WRITTEN TESTIMONY OF JEFFREY OWENS, DIRECTOR, OECD CENTER FOR TAX POLICY AND ADMINISTRATION BEFORE SENATE FINANCE COMMITTEE ON OFFSHORE TAX EVASION
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Chairman Baucus, Senator Grassley, members of the Committee, it is an honor for the Organization for Economic Co-operation and Development[1] to be invited to testify before you today on the subject of offshore tax evasion. Improving compliance, both on and offshore, is a major objective of our member countries and for many other countries.

By way of background, I am the Director of the OECD's Centre for Tax Policy and Administration ("CTPA"). The CTPA's tax experts support the work of the Committee on Fiscal Affairs, which leads the OECD's work on taxation issues. The Committee brings together senior tax policy and tax administration officials from the United States and 29 other member countries. The OECD is widely recognized as the main international standard setting body in the tax area and provides a valuable forum at which governments can exchange views on tax policy issues and develop best practices in the tax administration area.

The Committee on Fiscal Affairs has a long history of helping governments to design international rules to minimize frictions between national tax systems and to avoid double taxation or double non-taxation of cross-border activities. The OECD Model Tax Convention, which incorporates many of these rules, forms the basis for over 2700 bilateral tax treaties around the world. The Committee also provides comparative information and analysis on the operation of tax systems to help governments make informed choices on how best to design their tax systems. Recent examples of the scope of our work include a report on tax reform trends, the tax treatment of foreign direct investment, the taxation of pensions, encouraging savings through tax preferred accounts, taxing wages, and the political economy of environmental taxes. The OECD has also been at the forefront of encouraging countries to deny the tax deductibility of bribes paid to foreign public officials. Over the last four years we have intensified our work on improving the efficiency of tax administrations resulting in the publication of 26 comparative studies and best practice guidelines on topics ranging from taxpayers' rights to audit selection techniques. One of the unique outputs from this work is a comparative analysis of the structure and performance of revenue bodies in more than forty countries. Throughout this work, the OECD involves non-OECD economies and particularly the BRICS (Brazil, Russia, India, China and South Africa) in a variety of ways and we now have twenty-five non-OECD countries that have set out their positions on the OECD Model Tax Convention.

All of this work is intended to help governments design tax systems that encourage economic growth, produce a fair distribution of the tax burden, minimize tax compliance costs for taxpayers and at the same time ensure that taxpayers pay the right amount of tax, at the right time and in the right place. We at the OECD support tax reforms which lower rates and broaden the tax base. We support tax competition that is based on the service provided but not on the basis of secrecy. The OECD has consistently pursued a pro-competition agenda, including in the tax area. Our work on trade and investment liberalization and export credits are just a few examples. Our project on harmful tax practices is aimed at anti-competitive practices. It is focused on promoting international co-operation through exchange of information and providing a transparent, non-discriminatory fiscal environment within which real tax competition can flourish and where competition on the basis of excessive secrecy is eliminated.

[1] The OECD is made up of 30 market-based democracies: All NAFTA members, four Asian-Pacific countries (Australia, Japan, Korea and New Zealand) and 23 European countries. In the tax area, the OECD has regular dialogue with over 70 non-OECD economies.

Offshore tax evasion is a multifaceted problem which requires a variety of responses at both the national and international levels. There is no silver bullet. A long term strategic approach is required to ensure that the right legislative framework is in place, that tax administrations have the necessary information, tools and resources to address the problem and that bilateral and multilateral co-operation is intensified.

I am pleased to be here today to share with you the OECD's work on these issues and some of the solutions adopted in individual OECD countries.

I. OFFSHORE TAX EVASION: A GROWING PROBLEM

Offshore tax evasion is not about small islands that do not impose income taxes: it is about all countries that lack transparency and that are not prepared to cooperate to counter tax abuse. These practices make it difficult for other countries to enforce their own tax laws. With globally integrated financial markets and modern communication techniques the creation of offshore financial accounts, shell companies and the like are just the click of a mouse away. In this context, countries can no longer rely exclusively on their own sources of information to ensure compliance with their domestic tax laws. This is true for all countries, whether OECD or non-OECD, developed and developing, large or small, that rely on income taxes to fund the necessary governmental expenditures voted for by their national legislatures.

In this new era of "banking without borders", wealthy individuals can easily evade capital income taxes in their country of residence by transferring capital abroad and channeling passive investments through offshore jurisdictions. This type of tax evasion is facilitated by the existence of jurisdictions with strict bank secrecy rules which prevent information exchange with the residence country, the increased recourse to foreign institutional investors and shell companies with opaque structures based in offshore financial centers can make it very difficult for domestic tax authorities to track capital income. With the growth of cross-border capital flows, the potential for abuse created by the lack of access to bank information for tax purposes and the resulting adverse consequences have increased exponentially. At the same time, tax authorities find it more and more difficult to monitor foreign portfolio investments of their residents because of the removal of traditional sources of information on these transactions (e.g. exchange controls). Thus, a decision by one country to prevent or restrict access to bank information for tax purposes is now more likely than ever before to adversely affect tax administrations of other countries.

Furthermore, the progressive elimination of withholding taxes at source on non-residents' portfolio investment income allows more and more taxpayers to escape all forms of capital income taxes. Quite often, even when investing in their own countries, resident investors use foreign financial intermediaries and corporate or trust vehicles based in secrecy jurisdictions or offshore financial centers to disguise themselves as non-residents to evade domestic taxes. Thus, for example, an increasing proportion of investment into Asia is channeled through structures established in the British Virgin Islands. Even more significant is the possible use of bank secrecy jurisdictions to escape domestic taxes on income and wealth originating domestically (business income, substantial gains on the sale of assets, inherited wealth, etc.) that represent the "*principal*" of the foreign investment.

We know the offshore evasion problem is big but we do not have a precise estimate of the amount of tax at risk. Given that the main reason that tax evaders go offshore is the secrecy provided to enable them to hide their assets and income from their tax authorities, this is not surprising. We can approach the issue by looking at the size of the offshore sector and its tremendous growth over the last decade:

- Using data from the BIS, IMF and OECD, we estimate that a total of $5-7 trillion is held offshore.
- Brazil reports a commercial deficit of 4 billion dollars with the Caribbean islands.
- Singapore has now joined Luxemburg and Switzerland as the top private wealth centers of the world.

- The Bahamas is now ranked among the top five locations in the world for offshore mutual funds and trust funds and has also developed a significant inter-bank market.
- The Cayman Islands are the world's fifth largest banking center, and the first among offshore jurisdictions, with a prominent position both in the inter-bank business and in private banking.
- The British Virgin Islands has developed into one of the most successful centers for International Business Companies. Conservative estimates put the number of shell companies at over 300,000.

In recent years, the demand for offshore facilities has considerably expanded, owing to the high growth rates of cross-border investment and to the increased number of wealthy and not so wealthy individuals who are prepared to use the new technological and communication infrastructures to go offshore. There is also a growing use of multiple layers of transactions to structure offshore operations through vehicles located in different countries. The gradual relaxation of reserve requirements, interest rate controls and capital controls in the main "onshore" markets and the creation of offshore banking facilities in some of the main industrial countries (the US and Japan) have reduced the regulatory advantages of offshore financial centers, making them less attractive for conventional banking. In some respects, every country has an offshore element On the other hand, the tax avoidance facilities of offshore financial centers have become more and more important, particularly for foreign direct investment and asset management.[2] The limited initial investments needed to enter the offshore industry have induced new countries, especially the smaller ones, to implement the "offshore package" of financial services and asset protection products to compete for internationally mobile capital. As a result, the number of offshore financial centers has grown significantly.

Of course, many of these offshore holdings and arrangements are undertaken for sound commercial and legitimate tax planning reasons, without any intent to conceal income or assets from the home country tax authorities. The experiences of tax authorities, however, lead them to believe that much of this money is there to evade or avoid tax.

Some recent initiatives in OECD member countries bear this out:

- Ireland collected almost 840 million euros ($1.14 billion) from about 15,000 Irish residents hiding undeclared income in offshore bank accounts. This may not seem like a big number in the US context but it amounts to about 8% of total 2006 income tax collected and almost 30% of 2006 income tax collected from self-employed taxpayers. Ireland is currently negotiating tax information exchange agreements with some of these jurisdictions.

- In Italy, a recent tax amnesty resulted in the disclosure of 75 billion euros ($102 billion) in assets held offshore.

- The United Kingdom has just launched an offshore compliance initiative which the accounting firm, Grant Thornton, estimates could bring in 5 billion pounds ($10 billion) in back taxes, interest and penalties, which is almost 4 % of income tax receipts.

- South Africa has estimated that it is losing 64 billion rand ($ 9.1 billion) to tax havens.

- The Australian government recently approved more than $250 million for a multi-agency operation to address the promotion of and involvement in offshore tax evasion schemes. The potential loss of tax revenue from the schemes involving one promoter alone was estimated as exceeding $ 208 million.

[2] With reference to this latter market, the possibility of reducing inheritance and other capital taxes for individual investors acts as a prime incentive and has led to a large expansion in offshore fund management activity, in particular by the use of investment vehicles such as trusts and private companies.

The debate over improving offshore compliance is part of the broader debate on how to narrow the overall tax gap. Our research reveals that only four OECD countries (Mexico, Sweden, the United Kingdom and the United States) regularly publish estimates of the tax gap.[3] Discussions in the OECD's Forum on Tax Administration suggest that tax administrations will never be able to collect every dollar of tax due. In fact, it can be argued that this should not be the goal since the measures required to do this would be so intrusive as to lead taxpayers to revolt.

On the basis of the limited amount of information available, the US tax gap (approximately 14% of the estimated tax base) is consistent with the VAT gap calculated in the United Kingdom,[4] above the overall tax gap estimates in Sweden (6-9%) and significantly below the gap estimates in Mexico (35%).

II. THE BROADER POLICY IMPLICATIONS OF OFFSHORE EVASION

Offshore tax evasion has effects that go beyond the lost revenue of the tax evaded. Offshore tax evasion undermines the fairness and integrity of national tax systems and adversely affects the willingness of the vast majority of law abiding taxpayers to voluntarily comply with their tax obligations. Public attitudes to tax compliance are heavily influenced by perception and the "voluntary" element of compliance can be badly eroded if a minority of taxpayers, usually those with significant incomes, can evade or are perceived to be evading their taxes by hiding assets offshore**.**

Furthermore, tax evasion by some restricts the ability of governments to lower tax rates for all. As Treasury Secretary Paulson put it recently in testimony before this Committee, "when people fail to pay their taxes, it serves as a de facto tax increase on everyone else." [5]

Competition on the basis of secrecy and lack of tax co-operation reduces global welfare since decisions on where to locate funds are driven by the ease of evasion and not by the true economic return on capital. This is especially true once the gross returns have been adjusted to reflect the often substantial fees of scheme promoters, arrangers, advisors, offshore trustees, nominees etc.

Excessive bank secrecy and a lack of bilateral tax co-operation is particularly serious for developing countries where offshore tax evasion may erode already weak tax bases, which can seriously undermine their ability to make the vital investments in social services and economic infrastructure upon which sustainable economic development depends. Excessive bank secrecy and an unwillingness of countries to cooperate to counter tax abuse undermine the national fiscal sovereignty of other countries. In a global environment, individual governments can maintain sovereignty over the design of their respective tax systems only insofar as they can count on the cooperation of other governments to share information needed to enforce their tax policy choices: choices which reflect their economic, social and political preferences. This is true even for countries that have a territorial system of taxation because income derived in such countries can still be hidden offshore.

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[3] One reason why countries are reluctant to calculate any possible tax gap is that there is no agreed methodology to measure the gap. OECD is currently undertaking work in this area.

[4] VAT accounts for 20% of tax revenue in the UK.

[5] Testimony of Treasury Secretary Henry M. Paulson, Jr. before the Senate Finance Committee on Ways to Reduce the Tax Gap, April 18, 2007.

III. COUNTERING OFFSHORE NON-COMPLIANCE

A. OECD Tax Haven Initiative

The removal of barriers to cross-border trade, the liberalization of financial markets and new communications technologies have had very positive effects on global growth but have also opened up opportunities for money laundering, misuse of corporate vehicles, tax abuses and increased the threat to the stability of the financial system. All of these activities thrive in a climate of secrecy, non-transparency, and lack of bilateral and multilateral co-operation. Not surprisingly, the various initiatives launched by the international community to respond to these threats – the Financial Action Task Force, the Financial Stability Forum and the OECD's tax haven initiative -- have focused on improving transparency, exchange of information and other forms of international co-operation.

The OECD has consistently advocated exchange of information between countries as part of tax treaty policy. However, its efforts to promote exchange of information vis-à-vis offshore jurisdictions were stepped up in the context of its harmful tax practices initiative launched in 1998. The initiative looked at both potentially harmful preferential tax regimes in member countries and at tax havens. In 2000, the OECD reinforced this initiative by publishing a new standard of access to bank information for tax authorities, which included a set of measures that needed to be taken by the small minority of OECD countries that did not meet that standard.[6] Given the time constraints, I will not go into the details of all of our work on harmful tax practices or on improving access to bank information for tax purposes. A number of reports on these topics have been prepared over the years and they are available on our website www.oecd.org\ctp. I would also be pleased to provide more detailed information that may be useful to the Committee after today's hearing.

The term "tax haven"[7] is widely used but means different things to different people. For some, it simply means a low or no tax jurisdiction. For others, it means a secrecy jurisdiction. At the OECD, we decided to establish objective criteria to identify tax havens and these can be summarized as follows:[8]

i. No or nominal taxation on the relevant income. Why? Tax cheats generally don't try to hide money in places where it will be subject to significant taxation. No or nominal taxation is the starting point of the analysis but is never sufficient by itself to identify a tax haven.
ii. Lack of effective exchange of information for tax purposes.
iii. Lack of transparency of the tax or regulatory regime (e.g. excessive banking secrecy; inadequate access to beneficial ownership information, etc.) which may limit the availability of, or the access to, information when it is needed for tax examinations or investigations.
iv. Lack of a requirement that activities be substantial (e.g. shell companies).

Lack of transparency and lack of effective exchange of information are the key attractions for tax cheats because they can place their assets in a jurisdiction with these features in the knowledge that information

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[6] OECD (2000), *Improving Access to Bank Information for Tax Purposes;* OECD (2003), *Improving Access to Bank Information for Tax Purposes - The 2003 Progress Report*.

[7] Since 2000, the OECD has referred to offshore financial centers that have committed to improve transparency and to establish effective exchange of information as "Participating Partners".

[8] For more details on the definition of the term tax haven see 1998 OECD Report "*Harmful Tax Competition – An Emerging Global Issue*". Switzerland and Luxemburg abstained on the approval of that 1998 Report and their abstentions also apply to any follow up work undertaken. The report is available on www.oecd.org/taxation.

on their activities will not be disclosed to the tax authorities back home. They are also the key factors in identifying tax havens.[9]

Using the criteria referred to above, in 2000 the OECD issued a list of 35 jurisdictions which met the criteria (see Box I). A decision was taken not to include Bermuda, Cyprus, Cayman Islands, Malta, Mauritius and San Marino because prior to the issuing of the list, these jurisdiction made high level political commitments to implement the principles of transparency and effective exchange of information.

Box I

OECD 2000 TAX HAVEN LIST

Andorra
Anguilla – Overseas Territory of the United Kingdom
Antigua and Barbuda
Aruba - Kingdom of the Netherlands[1]
Commonwealth of the Bahamas
Bahrain
Barbados
Belize
British Virgin Islands – Overseas Territory of the United Kingdom
Cook Islands – New Zealand[2]
The Commonwealth of Dominica
Gibraltar – Overseas Territory of the United Kingdom
Grenada
Guernsey/Sark/Alderney – Dependency of the British Crown
Isle of Man – Dependency of the British Crown
Jersey – Dependency of the British Crown
Liberia
The Principality of Liechtenstein
The Republic of the Maldives
The Republic of the Marshall Islands
The Principality of Monaco
Montserrat – Overseas Territory of the United Kingdom
The Republic of Nauru
Netherlands Antilles – Kingdom of the Netherlands[1]
Niue – New Zealand[2]
Panama
Samoa
The Republic of the Seychelles
St Lucia
The Federation of St. Christopher & Nevis
St. Vincent and the Grenadines
Tonga
Turks & Caicos – Overseas Territory of the United Kingdom
US Virgin Islands – External Territory of the United States
The Republic of Vanuatu

[1] The Netherlands, the Netherlands Antilles, and Aruba are the three countries of the Kingdom of the Netherlands.
[2] Fully self-governing country in free association with New Zealand.

The 2000 Report made it clear that the listing was intended to reflect the technical conclusions of the Committee only and was not intended to be condemnatory. Rather, a further list was to be developed for that purpose (the "list of uncooperative tax havens"). Jurisdictions that made a commitment to implement the principles of transparency and effective exchange of information were not to be included on that list. A total of 33 jurisdictions (including Bermuda, Cyprus, Cayman Islands, Malta, Mauritius and San Marino)

[9] Because the lack of substantial activities criterion proved difficult to apply objectively, it was not used as a basis for determining whether a jurisdiction was unco-operative. See (OECD 2001), *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report.*

made such commitments,[10] leaving only five jurisdictions currently on the OECD's list of unco-operative tax havens (Box II). [11]

Box II **OECD LIST OF UNCO-OPERATIVE TAX HAVENS**	
Andorra	Monaco
Liberia	Marshall Islands
Liechtenstein	

Since the publication of the 2000 list, all the jurisdictions that have made commitments have been invited to participate in the OECD's "Global Forum on Taxation." The discussions in the Global Forum have lead to the development of high standards in the areas of transparency and exchange of information. These standards are embodied in the "2002 Model Agreement on Exchange of Information in Tax Matters" and in the 2006 report, "Tax Co-operation: Towards a Level Playing Field."

The publication of that report, which was the result of collaboration by 82 countries and jurisdictions, represents a major milestone in the international discussions between offshore and onshore financial centers. For the first time, we have available a comprehensive compilation of the transparency and exchange of information practices of these centers. OECD governments' policies towards offshore jurisdictions can now be based upon facts rather than perception of how far each jurisdiction meets the internationally agreed standards for transparency and information exchange in the tax area. Some of the conclusions that emerge from the Report are:

- There are only 5 countries (Cyprus, Hong Kong, Malaysia, the Philippines and Singapore) that require a domestic tax interest in order to obtain and respond to a request from a treaty partner for information.
- Of the countries that are able to exchange information for both civil and criminal tax purposes, the vast majority of the countries reviewed are able to obtain and provide banking information in response to a request for information related to a criminal tax matter in some or all cases. Only three countries (Guatemala, Nauru and Panama) are unable to obtain bank information for any tax information exchange purposes and a small minority of countries limit their exchanges to serious tax fraud (e.g. Andorra, Liechtenstein, Luxembourg and Switzerland).
- 74 of the countries reviewed reported that ownership information is available for companies and 45 countries reported it was available with respect to partnerships. In most cases, legal ownership information is available. Beneficial ownership information is available in an increasing number of countries.
- All countries reviewed treated as confidential any information received pursuant to tax treaties and tax information exchange agreements (TIEAs).

What is clear from the review undertaken is that considerable progress has been made since 2000. For example, Jersey and Guernsey have implemented high standards of transparency and 12 TIEAs have been signed. There is no longer any OECD country where a domestic tax interest, of itself, is an impediment to exchange of information. Many countries have improved transparency by implementing the FATF

[10] The text of every commitment is available on the OECD website. See www.oecd.org/taxation.

[11] Barbados was not included in the list of unco-operative tax havens because it had transparency, was already engaged in effective exchange of information with OECD countries, and because it is willing to enter into tax information exchange arrangements with the OECD countries with which it currently does not have such arrangements. The Committee also subsequently determined that the Maldives and Tonga should not be considered tax havens.

customer due diligence requirements and several countries have recently required bearer shares to be immobilized or held by an approved custodian. Nevertheless, progress is still needed, particularly in the following areas:

> (i) Further progress is required in some jurisdictions and countries to address the constraints placed on international co-operation to counter criminal tax abuses. In today's global environment it is essential for all countries to co-operate with other countries in the fight against all financial crimes, including tax crimes, and this requires the implementation of transparency and the establishment of effective exchange of information mechanisms.
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> (ii) Further progress is required to address those instances where offshore financial centers require a domestic tax interest to obtain and provide information in response to a specific request for information related to a tax matter. A domestic tax interest requirement, particularly in countries with a territorial tax system such as Hong Kong and Singapore, can seriously limit the information that can be exchanged because it is unlikely that the requesting and requested countries will both have an interest in the same information, taxpayer, tax year, etc.
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> (iii) Although most countries reported being able to obtain bank information for criminal tax matters, four OECD and several non-OECD countries continue to have strict limits on access to bank information which excessively constrain their ability to respond to specific requests for information in civil and criminal tax cases.
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> (iv) Further progress is required in some countries to ensure that competent authorities have appropriate powers to obtain information for civil and criminal tax purposes. Although the majority of countries have such powers, some non-OECD countries reported limitations on the use of their information-gathering powers to the onshore sector or otherwise lack the power to obtain information for exchange of information purposes.
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> (v) Most countries have access to legal ownership information of companies, trusts, partnerships, foundations and other organizational structures. Beneficial ownership information is available in a far fewer, but an increasing, number of countries. Further improvement is necessary. A large number of countries still allow bearer shares. In some countries the availability of ownership information is further complicated by the fact that responsibility for corporate law is in the hands of political sub-divisions. Progress in this area is expected to be assisted by countries' implementation of Recommendations 5, 33 and 34 of the FATF Recommendations and other international initiatives (e.g. EU Second and Third Money Laundering Directives[12]).

As a result of the OECD initiative we now have in place globally endorsed standards, a framework for constructive dialogue with offshore centers, a fact-based evaluation of how countries measure up to the standards and countries have the means (i.e. primarily TIEAs) to implement those standards.

Status of TIEA Negotiations

All of the jurisdictions that made a commitment to the OECD agreed to establish effective exchange of information on a bilateral basis with interested OECD member countries. The United States in particular has a long history of trying to improve exchange of information for tax purposes through the use of TIEAs going back to the Caribbean Basin Initiative launched in 1984 by the Reagan administration.

[12] The EU Second Money Laundering Directive has been transposed into the domestic law of all EU Member States. The EU Third Money Laundering Directive has been adopted by the Council of Economic and Finance Ministers and must be transposed into the domestic law of the Member States by December 15, 2007.

TIEAs are not just important because they permit the IRS to obtain, upon request, ownership, accounting, banking and other relevant information, but also because they send an important signal to those considering cheating on their taxes: you can no longer hide behind the veil of secrecy and lack of cooperation. TIEAs have, therefore, an important deterrent effect.

Since 2000, a total of 12 TIEAs have been signed between OECD countries and offshore jurisdictions: the United States has signed nine,[13] Australia three, the Netherlands and New Zealand one each.[14] More than 40 bilateral negotiations are currently ongoing.

Despite this progress, there are a small number of jurisdictions that have systematically refused requests by OECD countries to negotiate TIEAs, even though they committed to doing so. There have also been some jurisdictions that are prolonging the negotiations in the hope of obtaining full tax treaties, even where the jurisdiction does not impose income taxes and there are some countries that still refuse to endorse the standards (e.g. Andorra, Liberia, Liechtenstein, Marshall Islands, Monaco and Singapore). It is now critical to ensure that all negotiations come to a successful conclusion within a reasonable time period. It is also important to recognize those jurisdictions that have implemented transparency and signed TIEAs with effective exchange of information provisions.

The negotiation of TIEAs is a bilateral process that permits the contracting parties to take account of the totality of their bilateral relations, their respective legal systems and practices and their mutual economic interests. In the vast majority of cases where bilateral arrangements exist for effective exchange of information for both civil and criminal tax matters, the parties derive mutual benefits from the arrangement either as a result of a likely balance in the exchange of information or through other benefits. The nature of such benefits would necessarily depend on the legal systems and particular circumstances of the two parties to the arrangement. One of the obvious benefits for a jurisdiction in signing TIEAs is enhancement of its reputation as a legitimate financial center. Some countries, such as Australia and New Zealand, have agreed to include as part of their TIEA arrangements provisions for the allocation of taxing rights with respect to certain types of income earned by individuals (e.g. pensions, government services, students or business apprentices) and have also provided a mutual agreement procedure to deal with transfer pricing adjustments. Canada, as discussed further below, is proposing to extend an exemption from Canadian tax on active foreign source income to income earned in a country that has signed a TIEA. Other countries may consider providing non-tax benefits such as access to universities. What is clear, however, is that OECD countries are generally unwilling to enter into comprehensive tax treaties with tax havens.

Some of the smaller offshore jurisdictions will require assistance in replacing their "concealment center" activities by other real economic activities which can ensure the long term viability of these economies. This will require a "whole of government" approach from OECD countries that takes into account a number of different dimensions. Since the immediate beneficiaries of the implementation of the new tax standards will be the treasuries of OECD countries whereas the providers of assistance will be the state or foreign affairs departments of OECD countries, these policies must be coordinated both between OECD countries and between international organizations, particularly the IMF, World Bank and OECD. In addition, it is also important for OECD governments to consider the importance of establishing effective exchange of information mechanisms when expanding trade relations with offshore jurisdictions (e.g.

[13] Prior to 2001, the U.S. also signed TIEAs with Antigua and Barbuda, The Bahamas, Barbados, Bermuda, Colombia, Costa Rica, Dominica, Dominican Republic, Grenada, Guyana, Honduras, Jamaica, Marshall Islands, Mexico, Peru, St. Lucia, Trinidad and Tobago, and the U.S. Virgin Islands.

[14] See Annex.

through free trade agreements or other similar agreements) so that the further removal of trade barriers does not also result in expanded opportunities for offshore evasion.[15]

Also relevant in this context is the way that the EU has linked the good governance agenda, tax compliance and development by including in their partnership agreements with developing countries in Africa, the Caribbean and the Pacific goals on transparency and effective exchange of information. These agreements have almost €3 billion in the 10th European Development Fund allocated to incentives for implementing good governance:

> *When preparing new cooperation strategies with the ACP [African, Caribbean and Pacific] countries, the Commission will propose granting additional financial support to countries adopting or ready to commit themselves to a plan that contains ambitious, credible measures and reforms.*
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> ****
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> *For the Caribbean and the Pacific regions, the Community's priority will be to promote good financial, fiscal and judicial governance. These regions need to rapidly implement OECD standards on transparency and the effective exchange of information for tax purposes and to eliminate harmful tax practices. Special attention will be paid to such problems as money laundering, organised crime and terrorist financing.*

The next year will be crucial in assessing the willingness of jurisdictions to conclude and implement TIEAs. A failure to effectively implement transparency and exchange of information standards will force OECD countries to examine alternative strategies vis-à-vis these countries.

B. OECD Initiative to Strengthen the Article on Exchange of Information in Income Tax Conventions

The OECD's Committee on Fiscal Affairs continues to work on improving both the legal framework and practical aspects of exchange of information. In 2004, the Committee approved revisions to the exchange of information provisions of the OECD's Model Tax Convention. The key changes were to set out explicitly the requirement to exchange information held by banks, financial institutions, nominees or persons acting in an agency or fiduciary capacity and to require the exchange of information notwithstanding that the country requested to provide the information does not have an interest in obtaining the information to administer its own tax laws. The vast majority of OECD countries already can and do exchange banking information --only Austria, Belgium, Luxemburg and Switzerland cannot. OECD is very pleased to see that the new treaty signed between the United States and Belgium on November 27, 2006 does require exchange of bank information when such information is requested for a criminal or civil tax matter. It is the first tax treaty in which Belgium has agreed to such a provision.

The vast majority of OECD countries believed it was important to revise the Model Tax Convention to send a clear signal to all countries including jurisdictions outside the OECD such as Hong Kong and

[15] For example, the US Treasury announced the commencement of TIEA negotiations with Panama in January 2002 and in December 2006 the United States Trade Representative announced the completion of the Free Trade Agreement negotiations with Panama. The U.S.-Singapore Free Trade Agreement entered into force on May 6, 2003 but the United States still has no tax treaty or TIEA with Singapore.

Singapore, that effective exchange of information requires the ability to exchange bank information, whether or not the requested jurisdiction needs the information for its own purposes.

Countries are choosing to reinforce this signal at the national level as well. Canada has just announced in its 2007 Budget Proposal, "To enhance Canada's network for the sharing of tax information, the *International Fairness Initiative* proposes that Canada require that all new tax treaties and revisions to existing treaties (including treaties currently under negotiation) include the new OECD standards in relation to exchange of tax information." http://www.budget.gc.ca/2007/bp/bpc5ee.html

C. OECD Initiatives on Tax Shelters and Aggressive Tax Planning

When 35 tax commissioners met at the OECD's Forum on Tax Administration in Seoul in September 2006, the main focus was on how to improve international tax compliance. The final communiqué stated that

> *Our discussions in Seoul confirmed that international non-compliance is a significant and growing problem. Cross-border non-compliance can take many forms, up to and including outright tax fraud. Individuals have, for example, used offshore accounts, offshore trusts or shell companies in offshore financial centers or other countries to conceal taxable assets or income, as well as credit cards held in offshore jurisdictions to provide access to concealed assets; businesses of all sizes have created shell companies offshore to shift profits abroad often taking recourse to over or undervaluation of traded goods and services for related party transactions and some multinational enterprises (including financial institutions) have use more sophisticated cross-border schemes and/or investment structures involving misuse of tax treaties, the manipulation of transfer pricing to artificially shift income into low tax jurisdictions and expenses into high tax jurisdictions which go beyond legitimate tax minimization arrangements.*

The Forum on Tax Administration, which is chaired by IRS Commissioner Everson, agreed to pursue this work and to also examine the role of tax intermediaries (accountants, lawyers, investment bankers, etc) in promoting unacceptable tax minimization schemes. This work now encompasses the role that intermediaries play – both positive and negative – in the operation of national tax systems. The outcome of this initiative will be presented to the January 2008 meeting of the Forum, which will be hosted by South Africa.

IV. MEASURES USED BY COUNTRIES TO ADDRESS OFFSHORE TAX EVASION

A. Legislative Initiatives

Beyond the international dimension, countries are also acting at the national level by enacting legislation to address the offshore problem. Several countries (both OECD and non-OECD) have enacted measures to deal with their inability to obtain relevant information from offshore jurisdictions. Some of these types of legislative measures were discussed in the 2004 Progress Report on the OECD's Project on Harmful Tax Practices[16] and include:

- The use of provisions having the effect of disallowing any deduction, exemption, credit or other allowance in relation to all substantial payments made to persons located in tax havens except

[16] Available on www.oecd.org/taxation.

where the taxpayer is able to establish satisfactorily that such payments do not exceed an arm's length amount and correspond to bona fide transactions.

- The use of thin capitalization provisions restricting the deduction of interest payments to persons located in tax havens.
- The use of legislative or administrative provisions having the effect of requiring any resident who makes a substantial payment to a person located in a tax haven, enters into a transaction with such a person, or owns any interest in such a person to report that payment, transaction or ownership to the tax authorities, such requirement being supported by substantial penalties for inaccurate reporting or non-reporting of such payments.
- The use of legislative provisions allowing the taxation of residents on amounts corresponding to income earned by entities established in tax havens in which these residents have an interest and that would otherwise be subject to substantially lower or deferred taxes.
- The use of legislative provisions ensuring that withholding taxes at a minimum rate apply to all payments of dividends, interest and royalties made to beneficial owners receiving such payments from entities established in tax havens.

An example of legislative measures targeted at offshore tax evasion can be found in the 2007 Canadian government budget proposal, which includes an "International Tax Fairness Initiative" consisting of the following key elements:

- Enhancing Canada's ability to collect tax information from other jurisdictions, through revised tax treaties and TIEAs with non-treaty countries.
- Modifying the exemption from Canadian tax for foreign-source active business income which is currently limited to income earned in countries with which Canada has a tax treaty, to also include income earned in a non-treaty jurisdiction which has signed a tax information exchange agreement with Canada. This will give non-treaty countries an incentive to enter into TIEAs with Canada, as Canadian companies will then enjoy exempt surplus treatment in respect of active business income earned in that jurisdiction.
- To increase the incentive for countries to enter into TIEAs with Canada, income earned by foreign affiliates in non-TIEA, non-treaty countries will be taxed in Canada as it is earned. In the case of TIEA negotiations that begin after March 19 2007, this treatment will apply if those negotiations are not successfully completed after the passage of five years from the earlier of the commencement of TIEA negotiations and the date on which Canada proposed the negotiations. In the case of a country that is already in the process of negotiating a TIEA with Canada, this treatment will apply if the negotiations are not successfully completed before 2014. Canada will give public notice of its invitations for TIEA negotiations.
- Providing additional funding for auditing and enforcement by the Canada Revenue Agency (CRA).

See http://www.budget.gc.ca/2007/bp/bpc5ee.html for details.

Spain also offers an interesting example of a country that has designed a legislative framework to deal with offshore tax evasion. Spain has established a list of tax havens that currently identifies more than 45 jurisdictions. Spain will automatically remove a jurisdiction from the list when a TIEA with that jurisdiction or a treaty including a provision following Article 26 of the OECD Model Convention on Income and on Capital enters into force.

The Spanish list is used for a range of different tax purposes. For instance, certain rebuttable presumptions are created under Spanish controlled foreign corporation (CFC) rules for entities located in a listed jurisdiction. In such a situation all of the income is presumed to be passive and the tax rate is presumed to

be lower than the threshold rate that triggers the application of the CFC rules. The presumption does not apply if the CFC consolidates its accounts with a Spanish resident company.

Spain's list is also used for other purposes:

- The exemption method that applies to dividends received by Spanish resident corporations does not apply to dividends received from entities in listed jurisdictions.
- The thin capitalization rules prohibit resident corporations from applying a debt-equity ratio other than 3 in cases where the shareholders who directly or indirectly provide debt finance to the corporation are residents of a listed jurisdiction.
- The list is used to deny the exemption from withholding tax applicable to interest paid on public debt, including Spanish government bonds.
- Certain specific reporting rules also apply to Spanish resident taxpayers that have operations in, make payments to, or collect payments from properties or shares in listed jurisdictions.
- Dividends from a Spanish holding company that are derived from exempt income are not exempt from withholding tax if paid to a resident in a listed country. The tax exemption that may apply to capital gains derived from the sale of shares in a Spanish holding company is not available to a person resident in a listed country.
- A Spanish resident investor with an interest in a collective investment undertaking resident in a listed jurisdiction is subject to tax on a deemed gain equal to 15% of the acquisition value of the interest unless the taxpayer can demonstrate that that amount is not correct, in which case the investor is taxed on a mark-to-market basis.
- The exemption of income derived by an individual resident in Spain from dependent personal services exercised abroad for a non-resident entity or permanent establishment is not applicable if the entity or permanent establishment is situated in a listed jurisdiction.
- The deduction for investment in non-resident companies is not allowed for a non-resident company that is resident in a listed jurisdiction.
- Payments made to a transparent partnership (entidad en regimen de atribución de rentas) in a listed jurisdiction but without a taxable presence in Spain are subject to withholding taxes at the general rate, regardless of the residency of its partners.

B. Offshore Compliance Initiatives

Countries are establishing wide-ranging offshore compliance initiatives to better detect and deter offshore evasion. Several tax administrations have had recent successes with such initiatives. As mentioned above, in its most recent investigation alone Ireland collected €840 million from more than 15,000 taxpayers that came forward to make voluntary disclosures. The success was largely based on four factors:

(i) the availability of necessary powers under its domestic legislation,

(ii) a voluntary disclosure system,

(iii) persuading the banks to write to their customers with offshore accounts concerning the proposed government actions and

(iv) an extensive media strategy.

Before commencing the investigation the Irish tax administration approached certain large domestic banks with offshore operations. The banks were advised that their offshore operations would be investigated and were given a date at which investigations would commence. The banks agreed to co-operate and wrote to their customers informing them that an investigation would soon begin. At the same time the tax administration engaged in an extensive media strategy to ensure that all non-compliant taxpayers would be aware of the benefits of the voluntary disclosure regime.

The United Kingdom also has had some notable successes in its offshore investigations. Following two favorable court decisions that permitted the United Kingdom tax administration to obtain records on UK residents with undeclared offshore accounts, the UK on April 17, 2007 launched an "Offshore Disclosure Facility" (see https://disclosures.hmrc.gov.uk/oaics/). The initiative follows a pattern very similar to that used by the Irish tax administration.

Australia is employing a whole of government approach. In 2004, Australia established a multi-agency taskforce known as Operation Wickenby to counter offshore tax arrangements involving tax avoidance or evasion, and in some cases large-scale money-laundering. It combines the investigative powers of the Australian Taxation Office, the Australian Crime Commission (ACC), the Australian Federal Police, the Australian Securities and Investments Commission and the Commonwealth Director of Public Prosecutions, supported by AUSTRAC (Australian Transaction Reports and Analysis Centre), the Attorney-General's Department and the Australian Government Solicitor, to deal with large scale international tax avoidance and evasion. This approach recognizes the similarities in the means used to commit tax crimes and money laundering. By combining the expertise of the different law enforcement agencies involved in combating these crimes, Australia hopes to more effectively address international tax evasion and money laundering. Some examples of the progress made include:

- Arrests/charges:
    - Three company directors were arrested and charged in Southport, Queensland on 20 July 2006 with two counts each of conspiracy to defraud the Commonwealth of some $6.6 million.
    - In another investigation, one person of interest has been charged with a breach of the ACC Act for allegedly refusing to take the oath and take part in an ACC examination.
    - An individual faced court on 1 February 2007 in relation to serious tax offences. While not yet charged, the individual has advised the Court he will plead guilty to tax related offences and is scheduled to face a pre-sentencing hearing in the Victorian County Court on 2 July 2007.
- Legal challenges:
    - Since the establishment of the ACC, 20 challenges have been finalized in the Federal and High Courts in relation to ACC's Operation Wickenby, and the ACC has succeeded in all of those challenges. The ACC is currently defending a number of matters in the Federal Court in favor of the Commissioner of Taxation that disallowed claims for legal professional privilege.
    - There is also an appeal by a taxpayer against a Federal Court decision in favor of the Commissioner of Taxation on legal professional privilege.
- Audits:
    - More than 100 audits have commenced. Assessments totaling $26.95 million have issued with $24.9 million either collected or under payment arrangements.

V. CONCLUDING REMARKS

Without vigorous and coordinated action by governments to ensure that the right legislative framework is in place, that tax administrations have the necessary information, tools and resources to address the problem, and without greater bilateral and multilateral co-operation, offshore tax evasion will continue to grow and undermine the integrity of national tax systems.

No one country by itself can meet this challenge. The next year will be crucial to see how far offshore centers are prepared to move away from financial services based on concealment to legitimate financial services. For those jurisdictions that have already made this move, the international community and individual countries should provide political recognition of this progress and should ensure the further integration of these jurisdictions in the international financial system.

The U.S. has led the way in the signing of TIEAs and must continue to do so because closing one avenue for tax evasion simply redirects evasion to other offshore centers. A very clear example of this is the way Singapore has used the fact that it is not on the OECD list of tax havens and has restrictive exchange of information provisions in its tax treaties to market itself as the ultimate secrecy jurisdiction.

Jurisdictions like Singapore are rightly proud of their international co-operation in combating money laundering but if we are to succeed in the eradication of offshore tax evasion, we must work together to change the perception of such secrecy jurisdictions that it is acceptable in today's global economy to facilitate tax evasion by the residents of other countries. High level political commitment and action is needed to bring about such a change. Countries around the world stand ready to work with the United States to achieve this goal.

ANNEX

TIEAS SIGNED BY CO-OPERATIVE JURISDICTIONS AND UNCO-OPERATIVE TAX HAVENS

Committed Jurisdictions		
Jurisdiction	**Agreements signed with the US**	**Agreements signed with other OECD countries**
Anguilla		
Antigua and Barbuda	Dec. 2000	Australia, Jan. 2007
Aruba	Nov. 2003	
The Bahamas	Jan. 2000	
Bahrain, Kingdom of		
Barbados[17]	Nov. 1984	
Belize		
Bermuda	Dec. 1988	Australia, Nov. 2005
British Virgin Islands	Apr. 2002	
Cayman Islands	Nov. 2001	
Cook Islands		
Cyprus		
Dominica	May 1988	
Gibraltar		
Grenada	Dec. 1986	
Guernsey	Sept. 2002	
Isle of Man	Oct. 2002	Netherlands, Oct. 2005
Jersey	Nov. 2002	
Malta		
Mauritius		
Montserrat		
Nauru		
Netherlands Antilles	Apr. 2002	Australia & New Zealand, March 2007
Niue		
Panama	Commencement of TIEA discussions in January 2002 but negotiations appear to be stalled.	
Samoa		
San Marino		
Seychelles		
Saint Kitts and Nevis		
Saint Lucia	Jan. 1987	
Saint Vincent and The Grenadines		
Turks and Caicos Islands		
U. S. Virgin Islands	Tax Implementation Agreement, 1987	Exchange of information carried out through US tax treaty network
Vanuatu		

[17] See footnote 11 supra.

Unco-operative Tax Havens		
Jurisdiction	**Agreements signed with the US**	**Agreements signed with other OECD countries**
Andorra		
Liberia		
Liechtenstein		
Marshall Islands	Mar. 1991	
Monaco		Tax Treaty with France, May 1963