of tax claims: that countries be encouraged to review the current rules applying to the enforcement of tax claims of other countries and that the

Committee pursue its work in this area with a view to drafting provisions that could be included in tax conventions for that purpose.

III. Recommendations to intensify international co-operation in response to harmful tax competition

15. Recommendation for Guidelines and a Forum on Harmful Tax Practices: that the Member countries endorse the Guidelines on harmful preferential tax regimes set out [below] and establish a Forum to implement the Guidelines and other Recommendations in this Report.

Recommendation 15 Guidelines for Dealing with Harmful Preferential Tax Regimes in Member Countries

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The Guidelines are:

1. To refrain from adopting new measures, or extending the scope of, or strengthening existing measures, in the form of legislative provisions or administrative practices related to taxation, that constitute harmful tax practices as defined in Section III of Chapter 2 of the [1998] Report.
2. To review their existing measures for the purpose of identifying those measures, in the form of legislative provisions or administrative practices related to taxation, that constitute harmful tax practices as defined in Section III of Chapter 2 of the [1998] Report. These measures will be reported to the Forum on Harmful Tax Practices and will be included in a list within 2 years from the date on which these Guidelines are approved by the OECD Council.
3. To remove, before the end of 5 years starting from the date on which the Guidelines are approved by the OECD Council, the harmful features of their preferential tax regimes identified in the list referred to in paragraph 2. However, in respect of taxpayers who are benefiting from such regimes on 31 December 2000, the benefits that they derive will be removed at the latest on the 31 December 2005. This will ensure that such particular tax benefits have been entirely removed after that date. The list referred to in paragraph 2 will be reviewed annually to delete those regimes that no longer constitute harmful preferential tax regimes.
4. Each member country which believes that an existing measure not already included in the list referred to in paragraph 2, or a proposed or new measure of itself or of another country, constitutes a measure, in the form of legislative provision or administrative practice related to taxation, that might constitute a harmful tax practice in light of the factors identified in Section III of Chapter 2 of the

The Recommendations provide guidance to harmful tax jurisdictions on how to enact or reform their tax legislation and practices.[83] The Recommendations also encourage harmful jurisdictions to address treaty arrangements with OECD member nations.[84] Specifically, the 1998 OECD Report recommends that OECD countries terminate existing treaties with tax havens and not enter into new treaties with non-complying countries until harmful tax elements are removed.[85]

The 1998 OECD Report created a Forum to monitor the

> [1998] Report, may request that the measure be examined by the Member countries, through the Forum on Harmful Tax Practices, for purposes of the application of paragraph 1 or for inclusion in the list referred to in paragraph 2. The Forum may issue a non-binding opinion on that question.
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> 5. To co-ordinate, through the Forum, their national and treaty responses to harmful tax practices adopted by other countries.
> 6. To use the Forum to encourage actively non-member countries to associate themselves with these Guidelines.
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> 16. Recommendation to produce a list of tax havens: that the Forum be mandated to establish, within one year of the first meeting of the Forum, a list of tax havens on the basis of the factors identified in section II of Chapter 2.
> 17. Recommendation concerning links with tax havens: that countries that have particular political, economic or other links with tax havens ensure that these links do not contribute to harmful tax competition and, in particular, that countries that have dependencies that are tax havens ensure that the links that they have with these tax havens are not used in a way that increase or promote harmful tax competition.
> 18. Recommendation to develop and actively promote Principles of Good Tax Administration: that the Committee be responsible for developing and actively promoting a set of principles that should guide tax administrations in the enforcement of the Recommendations included in this report.
> 19. Recommendation on associating non-member countries with the Recommendation: [t]hat the new Forum engage in a dialogue with non-member countries using, where appropriate, the fora offered by other international tax organisations, with the aim of promoting the Recommendations set out in this Chapter, including the Guidelines.

Id. (bold and italics omitted).

83. Townsend, *supra* note 10, at 243.

84. *Id*.

85. *See* 1998 OECD REPORT, *supra* note 9, at 49–50.

implementation of the Recommendations and "to encourage countries to examine the structural features of their tax systems."[86] The Forum provides "a focal point for discussion on harmful preferential tax regimes."[87] The Forum also compiled a list of tax havens and countries with harmful preferential tax regimes.[88]

B. The 2000 OECD Report

In June 2000, the Forum released *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (2000 OECD Report), a report identifying OECD member countries with harmful preferential tax regimes and providing an update on communications with non-member countries.[89] The 2000 OECD Report identifies jurisdictions it considers tax havens[90] and lists defensive measures OECD member countries can adopt against tax-haven jurisdictions that do not comply with the Recommendations.[91]

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86. *Id*. at 53–55.

87. *Id*. at 54 (stating that the Forum's purpose is to have participation from all member countries to engage in a dialogue with non-member countries to reform harmful tax systems).

88. 2000 OECD REPORT, *supra* note 9, at 10.

89. *See id.* at 5–7, 17; *see also* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT 7–9 (2001) [hereinafter 2001 PROGRESS REPORT] (noting progress in commitment discussions).

90. *See* 2000 OECD REPORT, *supra* note 9, at 16–17 (stating that the findings were the result of the study and not intended to trigger defensive measures).

91. *Id*. at 25. The proposed defensive measures are:

- To disallow deductions, exemptions, credits, or other allowances related to transactions with Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To require comprehensive information reporting rules for transactions involving Uncooperative Tax Havens or taking advantage of their harmful tax practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.
- For countries that do not have controlled foreign corporation or equivalent (CFC) rules, to consider adopting such rules, and for countries that have such rules, to ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices (Recommendation 1 of 1998 Report).

The 2000 OECD Report identified forty-seven potentially harmful preferential tax regimes in OECD member countries.[92] It is important to note that these regimes were only identified as potentially harmful because the Forum had not made an overall assessment of the harmful effects of these regimes' tax practices.[93] Therefore, the list of regimes includes countries whose systems may not actually be harmful under certain circumstances.[94] This fact increases the difficulty in classifying a country's tax regime as harmful and complicates the

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- To deny any exceptions . . . that may otherwise apply to the application of regular penalties in the case of transactions involving entities organised in Uncooperative Tax Havens or taking advantage of their harmful tax practices.
- To deny the availability of the foreign tax credit or the participation exemption with regard to distributions that are sourced from Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To impose withholding taxes on certain payments to residents of Uncooperative Tax Havens.
- To enhance audit and enforcement activities with respect to Uncooperative Tax Havens and transactions taking advantage of their harmful tax practices.
- To ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with Uncooperative Tax Havens and to transactions taking advantage of their harmful tax practices.
- Not to enter into any comprehensive income tax conventions with Uncooperative Tax Havens, and to consider terminating any such existing conventions unless certain conditions are met (Recommendation 12 of the 1998 Report).
- To deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in Uncooperative Tax Havens.
- To impose "transactional" charges or levies on certain transactions involving Uncooperative Tax Havens.

Id.

92. *Id*. at 12–14. The OECD member countries identified as having harmful preferential tax regimes are: Australia, Belgium, Canada, Finland, Germany, Greece, Hungary, Iceland, Ireland, Italy, Korea, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United States. *Id*.

93. *See id*. at 12 (stating that additional studies will allow OECD member countries to determine the harmful extent, if any, of certain regimes).

94. *Id*.

communication of guidelines to eliminate harmful practices.[95]

To better clarify what constitutes the conduct or consequences of a harmful regime, the Forum intends to develop guidelines, known as application notes.[96] "The application notes will assist [m]ember countries in determining whether preferential regimes are, or could be applied to be, harmful and in determining how to remove the harmful features of such regimes."[97]

The OECD asserts that non-member countries have an integral role in combating harmful tax competition.[98] Because the OECD views harmful tax competition as a global phenomenon, it wants non-member countries to adopt the features of the 1998 OECD Report.[99]

Applying the criteria stated in the 1998 OECD Report, the 2000 OECD Report identifies thirty-five jurisdictions as tax havens.[100] The OECD wants these jurisdictions to reform their fiscal policies to conform to the Recommendations of the 1998 OECD Report.[101] The 2000 OECD Report considers non-compliant jurisdictions to be uncooperative, which may subject them to defensive measures from OECD member countries.[102]

95. *See id.* (stating that additional studies will assist OECD member countries in determining which of their potentially harmful regimes are, or could be, actually harmful).

96. *See id*. at 15 (stating that application notes will illustrate problematic features of various tax regimes based upon criteria outlined in the 1998 OECD Report, but will not refer to specific country regimes); 2001 PROGRESS REPORT, *supra* note 89, at 6.

97. 2001 PROGRESS REPORT, *supra* note 89, at 6.

98. 2000 OECD REPORT, *supra* note 9, at 22.

99. *See id*. (stating that coordinated efforts with non-member countries would assist removal of harmful tax practices).

100. *Id*. at 17. The jurisdictions identified as tax havens are: Andorra, Anguilla, Antigua and Barbuda, Aruba, Commonwealth of the Bahamas, Bahrain, Barbados, Belize, British Virgin Islands, Cook Islands, Commonwealth of Dominica, Gibraltar, Grenada, Guernsey/Sark/Alderney, Isle of Man, Jersey, Liberia, Liechtenstein, Maldives, Marshall Islands, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, Seychelles, St. Lucia, St. Christopher and Nevis, St. Vincent and the Grenadines, Tonga, Turks and Caicos, U.S. Virgin Islands, and Vanuatu. *Id*.

101. *See id*. at 22; *see also* 1998 OECD REPORT, *supra* note 9, at 67–71 (the Recommendations).

102. *See id.* at 24–25 (providing a framework of defensive measures); *see also* 2001 PROGRESS REPORT, *supra* note 89, at 13.

However, a jurisdiction will not be considered uncooperative if it commits to transparency and effective exchange of information.[103]

To identify tax havens, the Forum analyzed information that suspected tax havens submitted about their tax systems.[104] When the Forum determined jurisdictions to have harmful practices based on submitted information, it conducted technical evaluations that served as the basis for the preliminary list of identified tax havens.[105] A country may avoid inclusion on the list by making an advance commitment to eliminate the harmful features of its tax system and to comply with the Recommendations of the 1998 OECD Report.[106] If a jurisdiction does not make an advance commitment, but wishes to demonstrate its cooperation with the OECD, a country may opt for a "scheduled commitment."[107]

IV. POSITION OF THE U.S. TREASURY

A. *Position During the Clinton Administration*

During the Clinton Administration, the United States was generally supportive of the 1998 and 2000 OECD Reports.[108] In

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103. 2001 PROGRESS REPORT, *supra* note 89, at 11. In light of concerns expressed by both member countries and tax havens, the OECD concluded that the no substantial activities test would not be used to determine whether or not a tax haven is uncooperative. *Id*. at 9–10.

104. 2000 OECD REPORT, *supra* note 9, at 10–11 (stating that information provided enabled application of 1998 OECD Report criteria for tax havens to the jurisdiction's specific situations).

105. *Id*. at 11, 17.

106. *Id*. at 16–17; *see also* Townsend, *supra* note 10, at 248–49; Goulder, *Cayman Islands*, *supra* note 40, at 231 (stating that the Cayman Islands was one of six nations that satisfied the technical criteria for tax-haven status, but avoided inclusion on the OECD tax-haven blacklist by making an advance commitment in June 2000); 2001 PROGRESS REPORT, *supra* note 89, at 9 (noting that five jurisdictions have made commitments since the 2000 Report).

107. *See* 2000 OECD REPORT, *supra* note 9, at 19 (describing "scheduled commitment" requirements); *see also* 2001 PROGRESS REPORT, *supra* note 89, at 9–11 (noting modifications to the tax haven works).

108. Vaugh E. James, *Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty*, 34 U. MIAMI INTER-AM. L. REV.

the 2001 budget proposal, the Clinton Administration proposed blacklisting certain identified tax havens.[109] This enactment would have decreased a taxpayer's otherwise allowable foreign tax credit to the extent the taxpayer's income was attributable to certain identified tax havens.[110]

B. Position During the Bush Administration

The Bush Administration has reconsidered the U.S. position on the OECD tax-competition initiative.[111] The United States supports tax competition,[112] and several legislators have spoken out against the OECD effort because of concern that the OECD initiative is destructive to tax havens' competitive status within the global economy.[113] The OECD responds that it favors tax competition and merely seeks to eradicate tax evasion so that benefits received in a country are commensurate with the tax burden imposed.[114]

Throughout these developments, the principal concerns of the United States have been twofold: (1) the need for countries to be able to obtain specific information from other countries upon request in order to prevent non-compliance with their tax laws and (2) the need to avoid interference with the internal tax policy decisions of sovereign nations.[115] The United States

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1, 45 (2002).

109. *See* Mitchell B. Weiss, *International Tax Competition: An Efficient or Inefficient Phenomenon?*, 16 AKRON TAX J. 99, 126 (2001).

110. *Id*.

111. *See* Dana Milbank, *U.S. to Abandon Crackdown on Tax Havens; OECD Effort is Too Broad and Could Raise U.S. Taxes, Treasury's O'Neill Says*, WASH. POST, May 11, 2001, at A29.

112. *See id.*

113. *See* Cordia Scott & Robert Goulder, *U.S. Congressman Owens Calls for U.S. Government to Rescind Support of OECD Tax Competition Initiative*, 22 TAX NOTES INT'L 1202, 1202 (2001) (reporting that U.S. Representative Major R. Owens, D-New York, became the first Democrat to join several Republican colleagues in asking the U.S. government to rescind its support of OECD tax-reform initiatives).

114. *See* Trevor Drury, *Center for Freedom and Prosperity Meets in Paris*, 22 TAX NOTES INT'L 1201, 1202 (2001).

115. *What Is the U.S. Position on Offshore Tax Havens: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Governmental Affairs*, 107th Cong. 49 (2001) (statement of Paul H. O'Neill, Secretary of the Treasury) [hereinafter *O'Neill Testimony*]; *see also* Hoffman, *supra* note 20, at 513 (declaring the right of

recognizes that jurisdictions with strict bank secrecy laws and non-cooperative positions on tax matters facilitate the evasion of U.S. taxes.[116] The United States also sees the potential of the OECD initiative to advance U.S. interests in this regard.[117] However, the United States is concerned that the OECD project may be too broad and could hinder, not promote, this objective.[118] Therefore, to continue supporting the OECD initiative, the United States may want to refocus the initiative away from stifling tax competition and towards emphasizing the need for countries to be able to obtain specific information from other countries in order to prevent non-compliance with tax laws.[119]

Presently, the scope of personal tax information is still under deliberation. "Some OECD members want to force tax havens to transfer automatically data on the accounts of all depositors."[120] However, opponents want to restrict exchanges of information to situations when a requesting nation can show probable cause to suspect criminal tax evasion.[121] "The Bush Administration says it hasn't reached a final position on the information-exchange issue."[122]

Assuming the true concern with tax-haven activities lies in the acts of money laundering, drug dealing, and terrorism, a less intrusive alternative to the 1998 OECD Report may be an acceptable solution for the United States. Arguably, the release and exchange of depositor and transaction information only when there is probable cause to suspect criminal activities would allow jurisdictions to maintain their tax systems while demonstrating legitimacy by opposing criminal activity within

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sovereign nations to determine internal taxation policies as an issue of negotiation between the OECD and countries engaged in harmful tax practices).

116. *O'Neill Testimony*, *supra* note 115, at 46.

117. *Id*. at 47.

118. *See id*. at 49; *see also* Rebecca Christie, *O'Neill Assails Crusade Aimed at Tax Havens*, WALL ST. J., May 11, 2001, at A8 (quoting Secretary O'Neill on U.S. involvement in OECD initiative).

119. *O'Neill Testimony*, *supra* note 115, at 49.

120. David S. Cloud, *Politics and Policy*, *Virginian Fights for International Tax Havens—Lobbyist Finds Bush Receptive to Ideas Clinton Rejected*, WALL ST. J., July 30, 2001, at A20.

121. *Id*.

122. *Id*.

their jurisdictions.[123]

V. IMPEDIMENTS TO HARMONIZATION AND THE POLICY IMPLICATIONS OF COMPETITION

A. A Divisive Document

The OECD gave its 1998 initiative the title *Harmful Tax Competition: An Emerging Global Issue*,[124] but as the question arose during recent deliberations on these matters, one may reasonably ask: "[W]ho is being harmed?"[125] In answering his own question during the August 2001 Pacific Islands Forum, President Rene Harris of Nauru stated, "I put it to you that the fact that many small island countries choose not to levy taxes on their people does not harm the people of that [sic] country."[126] The implication of these words is profound. There is a clear division between the OECD, the majority of whose member countries support the initiative, and many small island nations that constitute the list of OECD-deemed tax havens.[127] The OECD members determined the Recommendations for the OECD-deemed tax havens, and the expected result was to motivate tax-haven compliance through the unfulfilling reward of non-retaliatory OECD actions.[128] Harmonization appears to be an inherently challenging endeavor in the context of taxation among various nations, and the OECD initiative does not

123. *See* William C. Caccamise, Jr., Note, *U.S. Countermeasures Against Tax Haven Countries*, 26 COLUM. J. TRANSNAT'L L. 553, 555–56 (1988) (explaining how anonymity provided by tax havens facilitates both tax evasion and other criminal activity).

124. 1998 OECD REPORT, *supra* note 9, at 1.

125. Hoffman, *supra* note 20, at 518 (quoting the host of the August 2001 Pacific Islands Forum, President Rene Harris).

126. *Id*. at 519 (quoting the host of the August 2001 Pacific Islands Forum, President Rene Harris).

127. *See id.* at 513 (indicating that, while the OECD nations consider the initiative vital to their economies, Caribbean nations fear it will devastate their economies).

128. *See id*. (stating the OECD agreed to withdraw the "scheduled commitment" framework in exchange for proceeding with the basic reform principles—transparency, non-discrimination, and effective exchange of information); *see also* 2000 OECD REPORT, *supra* note 9, at 19 (describing "scheduled commitment" requirements).

provide a bridge to resolve the disaccord inherent in the challenges.[129] The overpowering position of the OECD as set forth in its initiative,[130] coupled with the OECD's assumption that governments, countries, and industries are fungible,[131] will lead to the imminent downfall of the initiative.[132]

It is plausible that the industrialized nations of the OECD could directly address this situation by taxing the global income of their residents and not granting tax-deferral alternatives.[133] However, one of the problems that the OECD recognizes is that "governments may find themselves in a 'prisoners dilemma' where they collectively would be better off by not offering [tax] incentives, but each feels compelled to offer the incentive to maintain a competitive business environment."[134] Essentially, the government that takes the initial step will disadvantage itself and its taxpayers; therefore, no country will want to proceed with this alternative.[135] Accordingly, the industrialized nations are limited to attempts at working within the framework of the 1998 OECD Report.[136]

The 1998 and 2000 OECD Reports clearly present an intrusive solution through non-traditional fiscal remedies.[137]

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129. *See* Roin, *supra* note 31, at 548–49; 1998 OECD REPORT, *supra* note 9, at 41–42.

130. *See* 1998 OECD REPORT, *supra* note 9, app. at 67–71.

131. *But see* Roin, *supra* note 31, at 555 (arguing that harmonization among jurisdictional taxation systems should not be expected because the harmonization argument assumes that governments, countries, and industries are essentially fungible when, in fact, they are not).

132. *See* Weiss, *supra* note 109, at 124.

133. *See* Cynthia A. Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705, 748 (2002) (discussing impediments to global economic equality); 1998 OECD REPORT *supra* note 9, at 37, 40–41.

134. Williams, *supra* note 133, at 748 (quoting ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 34 (1998)).

135. *See id*. (recognizing that globalization may be expected to constrain governmental choice of tax structures because internationally mobile investors can easily avoid taxes levied in particular countries).

136. *See id.* (recognizing that governments are constrained in what taxes they can impose, given the competition for capital); 1998 OECD REPORT, *supra* note 9, at 37, 39–40.

137. Townsend, *supra* note 10, at 251.

Countries typically use treaties to address international fiscal issues because treaties allow for the resolution of common issues without infringing upon national fiscal sovereignty.[138] Although the OECD hopes to reform the tax systems of these tax-competitive nations and to deter the current influx of capital into these markets, it eschews a cooperative approach in favor of a coercive one.[139] The OECD members, generally the most industrialized nations of the world, economically dominate smaller, less-developed nations and compel them to alter their respective tax laws.[140] This economic influence removes any possibility of harmonization and instead retains monopolization and domination of the global economy.[141]

It is difficult to determine what the OECD labels as voluntary compliance in its Recommendations when the threat of defensive measures tends to coerce targeted jurisdictions.[142] The jurisdictions on the OECD tax-haven list are economically weaker than and more dependent on OECD member countries as trading partners.[143] The lack of resources and labor that challenges the typical tax-haven jurisdiction requires it to depend on goods and resources from the more industrialized nations of the OECD.[144] The limitations imposed on tax-haven jurisdictions' economies extinguish most viable possibilities for them to develop globally-competitive economies.[145] The economically dependent position in which tax havens are trapped makes it difficult to refuse OECD demands.[146]

138. *Id*. at 251 n.217.

139. *Id*. at 217–18.

140. *Id*.

141. *See id*. (arguing that the OECD uses monopolistic and dominating economic influence over developing nations).

142. *Id*. at 252.

143. *Id*.

144. *Id*. at 252–53.

145. *See id.* at 253.

146. *See id*. (arguing that "this weaker and more reliant position of tax competitive nations hardly places them in any position to refuse to the OECD's monopolizing demands").

B. A One-Sided Effort

Another shortcoming of the 1998 and 2000 OECD Reports is that they do not incorporate the interests and concerns of the targeted nations; they focus instead only on the interests of OECD member countries.[147] In fact, no effective consultations with tax-haven jurisdictions occurred during the drafting of the 1998 OECD Report, which contained the Recommendations.[148] After the publication of the 1998 OECD Report, the only OECD communication with non-member tax-haven jurisdictions consisted of advice as to compliance with the OECD-established Recommendations and acknowledgement of jurisdictions that agreed to comply.[149] This approach completely undermines the notion of a nation's fiscal sovereignty and invites repercussions that benefit no one.[150] For example, harmonization will lead directly to higher transaction costs, thereby producing lower returns on invested capital.[151] Tax havens will become more dependent on foreign aid because of a loss of foreign capital investment, leading to a higher financial burden on developed countries to support and maintain the economies of developing countries.[152]

C. Vagueness Impedes Effectiveness

The vagueness of the 1998 and 2000 OECD Reports is another limitation to the tax-competition initiative.[153] In determining whether a jurisdiction has a low or nominal tax rate, the 1998 OECD Report fails to provide an exact figure or range that would determine the threshold.[154] For example, in the Tax Reform Act of 1986, the U.S. Congress reduced the

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147. *See id*. at 255 (noting that the 1998 and 2000 OECD Reports take an "OECD-centered approach" omitting many interests in the world).

148. *See id*.

149. *See id*.

150. *See id*. at 257.

151. *See id*. at 256.

152. S*ee id*. at 257 (asserting that tax competition allows developing nations to build their economies without relying on subsidies from more industrialized nations).

153. *See, e.g.*, *id*. at 255–56.

154. *See id*. at 256 (expressing the need for an example of an appropriate tax rate to guide jurisdictions).

maximum marginal rate on corporate income to thirty-four percent.[155] Compared to other industrialized nations at the time, this rate was low.[156] However, the United States has not found itself a target, even though it likely diverts significant revenue from other nations due to firms seeking the greatest return on their capital.[157]

Additionally, the tax-haven criterion of no substantial activities lacks determinative guidelines and allows a subjective interpretation of what is substantial.[158] The OECD fails to specify what factors are definite indicators of tax havens or what relative weights to attribute to the various factors.[159] This indeterminacy, coupled with the OECD's admission that "the concept of 'tax haven' does not have a precise technical meaning,"[160] greatly diminishes any credibility that the tax-competition initiative has and leads to arbitrary and subjective application.[161]

In support of this contention, commentators have observed that many industrialized nations—including the United States and the United Kingdom—technically satisfy the OECD criteria for a tax haven.[162] In addition to the absence of a withholding tax for interest earned on non-resident bank deposits,[163] U.S. tax authorities maintain full information-exchange practices only

155. Tax Reform Act of 1986, Pub. L. No. 99-514, § 601, 100 Stat. 2085 (1986).

156. Brown, *supra* note 1, at 316 (stating that 34% was a comparatively low marginal corporate tax rate).

157. *See* Weiss, *supra* note 106, at 108 (providing Latin American countries as examples).

158. Townsend, *supra* note 10, at 256.

159. Weiss, *supra* note 109, at 124.

160. *Id*. (quoting the 1998 OECD Report, and noting that the Report is "peppered with qualifiers").

161. *See id.* (declaring the OECD's attempt to curb tax competition through identifying harmful tax competition, harmful tax practices, and tax preference schemes without concrete definitions is obviously weak and doomed to fail).

162. Robert Goulder, *U.S. Congressional Staffer; Opposition to OECD Tax Haven Campaign May Be Growing in Washington*, 22 TAX NOTES INT'L 236, 236 (2001) [hereinafter Goulder, *Opposition to OECD*] (describing a presentation by Bruce Zagaris during a symposium hosted by the Center for Freedom and Prosperity).

163. *See* Weiss, *supra* note 109, at 106 n.19 ("[F]oreign persons are generally not subject to U.S. tax on their U.S.-source capital gains . . . .").

with Canada.[164] Thus, when it appears that OECD member countries seek to impose certain standards on OECD-deemed tax-haven jurisdictions that they do not impose on themselves, it is difficult to justify constructive efforts to harmonize tax practices.[165] For these reasons, harmonization appears unlikely in the context of taxation among various nations.

D. Potential Consequences of the 1998 OECD Report

After considering the pitfalls of attempting harmonization, it is appropriate to consider the inherent harmony that a competitive approach offers. Countries vary in many different ways; some of these differences attract investors.[166] These competitive advantages should be exploited—not stifled—for the greatest return on capital.[167]

Some commentators believe that the OECD efforts to contain tax competition will stifle overall global economic development.[168] In an effort to curb tax-revenue depletion from the effects of tax competition, industrialized nations may be reinforcing the economic dependence of developing nations.[169] Some tax-haven countries fear the OECD initiative could cause as much as a twenty-five percent drop in their Gross Domestic Product because their economies are so dependent on the financial industry.[170] Tax competition benefits developing

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164. Goulder, *Opposition to OECD*, *supra* note 162, at 236.

165. *See* Brown, *supra* note 1, at 315 (stating the 1998 OECD Report constructs its arguments from the isolated perspective of the developed world and excludes some of the practices of developed countries that are OECD members; implying also that developing countries who lacked input into the 1998 OECD Report do not support it or its policies).

166. *See* Roin, *supra* note 31, at 561 (suggesting that certain differences among countries are very important to investors).

167. *See id.* at 555 (pointing out that the development of options is encouraged at the consumer level and should not be undesirable at the investor level).

168. Townsend, *supra* note 10, at 256 (arguing that tax treaties help alleviate the harmful effects of double taxation and that tax incentives to business enterprises encourage international development).

169. *Id.* at 257 (stating that effective and sustainable economic development is most beneficial when it is internally generated and not when in the form of aid from industrialized nations).

170. Hoffman, *supra* note 20, at 513 (stating Caribbean nations fear the OECD efforts will devastate their economies).

nations by allowing them to build their economies without relying on subsidies from more industrialized nations.[171] Industrialized nations' efforts at utilizing tax harmonization to prevent tax revenues from escaping into tax-haven economies could have the unintended effect of decreasing transactions because of the higher tax consequences.[172] OECD regulations could invite corruption and high crime rates that would devastate the tourist industries in these jurisdictions and force tax havens to rely on foreign aid.[173]

Other commentators anticipate that structural deficiencies of the 1998 OECD Report will only have the opposite effect of OECD intentions.[174] Specifically, if all OECD member countries enact controlled-foreign-corporation (CFC) and foreign-investment-fund (FIF) provisions and the FIF or parent corporation is located in an OECD member country, the provisions may subject individual or corporate shareholders to current tax on certain types of income.[175] Therefore, the 1998 OECD Report will merely cause entities and capital to shift away from OECD member countries to tax-haven jurisdictions where books and records remain inaccessible to outside authorities.[176] Without access to the books and records, tax authorities of OECD member countries cannot apply the CFC and FIF rules to impose tax on income generated in the tax-haven jurisdiction.[177]

171. Townsend, *supra* note 10, at 257.

172. *See id.* at 256 (stating the OECD's effort to curb tax competition is likely to hinder overall global economic development).

173. Hoffman, *supra* note 20, at 513 (stating that Caribbean financiers fear a "domino effect" from the OECD efforts and the subsequent devastation of the nation's industries).

174. *See* Weiss, *supra* note 109, at 125 (declaring that non-member states will become the main benefactors of the agreement, contrary to its intended purpose).

175. *Id*.

176. *See id*. at 125–26 (arguing that the flaws in the OECD approach to curbing tax competition will merely cause a shift away from OECD member states and make the tax havens look even more attractive for capital investment).

177. *See id.* (stating that before a member state can determine if anti-deferral provisions apply, it must have access to a foreign entity's books).

E. Lack of Equitable Application

It is worth noting that developing nations are not the only ones that offer tax incentives to attract foreign investments and capital.[178] In 1984, the U.S. Congress abolished the thirty percent withholding tax previously imposed on non-resident aliens' portfolio-interest income and the thirty percent withholding tax on capital gains that applied to certain non-resident aliens present in the United States.[179] Arguably, this tax incentive to foreign-portfolio investments that the United States offers makes it one of the world's most profitable tax havens.[180] As a consequence of the U.S. Congress repealing the portfolio-interest-withholding tax, the United States attracted an estimated three hundred billion dollars away from Latin American countries.[181] Despite this kind of tax-competitive behavior, the OECD has not targeted U.S. tax practices. This failure raises questions regarding the credibility of primarily targeting developing countries.[182] Without clearly defined thresholds for satisfactory tax rates,[183] the equitable application of the OECD Recommendations appears challenging and an economically powerful country, such as the United States, may use the tax initiative to extend its global economic domination over developing nations.[184] For these reasons, competition is the most appropriate alternative to address the situation.

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178. *See id.* at 105 (providing the United States as an example).

179. *Id.* at 105–06 (describing significant tax cuts leading to a massive budgetary deficit that could only be financed from abroad and that were addressed as part of the Tax Reform Act of 1986).

180. *Id*. at 107.

181. *Id*. at 108.

182. *See* Brown, *supra* note 1, at 314 (arguing that the 1998 OECD Report does not acknowledge the dominance of tax regimes of many developed countries, such as the United States, and their influence on the economies of developing countries).

183. *See id*. at 316–17 (stating that the 1998 OECD report fails to distinguish between the practice of imposing excessively low income tax rates and a system that collects revenues from a generally imposed income tax, but has preferential features for selected types of income).

184. *See id.* at 315.

VI. CONCLUSION

Based on these arguments, the OECD findings are fundamentally flawed; the lack of involvement of the OECD-deemed tax havens in tax-harmonization deliberations undermines the credibility of the 1998 OECD Report. A nation's resources and competitive advantages rightly determine the most appropriate revenue-generating policies affecting investment in the global marketplace. Competition allows a nation to structure its affairs to best serve its interests and to capitalize on its competitive advantages, while simultaneously providing the opportunity for other nations to receive the highest return on capital. Though investment capital may be displaced, the notion of sovereignty dictates that a nation best determines the structure of its own affairs; competition will be the means through which investors determine the best investment location for the greatest return on their capital.