Exchange of Tax Information: Neutrality and

Inter-Nation Equity

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Abstract

Tax information exchange has been one of the principal themes in taxation related multilateral dialogue over the past ten years. This dialogue has been influenced by competing claims that various concepts of fairness, equity or efficiency supported particular proposals to reform tax information exchange practices. Much of the debate has focused on considerations of administrative efficiency and inter-individual equity in a single state context, to the exclusion of issues related to global welfare and inter-nation equity. The lack of consideration given to inter-nation equity highlights a gap in the tax literature.

The first part of this thesis locates the research and poses a series of questions relating to the theory underlying concepts of fairness, inter-nation equity and the neutrality of taxation systems in the context of tax information exchange. It illustrates that while theory suggests that the provision of tax information to foreign tax authorities may enhance tax administration efficiency and assist in ensuring horizontal and vertical equity among taxpayers in a single state, it also suggests that it may do so in some instances at the expense of global economic efficiency and inter-nation equity. New constraints on tax information exchange are proposed as mechanisms which will decrease the risk of undermining inter-nation equity and economic efficiency.

The second part of this thesis presents a case study examination of the extent to which considerations of inter-nation equity and fairness have influenced the evolution of proposals for tax information exchange in the context of the Organisation for Economic Cooperation and Development’s Harmful Tax Competition Initiative. It also examines the extent to which international regime theory may contribute to an understanding of that Initiative and its proposals for tax information exchange.

The final part of the thesis presents a series of answers to the questions posed as well as observations relating to the implications for both theory and policy arising from the answers.

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TABLE OF CONTENTS

CHAPTER 1 ................................................................................................... 12

1.0 INTRODUCTION........................................................................................................ 12
1.1 THE SCOPE OF THE PRESENT WORK ......................................................................... 13
1.2 LOCATION OF THE PRESENT RESEARCH ................................................................... 14
1.3 EQUITY, BIASES AND TAX COMPETITION................................................................ 18
   1.3.1 Strategies for Limiting Tax Competition.......................................................... 24
1.4 PREFERENCES FOR INTRA-NATION WELFARE AND INTER-NATION EQUITY - HOW
MIGHT COUNTRIES BE EXPECTED TO WEIGH EACH OF THE THREE OBJECTIVES............ 27
1.5 THE FRAMEWORK OF THE LAW OF INTERNATIONAL TAXATION AT THE LACUNA ... 30
   1.5.1 The Law of International Taxation from a Global Perspective ......................... 31
   1.5.2 Sovereignty as a Theoretical Limit on the Exercise of Rights to Impose
International Taxation? ........................................................................................................ 37
   1.5.3 Utility as a Pragmatic Limit to International Taxation........................................ 40
   1.5.4 Considerations of Equity and Fairness as Constraints on Law Relating to
International Taxation ........................................................................................................ 42
   1.5.5 The Potential Role of International Regimes in the Coordination of Exchange
of Tax Information Arrangements .................................................................................. 44

CHAPTER 2 - EXCHANGE OF INFORMATION .................................................. 51

2.0 INTRODUCTION........................................................................................................ 51
2.1 PROTOCOLS FOR TAX INFORMATION EXCHANGE ............................................. 52
2.2 THEORETICAL JUSTIFICATION FOR THE PROVISION OF EXCHANGE OF TAX INFORMATION ................................................................. 54

2.2.1 The 'Third Country' and 'Last Man Standing' Problems ....................................... 59

2.3 UTILITY AND ECONOMIC EFFICIENCY AS FACTORS SHAPING THE EVOLUTION OF EXCHANGE OF TAX INFORMATION NETWORKS ................................................................. 61

2.4 THE JUSTIFICATION FOR EXCHANGE OF TAX INFORMATION SET OUT IN COMMENTARY TO THE MODEL CONVENTIONS ................................................................. 66

2.5 THE EVOLUTION OF TAX INFORMATION EXCHANGE - SELECTIVE OVERVIEW OF EXCHANGE OF TAX INFORMATION FROM 1843 TO 2006 ................................................................. 68

2.5.1 Tax Information Exchange in The Period from 1843 - 1920 .................................. 69

2.5.2 Tax Information Exchange in the Context of the League of Nations and the Expansion of the Tax Treaty Network ................................................................. 70

2.5.3 The OECD and UN Tax Information Exchange Models Arrangements from 1963 to 2006 ........................................................................................................ 80

2.6 CURRENT LEGAL AND ADMINISTRATIVE FRAMEWORKS AND CONSTRAINTS ON TAX INFORMATION EXCHANGE ................................................................. 84

2.6.1 Legal and Administrative Frameworks for the Exchange of Information for Taxation Purposes as at December 2005 ........................................................................ 87

2.6.2 The Scope of and Limits to Exchange of Information ............................................. 89

2.6.3 Access to Bank Information as a Limit to Exchange of Information .................. 93

2.6.4 Access to Identity, Ownership and Accounting Information as a Limit to Exchange of Information ......................................................................................... 95
CHAPTER 3 - INTER-NATION EQUITY IN THE ALLOCATION OF TAX RESOURCES

3.0 INTRODUCTION ....................................................................................................... 103

3.1 INTER-NATION EQUITY, FAIRNESS AND DISTRIBUTIVE JUSTICE ....................... 106

3.1.1 A Selective Survey of the Concepts of Inter-nation Equity, Fairness and
Distributive Justice in a Multi-state Context .......................................................... 106

3.2 THE THEORETICAL JUSTIFICATION FOR INTER-NATION EQUITY IN THE DISTRIBUTION
OF TAXATION RESOURCES ......................................................................................... 112

3.3 CONCEPTS OF INTER-NATION EQUITY IN THE INTERNATIONAL TAXATION LAW
LITERATURE ................................................................................................................ 113

3.3.1 Inter-nation Equity and the Equity – Efficiency Trade-off .................................... 119

3.4 INTER-NATION DISTRIBUTIVE JUSTICE ................................................................ 121

3.4.1 Inter-nation Distributive Justice, Social Contracts and Cooperation in Tax
Administration ............................................................................................................. 124

3.4.2 Is There Any Obligation to Treat Foreign States or Their Residents Fairly? 126

3.4.3 Are there Competing Claims for Fairness which may Arise as a Result of Tax
Related Externalities? ................................................................................................. 128

3.5 TAX COMPETITION AND THE LIMITS OF MODELS OF INTER-NATION EQUITY .... 131
3.6 Inter-Nation Equity, Tax Competition and the Creation, Denial and Utilisation of Economic Opportunities ............................................................... 134

3.6.1 Fairness in Taxation Resource Distribution and Restrained Tax Competition ................................................................................................. 138

3.6.2 Constrained Tax Competition, Fairness and the Level Playing Field........ 140

3.7 Inter-Nation Equity, Opportunity and the Level Playing Field ................. 142

CHAPTER 4 - Neutrality and Inter-Nation Equity ......................... 147

4.0 Introduction .......................................................................................... 147

4.1 Non-Neutralities and International Taxation ............................................. 153

4.2 Neutrality and Tax Competition ............................................................... 155

4.2.1 Competition Neutrality and the Level Playing Field ................................. 157

4.3 The Creation of Non-Neutrality through Domestic Legislation in a Multi-State Frame of Reference ................................................................. 158

4.3.1 Domestic and Foreign Preferences as Non-Neutralities ....................... 158

4.3.2 Non-Neutralities Resulting from the Operation of Tax-Related Treaties ..... 160

4.4 The Provision of Tax Information and its Effects on the Operational Neutrality and Inter-Nation Equity of International Taxation Systems .... 164

4.4.1 Might the Provision of Tax Information Amplify the Effects of Non-Neutrality under Certain Conditions ................................................................. 165

4.4.2 Non-Neutralities and the Setting of International Rules for Cross-border Taxation .......................................................................................... 167

4.4.3 Competition Neutrality and Tax Information Exchange ...................... 169

PART 1

5.0 INTRODUCTION

5.1 THE OECD AND THE DEVELOPMENT OF REGIMES RELATING TO INTERNATIONAL TAXATION

5.1.1 The Objectives for International Taxation and the Aims of the OECD

5.1.2 The Role of the OECD as an Exclusive Inter-Governmental Organisation in Perspective

5.2 THE HISTORICAL CONTEXT OF TAX COMPETITION

5.3 LIMITING TAX COMPETITION IN THE GLOBAL FINANCIAL SERVICES SECTOR

5.3.1 The spectre of globalisation

5.4 NON-TRANSPARENT DESIGN AND THE HTC INITIATIVE


5.6 PHASE 0 - THE DECADE LEADING UP TO THE 1996 MINISTERIAL ENDORSEMENT OF THE HTC INITIATIVE
5.6.1 The Roles of Considerations of Inter-Nation Equity, Neutrality and Tax Information Exchange in Phase 0

5.7 Phase 1 – From the 1996 Ministerial Authorisation to 1998 Publication

5.7.1 Procedural Fairness in the Preparation of the 1998 Report

5.7.2 Taxation Related Distortion and Competitive Advantage in the HTC Initiative

5.7.3 The Inclusion of non-OECD Countries in the HTC Initiative

5.7.4 Building Consensus: Separating ‘Them’ from ‘Us’

5.7.5 Regime Formation and Differentiation of Treatment of Member and Non-member States

5.7.6 The Concept of a Tax Haven

5.8 Concepts of Fairness in the HTC Report

5.9 The Meaning of Fairness as Applied in Phase 1 of the HTC Initiative

5.10 Standard Setting and Inter-Nation Equity in Phase 1 of the HTC Initiative

5.11 Fairness, Exchange of Information and Regime Formation in Phase 1 of the HTC Initiative

CHAPTER 6 - Tax Information Exchange, Neutrality and Inter-Nation Equity in the Context of the OECD’s Harmful Tax Competition Initiative
6.0 Introduction .............................................................................................................................................. 260

6.1 Phase 2 of the OECD Harmful Tax Competition Initiative ................................................................. 261

6.1.1 Reactions to the HTC Report ........................................................................................................... 263

6.1.2 Procedural Fairness and Substantive Fairness in Phase 2 ............................................................... 265

6.2 The Foundations of Fairness Discourse ................................................................................................. 270

6.2.1 The Commonwealth as Catalyst ................................................................................................... 272

6.3 Fairness and the HTC Initiative’s Metric of Legitimacy ...................................................................... 275

6.4 Fairness, Suasion Games and the Threat of Sanctions ......................................................................... 280

6.5 Exchange of Information and the Un-Level Playing Field ................................................................. 282

6.5.1 Timing of Implementation and the Un-Level Playing Field ............................................................ 285

6.6 Phase 3 of the OECD Harmful Tax Competition Initiative – June 2000 to April 2002 ................................................................. 287

6.6.1 Fairness Discourse and the Role of the Commonwealth in Phase 3 ........................................ 289

6.6.2 Fairness within the HTC Initiative and Shifts in US Policy ......................................................... 292

6.7 The Barbados Dialogue – Fairness and Regime Promotion .................................................................. 293

6.7.1 Shared Understanding in Relation to Fairness and Regime Formation .................................... 297

6.7.2 The Barbados Outcomes .............................................................................................................. 301


6.9 The Intervention of the United States ................................................................................................ 307

6.10 The 2001 Revision of the HTC Initiative .......................................................................................... 309

6.11 The Formation of the International Trade and Investment Organisation ........................................ 312
6.12 THE DEVELOPMENT OF THE 2002 MODEL TAX INFORMATION EXCHANGE AGREEMENT ........................................................................................................................................ 314

6.12.1 Fairness in the 2002 Model Agreement ........................................................................................................................................ 316

6.13 PHASE 4 OF THE OECD HARMFUL TAX COMPETITION INITIATIVE .......................................................................................... 317

6.13.1 The October 2002 Cayman Islands OECD Global Forum ........................................................................................................... 318

6.13.2 The Competition between Commitments to Non-OECD Countries and Regime formation in Relation to the European Union ........................................................................................................... 321

6.13.3 The October 2003 Ottawa OECD Global Forum ......................................................................................................................... 322

6.13.4 The June 2004 Berlin OECD Global Forum ................................................................................................................................. 326

6.14 THE 2005 LEVEL PLAYING FIELD ASSESSMENT - BENCHMARKING TRANSPARENCY AND FRAMEWORKS FOR EXCHANGE OF INFORMATION .................................................................................. 333

6.15 MEASURING THE SUCCESS OF THE HTC INITIATIVE AND IDENTIFYING ITS REMAINING SHORTCOMINGS ........................................................................................................................................ 334

CHAPTER 7 - FURTHER CONSIDERATIONS AND CONCLUSIONS ............ 337

7.0 INTRODUCTION ........................................................................................................................................ 337

7.1 TAX INFORMATION EXCHANGE, EFFICIENCY AND INTER-NATION EQUITY ......................................................... 338

7.2 RESTRICTING TAX INFORMATION EXCHANGE – THEORETICAL JUSTIFICATIONS AND GENERAL POLICY CONSIDERATIONS ................................................................................................. 340

7.3 MECHANISMS FOR RESTRICTING TAX INFORMATION EXCHANGE SO AS TO ENHANCE ECONOMIC EFFICIENCY AND INTER-NATION EQUITY ........................................................................ 349

7.3.1 Tax Information Exchange Restrictions and Relative Competitive Advantage .................................................................................. 354
7.3.2 Determining the Reasonable Latitude for Taxation System Design and Restrictions on Tax Information Exchange............................................................. 356

7.3.3 Tax Information Exchange and Inter-Nation Equity in Bilateral Arrangements ............................................................................................................. 358

7.3.4 Tax Information Exchange, Inter-Nation Equity and Limited Tax Competition ............................................................................................................. 361

7.4 Fairness and Inter-Nation Equity as Factors Influencing Regime Formation in the HTC Initiative ................................................................. 365

7.4.1 Procedural Fairness as a Factor Influencing Regime Formation in the HTC Initiative ............................................................................................................. 365

7.4.2 Technical Capacity as a Determinant of Access to Procedural Fairness .... 371

7.4.3 Inter-Nation Equity, Substantive Fairness and Multilateral Dialogue on Exchange of Tax Information Exchange................................................................. 374

7.5 International Regime Theory in the Context of the Tax Information Exchange component of the HTC Initiative................................................................. 390

7.7 If at First you Don’t Succeed - Fallout from the OECD Global Forum’s search for a Level Playing Field in Relation to Tax Information Exchange ............................................................................................................. 396

BIBLIOGRAPHY ............................................................................................................. 401
CHAPTER 1

1.0 INTRODUCTION

Tax information exchange has been the subject of a great deal of bilateral and multilateral dialogue over the past fifteen years. Much of this discourse has focused on its utility as a tax enforcement tool. The present work proceeds from a series of linked hypotheses. The first is that, while the exchange of taxpayer specific information between tax authorities of sovereign states may enhance tax administration efficiency and assist in ensuring horizontal and vertical equity among taxpayers within a single state, under certain conditions it may do so at the expense of global economic efficiency and inter-nation equity in the distribution of global taxation resources.\(^1\) To the extent that the first hypothesis is correct, policy makers seeking to establish cooperative mechanisms for tax information exchange may be called upon to identify means of balancing inter-nation equity, intra-nation equity and administrative efficiency. Constraints on tax information exchange may provide one set of mechanisms which can be used in this process.\(^2\)

A subsidiary hypothesis is that, as administrative efficiency may require the development of cooperative systems for tax information exchange among

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\(^1\) The concept of economic efficiency is discussed in Chapter 2 of this work while the concept of inter-nation equity is discussed in Chapter 3.

\(^2\) The manner in which constraints on tax information exchange may be used is discussed in Chapter 4 of this work.
states, then under non-coercive conditions, considerations of equity and fairness in a multi-state context may influence the evolution of such cooperative systems and the design of international instruments intended to provide for tax information exchange. Finally, it is hypothesised that international regime theory may afford an understanding of how states cooperate in balancing efficiency and equity in the development and implementation of systems for tax information exchange.

1.1 THE SCOPE OF THE PRESENT WORK

There are three components in the present work. The first is an outline of tax information exchange, inter-nation equity in the distribution of taxation resources and the concept of neutrality in the context of international aspects of taxation systems. The second is an examination from a theoretical perspective of whether tax information exchange may under certain conditions adversely affect global economic efficiency and inter-nation equity, together with an assessment of arguments for and against restricting the provision of taxpayer specific information to foreign governments in circumstances in which the provision of tax information may undermine such efficiency and inter-nation equity. Included in this second component is an analysis of various mechanisms by which such restrictions might be imposed.

3 The concept of neutrality is discussed in Chapter 4. In very general terms, a taxation system may be said to be neutral if it does not affect the investment, consumption and other economic choices of taxpayers.
The third component in the present work is a case study analysis of the evolution of a proposed international regime for limiting tax competition through the use of tax information exchange in the context of the Organisation for Economic Cooperation and Development's Harmful Tax Competition Initiative (HTC Initiative). The first objective of this analysis is to identify whether, and if so how, notions of fairness, inter-nation equity, the neutrality of taxation systems, and the appropriate role of tax information exchange in international cooperation, have shaped the evolution of an international regime. The second objective is to determine whether an analysis of the HTC Initiative using the lens of international regime theory affords an understanding of the development of inter-nation cooperation in the context of tax information exchange.

1.2 LOCATION OF THE PRESENT RESEARCH

The theoretical basis for the present research is located at the intersection of three normative constructs. These normative constructs, each of which has been previously identified in the international taxation literature, are most frequently

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represented in the form of three policy objectives from among the many which shape the law of international taxation. The three policy objectives are:

a) encouraging the neutrality of taxation systems, and thereby economic efficiency in the global allocation of economic resources so as to maximise global welfare,\(^6\)
b) enhancing inter-nation equity in the allocation of taxation resources,\(^7\) and
c) enhancing administrative cooperation among national tax administrations by means of the provision or exchange of taxpayer specific information,\(^8\) so as to maintain or extend the design latitude available to sovereign states with respect to their taxation systems.\(^9\)

It is recognised that these three objectives by themselves are unlikely to be determinative of the tax policies of individual states, but neither are they remote to the reality of international dialogue on taxation\(^10\). Considerations of elements of inter-nation equity have been juxtaposed with those of tax information exchange and considerations of the neutrality of taxation systems in the HTC Initiative. As

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\(^8\) Unless the context otherwise requires, in this work the expression 'exchange of tax information' includes the unilateral provision of tax information.


was noted by the OECD’s 2006 Assessment of tax information exchange frameworks:

The level playing field is fundamentally about fairness... In the context of exchange of information achieving a level playing field means the convergence of existing practices to the same high standards for effective exchange of information on both criminal and civil taxation matters within an acceptable timeline for implementation with the aim of achieving equity and fair competition.\(^\text{11}\)

Each of the three policy objectives identified above has a body of legal scholarship associated with it. The academic and practitioner literature, while relatively well developed in relation to the normative constructs underlying each of these objectives in isolation, contains little at the intersection of these areas of research.

The lacuna which locates the theoretical basis for the present research is also characterised by the fact that much of the relevant academic and practitioner literature on international taxation in this subject area is populated with material written from a developed country perspective. Much of this material also relates to the application of one particular country’s tax law to economic activity which has a trans-national component. This single developed country perspective tends to extend even to considerations of the roles of inter-nation equity and economic efficiency within the subject of the law of international taxation. This can be seen in the tendency for some academic writers to adopt a “what is in it for us” national,
(and typically geo-politically powerful), perspective in relation to equity, efficiency and cooperation, rather than a global perspective. Graetz, by way of example has written the following in relation to whether global welfare or national welfare is the appropriate lens for evaluating the tax policy of the United States of America:

In denying that a worldwide perspective is the proper lens for U.S. international income tax policy, I am not rejecting an important role for considerations of economic efficiency in formulating that policy. But I believe the proper function of economic efficiency in this context is to ask - from the national perspective - what international income tax rules will enhance Americans' standard of living.... As with domestic tax policy, the proper question is about the effects of international tax rules on the economic well-being, the welfare, of U.S. citizens and residents. 12

This approach also has support in the academic literature, particularly that portion of it produced within developed countries. 13

The present work rejects a single state perspective in favour of a global perspective. It proceeds from the position that while each of the three objectives which locate the lacuna may be appropriate for law relating to international taxation, a preference for global welfare over national welfare does not require that each is given the same weight in policy design.

13 Musgrave (n 7), 115. Musgrave endorses the use of domestic taxation devices to modify the movement of capital when it is more efficient than other policy instruments.
The final element in the location of the present work is the intersection of taxation law at the above described nexus with international regime theory as this subject has been developed in the international relations literature, and more recently applied in the field of international taxation. This element seeks to focus on whether and to what extent, considerations of inter-nation equity and neutrality may influence how states come to agree on specific tax information exchange standards, and the manner in which they are applied.

1.3 EQUITY, BIASES AND TAX COMPETITION

An equitable global distribution of mobile factors of economic production is arguably a key element in meeting the long-term development objectives of smaller and developing countries. Taxation of such factors arguably affects their distribution and similarly, the distribution of taxation resources related to such factors. Sovereign states commonly design their taxation systems in order to bias investment decisions related to mobile factors of production. They do this unilaterally and through multilateral collaboration using mechanisms such as

14 Ring (n 5).
model taxation conventions and tax treaty networks. Typically these biases have the effect of shifting investment preferences to the benefit of the states creating the biases, or states with which the state creating the bias has close economic relations. The creation and refinement of such biases are integral parts of tax competition, which may be viewed as the informed competition among states for factors of production based on how attractive the taxation system of a state makes its investment climate.

Tax competition is not new and the nature of such competition is relatively predictable. States naturally prefer tax competition which relates to economic activities in respect of which their natural and other endowments provide relative advantages. Similarly, they tend to oppose tax competition which relates

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19 Ring (n 5), 33-44. Double taxation treaties reduce the incidence of double taxation and generally provide for reduced rates of source state withholding tax, each of which may provide a competitive advantage compared to the situation without such a treaty, particularly in the absence of unilateral relief from double taxation.

20 While there are a number of definitions of tax competition in the literature, for purposes of the present work the definition established by Wilson and Wildasin is utilised. JD Wilson and DE Wildasin 'Tax Competition: Bane or Boon' (2001) <http://www.bus.umich.edu/otpr/WP2001-11paper.pdf> accessed 28 January 2005. '[W]e define tax competition as non-cooperative tax setting by independent governments, under which each government's policy choices influence the allocation of a mobile tax base among "regions" represented by these governments.'

to economic activities in which of which their relative endowments or socio-political orientation do not provide competitive advantages.\textsuperscript{22}

There is evidence of long-standing tax competition among states within federal systems going back more than 100 years.\textsuperscript{23} For most of that period, the externalities which might be created by tax competition were little considered by either academics or the designers of tax systems. To the extent that the implications of tax competition were considered in academic research,\textsuperscript{24} it is arguable that the assumptions of researchers regarding whether governments are naturally welfare maximising and efficient, or on the other hand leviathans in need of discipline, pre-determined the conclusions of their research. As noted by Graetz; Some claim that tax competition is "efficiency-enhancing", others that it is "wasteful"; both views depend on a myriad of assumptions, which are debated on both empirical and normative grounds....The critical question is whether competition for capital through differential tax policies leads to a harmful race to the bottom, or whether tax competition – at least in some circumstances – is a beneficial engine of efficient capital allocation.\textsuperscript{25}

Much of the academic tax literature has inevitably tended to reflect, if not project, the biases of its writers who have tended to come from developed

\textsuperscript{22} Ring notes that from a neo-realist perspective of international regimes, states may be viewed as seeking to secure relative advantage over other states. Ring (n 5) 17.


\textsuperscript{24} Wilson (n 20).
countries. Much of that part of this literature opposed to tax competition has emphasized what were viewed as the potential undesirable consequences which might be produced by foreign competition in general and tax competition in particular, as well as the 'risks' posed by jurisdictions which adopt taxation systems which differ from the states in which the writers resided. Piccioto by way of example, writing in the context of competition in the financial services sector, rejects an objective classifications of countries engaged in tax rate competition in favour of a purely subjective test which arguably pre-determines the outcome:

[T]he broadest definition of a tax haven would include any country whose tax laws interact with those of another so as to make it possible to produce a reduction of tax liabilities in that other country. By such a definition virtually any country might be a 'haven' in relation to another. Tax havens are therefore more narrowly defined as countries which offer themselves or are generally recognised as havens: this is referred to in the Gordon Report as the 'reputation' test... 26

Not surprisingly, a significant part of the academic literature produced in the geopolitically dominant countries has tended, with some exceptions, to apply terms such as 'tax haven' pejoratively to 'other' countries with which their own countries are in competition.27 This subject area is developed further in Chapters 5 of this work.

25 Graetz (n 12) 511.
Tax competition has been linked to the question of whether it might result in a ‘race to the bottom’ in taxation rates for much of the last quarter century.\(^\text{28}\) The spectre of a threat to the capital tax bases of developed countries arising from a tax competition induced ‘race to the bottom’ appeared in a series of articles in the late 1980s and early 1990s, although the Oates’ seminal article appeared a decade earlier.\(^\text{29}\) It seems highly likely that this spectre was one component contributing, whether as causation or justification, to the leading industrialised states attempts to limit tax competition which developed towards the end of this period.\(^\text{30}\) While in retrospect the ‘race to the bottom’ hypothesis may appear simplistic in its essentially one-dimensional approach,\(^\text{31}\) and while there is little empirical evidence that a race to the bottom in rates of capital taxation was a real threat to the social welfare systems of the dominant economies,\(^\text{32}\) controlling any potential risk of such a race became a collective objective of the most powerful of states.\(^\text{33}\)

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\(^\text{30}\) OECD (N 4), 15.


In one sense, the proponents of 'race to the bottom' theories among tax economists whose opinions coincided with the political vogue of the time, may have contributed to the perceived need for a regime for cooperation among the governments of the developed countries in regard to this aspect of international taxation. The subsequent publication of further materials which emphasised the limitations of the original 'race to the bottom' models and which demonstrated the paucity of evidence of any such entity in practice, attracted little attention among the states which had politically endorsed this threat and implemented measures to avert it. The momentum of the 'race to the bottom' narrative persisted despite the fact that Oates himself doubted that the 'race to the bottom' was the inevitable outcome of tax competition. This policy inertia is consistent with the observation noted by Ring that epistemic communities of academics have little influence over the utilisation of a regime once it has been developed. In this case, it is arguable


33 OECD (n 4), 15.

34 Ring (n 5). Ring's observations regarding the development of regimes in the area of international taxation are discussed in more detail in section 1.5.5.


36 WE Oates, 'Fiscal Competition or Harmonization: Some Reflections' (2001) 54 National Tax Journal 3 507-512

37 Ring (n 5), 64. Ring notes that although committees of experts were initially involved in developing the League of Nations and UN Model tax conventions, once these models had been developed, they developed momentum and direction independent of the original visions of the experts.
that having provided what was politically acceptable, if scant, evidence of what may be termed 'weapons of tax destruction', subsequent caution expressed in the academic literature regarding the significance of supporting evidence has been ignored at the policy level.

1.3.1 Strategies for Limiting Tax Competition

The strategies for limiting tax competition developed over the past decade, while diverse, have tended to include the enhanced exchange of information between tax administrations. One of the advocated approaches to limiting such tax competition has involved the design of new legal instruments providing for greater access to foreign source taxpayer specific information. Another has involved alterations to both existing model conventions and the interpretation of existing tax treaties in order to provide for greater access to such information.

39 OECD (n 4).
Existing treaty arrangements incorporating the provision of taxpayer specific information, of which there are more than two thousand, are in general based on models produced by the Organisation for Economic Cooperation and Development (OECD), and the United Nations Ad Hoc Group of Experts in Taxation Matters. Even with more than two thousand treaties however, the existing network of bilateral treaties comprises only a small fraction of the number of bilateral treaties which would be necessary to ensure even theoretically uniform access to tax information.

The rationale most commonly advanced for seeking greater access to such information is that access to information allows countries with residence-based tax systems to apply the same rate of taxation to their residents irrespective of where such residents place their capital or earn their income. Access to such information is that access to information allows countries with residence-based tax systems to apply the same rate of taxation to their residents irrespective of where such residents place their capital or earn their income.


45 There are more than 200 jurisdictions with sovereignty in relation to taxation matters. In theory each jurisdiction with tax sovereignty could enter into a tax treaty with each other jurisdiction. This would produce approximately 40,000 treaties. However, there are only an estimated 2000–2500 treaties containing assorted tax information exchange provisions. UN (n 39); Arnold (n 39).

46 TJ Goodspeed and AD Witte, 'International Taxation' (1999) <http://encyclo.findlaw.com/6080book.pdf> accessed 2 April 2006. Goodspeed and Witte observe that: 'In principal, two methods of taxation have been distinguished for direct taxes such as personal and corporate income taxes: the territorial (or source) system of taxation and the worldwide (or residence)
information is also thought to minimise tax evasion and avoidance advantage in relation to foreign source income, and in particular income which might by derived from the use of foreign financial services providers. Further, access to taxpayer specific information may therefore also indirectly limit one type of tax induced bias in the location of services activities and the taxation revenues they produce. That is to say, that to the extent that global service activities might be located in jurisdictions which seek to attract foreign capital and financial services activity associated with such capital, then both capital and those financial services providers which seek to work with such capital would perhaps be less likely to locate where access to tax information exists.

Access to tax information is therefore more than just a compliance assurance and auditing tool for tax administrations. It can be used to both limit and increase the efficacy of tax related biases which are used in tax competition. Countries which require access to taxpayer specific information in order to enforce self-serving biases, or which require information to eliminate biases which are not in their favour, naturally place a high priority on access to such information. Countries disadvantaged by biases in other countries’ taxation systems understandably have been reticent about providing tax information which would give effect to biases which work against their interests.

47 The manner in which this may occur is discussed in Chapter 4 of this work.
Disagreement among states over the relative priority which ought to be
given to the provision of tax information to foreign states, as well as disagreement
over constraints which ought to apply to that provision, have been at the core of
very heated debate over the past ten years.48 As recently noted by Keen and
Ligthart, 'The exchange of taxpayer-specific information between national tax
authorities has emerged over the last few years as a - probably the - central issue in
international tax policy discussion.'49

1.4 PREFERENCES FOR INTRA-NATION WELFARE AND INTER-NATION
EQUITY - HOW MIGHT COUNTRIES BE EXPECTED TO WEIGH EACH OF
THE THREE OBJECTIVES

Generally, in weighing the importance to be given to each of the three objectives
for international taxation selected for the present work,50 those countries benefiting
from the current allocation of global tax resources may tend to give priority to the
acquisition of tools such as exchange of tax information agreements which can be
used to enhance enforcement efficacy, and thereby to expand and perpetuate their

48 This is discussed in detail in Chapters 5 and 6 of this work.
49 M Keen and J Ligthart, 'Information Sharing and International Taxation: A Primer' 13 International Tax and Public Finance,
2006 81-110; M Keen and J Ligthart, 'Incentives and Information Exchange in International Taxation' (2004) RePEc
50 These objectives relate to inter-nation equity, neutrality, and exchange of tax information.
relative advantage. Countries disadvantaged by the current allocation of global tax resources may tend to call for greater inter-nation equity in the global allocation of taxation resources, and may be hesitant to provide enforcement assistance to countries which they perceive as undermining such equity. Disadvantaged countries may see the provision of enforcement assistance in relation to certain tax practices as potentially entrenching the inequities in the current global taxation resource allocation.

Countries which wish to change the current allocation of global tax resources may also call for dialogue in a forum, and with terms of reference which are conducive to change. Countries wishing to maintain the status quo in terms of the global allocation of tax resources may try to avoid dialogue, or to seek a forum and terms of reference for dialogue which lend themselves to their ends.

51 OECD (n 4); Ring (n 5). Ring notes that neo-realist international regime theory indicates that states seek comparative advantage and therefore support international regimes which meet this objective. The HTC Initiative arguably is consistent with this observation.


53 McIntyre has suggested that developed countries may not in practice provide information to developing countries with which they have tax information exchange agreements. M McIntyre, 'Institutional framework for international tax cooperation' (2003) <http://www.law.wayne.edu/McIntyre/text/Treaty_Class/UN_institutional_framework.pdf#search=%221963%20OECD%20Convention%20Taxation%20%22exchange%20information%22%22> accessed 6 October 2006. To the extent this is true, developing countries may not be motivated to provide information in return.

54 This type of polarization is reflected in the respective positions taken by the states which designed the HTC Initiative on the one hand, and those targeted by it on the other as discussed in Chapters 5 and 6 of this work.


56 The OECD often appears to assume that it is the global 'standard setter' for taxation matters. OECD, 'The OECD Model Convention - reflections and developments. Speech by Gabriel Makhlouf, Chair, Committee on Fiscal Affairs,
therefore perhaps not surprising that, as will be discussed in the last three chapters in this work, at the international level, and in the absence of any factors which might tend to destabilise the status quo, the attainment of the three objectives set out above has been limited, not only by differences in national priorities, but also by procedural issues which themselves have tended to limit dialogue on matters of international cooperation in taxation matters.

Further practical difficulties arise at the intersections of the three objectives from other factors as well. These include the deeply engrained and widely held concept of taxation as a critical element in sovereign power, the complexity of interactions of the disparate taxation regimes deployed by some two hundred countries, the use of taxation regimes as tools for economic competition among states, and the fact that countries also use their taxation systems as instruments of foreign policy and not solely for the raising of revenue for public services and the redistribution of wealth within the relevant state.
1.5 The Framework of the Law of International Taxation at the Lacuna

Each country’s taxation policy reflects its relative preferences for each of the three normative constructs which locate the present research. Such preferences are also a function of each country’s understanding and application of international relations policies, and its expectations of international rule making as this relates to international taxation. Such expectations arguably are heavily influenced by traditions of sovereignty and international rule making based upon power relationships and perceptions of national interest.60 While the intersection of international relations theory with international taxation theory has received only limited attention in the academic literature, it is suggested that the examination of this intersection may offer an approach to an understanding of how countries collaborate to establish and maintain dynamic working relationships in the area of international taxation.61

In the following sections of this chapter, the concept of law relating to international taxation, the limitations of traditional concepts of sovereignty as related to taxation, and the potential for cross-disciplinary approaches to


61 Ring (n 5)
international taxation involving the application of international regime theory to taxation matters, will be explored in overview.

1.5.1 The Law of International Taxation from a Global Perspective

Is there anything which can be viewed as a coherent system of international taxation outside of a single country frame of reference? That is, do countries interact, or at least attempt to interact, in a systematic fashion on matters relating to cross-border taxation and the externalities potentially produced by each state’s taxation system?

As noted by Easson, this is questionable:

[O]ne can question whether there exists any body of rules or principles that can properly be referred to as a ‘system’ at all. Rather, there exists a variety of national provisions that have been described as “an Alice-in-Wonderland set of rules” and as “a patchwork structure which often makes little sense.” In sum, to quote Professor Richard Bird, “the accepted rules of the international tax game appear, on close analysis, to be either unworkable, unrealistic or undesirable, or all three”. 63

Kaufman on the other hand, appears to see some type of system, which she describes in the following terms, ‘The existing jurisdictional framework

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62 The term ‘system’ in this context refers to a coherent set of rules or regimes which define and regulate a subject area.
operates as a trellis on which hangs the overlapping and underlapping domestic international tax rules of various countries. While this analogy has some descriptive appeal, it is not persuasive with respect to the existence of any coherent system of international taxation. Kaufman also concludes that some aspects of law related to international taxation, specifically the use of source and residence concepts as the bases for the taxation of income have attained the status of customary norms, although she notes powerful arguments against this proposition. She then goes on to question whether on the basis of fairness or equity this should be so, but does not reach any conclusions in this regard.

It may also be argued that the existing system of more than 2000 treaties on double taxation, together with the two model conventions from which the vast majority of such treaties are derived, provide evidence of a system of international taxation. To the extent that they do, arguably the system they provide evidence of is far from ideal. As will be discussed more fully in Chapter 2 of this work, the current treaty network traces a significant part of its origins to the efforts of a very small group of persons including four economists working in the 1920s, each representing the interests of a state with either colonial interests or

65 ibid 148.
67 OECD (n 43); UN (n 44).
68 Ring (n 5), 42.
colonial aspirations. Unlike the existing system of trade negotiations which are at least notionally more inclusive, it is a system which in its evolution excluded most nations and which continues to exclude many, from the process of design and at least some of the benefits of its outcomes. It is also a system in which a club of rich nations continue to have the greatest ongoing design input, and a system which in the detail of its application in practice, has at least as many variations as there are countries. These variations apply in many areas including the provision


70 The World Bank (n 15), 206-217.

71 Horner (n 18); UN, 'Institutional Framework for International Tax Cooperation' (2003) UN <http://www.law.wayne.edu/McIntyre/text/Treaty_Class/UN_institutional_framework.pdf#search=%221963%20OECD%20Convention%20on%20Taxation%20of%20Income%22> accessed 3 October 2006. Michael McIntyre, the principle author of the UN report notes, “The League of Nations model tax convention of 1928 was prepared by a group of government experts on double taxation and tax evasion. The initial group, formed in 1922, had seven members, all officials from European countries. In 1925, the committee was expanded to include two more European representatives and three additional representatives from outside Europe. Beginning in 1927, the United States, which was not a member of the League, participated on an informal basis. The expanded committee produced a report and draft convention in 1927…”

72 FM Horner, 'International Tax Cooperation and Development Beyond Monterrey' (2002) <http://www.new-rules.org/docs/afterneolib/horner.pdf> accessed 29 June 2004; Ring (n3); AJ Cockfield, 'The Rise of the OECD as Informal 'world tax organization' through the Shaping of National Responses to E-commerce Tax Challenges' (2006) Yale Journal of Law & Technology Spring 136 - 187. As an example of the continued exclusion of non-OECD countries, a recent UN document notes, “The conflict between the goals of the OECD member States and the developing countries has been evident in the recent efforts of OECD to establish an international consensus on the proper tax treatment of income derived from crossborder e-commerce. OECD has favoured a regime that would prevent the source State, in most situations, from taxing such income. Some developing and transitional countries were invited to participate in public forums on e-commerce. The basic decision to limit source jurisdiction apparently had been made by OECD before the public debate even began. The developing and transitional countries obviously did not have a seat at the table when that decision was made.” UN (n 71).

73 Ring (n 5), 58-60. Ring describes how tensions between country preferences may shape unique results in each treaty negotiation.
of tax information to treaty partners.\textsuperscript{74} Given this history, it is accepted for purposes of this work that Easson’s analysis of whether there is an acceptable system of international taxation is correct.\textsuperscript{75} If then there is no acceptable system of law relating to international taxation, but there are intersecting rules which are discernable across states in relation to international taxation, what shapes these rules?

There is a clear line of reasoning going back to Adam Smith, if not earlier, that economic efficiency, equity and the practicalities of enforcement are among the forces which shape, or at least ought to shape, taxation rules.\textsuperscript{76} This line of reasoning has persisted.\textsuperscript{77} As noted in 2000 by then U.S. Deputy Treasury Secretary Stuart Eizenstat:

\begin{quote}
[G]lobal taxation standards are needed to keep pace with the increased flow of international trade. To meet this challenge, and help create the best conditions for stability and growth, we have historically followed a number of policy goals in the international tax area.
-- To meet America's revenue needs in a fair manner;
-- To maintain neutrality and minimize distortions that can be created when tax considerations play an undue role in investment decisions;
-- To minimize compliance and administrative burdens; and
-- To conform with international norms, where possible.
I would add to these that we also need to:
\end{quote}

\textsuperscript{74} OECD, \textit{Towards a Level Playing Field 2006 Assessment by the Global Forum on Taxation} (OECD, Paris 2006). In part this is derived from Article 26 in each the OECD Model Convention and the United Nations Model which provides that a signatory is not obliged to do anything which is not in keeping with its domestic administrative practice.
\textsuperscript{75} Easson (n 63) 1.
\textsuperscript{77} Ring (n 5).
-- Avoid disadvantaging U.S. companies as they compete in the global marketplace;
-- Maximize the coordination of our tax rules and policies with those of other countries so as to prevent both double taxation and unintended double non-taxation;
-- And minimize inappropriate discrimination in the taxation of similarly situated taxpayers and transactions. 78

A more narrow approach to the policy and legal issues related to transnational effects of taxation from the perspective of industrialised countries can be found in the academic literature. 79 This approach reduces the subject of law relating to international taxation to a set of rules designed principally for dealing with specific bilateral issues of double taxation and unintended non-taxation. It tends to narrowly circumscribe this subject to issues which arise for a taxpayer and the relevant taxing states in situations where more than one country has a domestic legal basis for seeking to tax the same income or capital. Such overlapping claims typically arise as a consequence of there being no single basis for direct taxation of income and capital which is applied by all countries, with the further complication that many countries apply more than one basis for such direct taxation. Jeffery sees these overlapping or incoherent claims, which he views as giving rise to 'distortions', as an inevitable consequence of the exercise of unrestricted sovereign rights of taxation. 80

79 Graetz (n 12), 5.  
80 Jeffery (n 57), 175. See also 1-23.
In the typical illustration of 'distortions' used within this narrow approach, the country which is the 'source' of the income as well as the country in which the entity which earned the income is 'resident', each exercises a right to tax that income. As noted by Graetz:

Such “double taxation” is generally regarded as unfair and may create substantial barriers to cross-border economic activity and investments. The essential task of international tax policy is to mediate these claims of residence and source countries in an effort to ensure that income is taxed only once and, in some cases, to ensure that it is taxed at least once.\(^\text{81}\)

This narrow perspective which focuses on the administration of existing national rules to the exclusion of considerations of global efficiency and inter-nation equity is rejected for purposes of the present work. The mediation of conflicts related to double taxation and unintentional non-taxation involving the tax administrations of two or at most a few countries does not by itself provide a sufficient basis for broad economic neutrality or inter-nation equity in the global allocation of taxation revenues, or for cooperation between tax administrations. This is so for a number of reasons, not the least of which is that such a perspective ignores the externalities which affect countries remote to the claims giving rise to double taxation.\(^\text{82}\)

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\(^{81}\) *Graetz* (n 12), 5. It is noted that Graetz identifies both equity and efficiency arguments. The 'unfairness' is primarily to the taxpayer, while the inefficiency arguably produces adverse consequences for all residents of the state in question and potentially globally as well.

\(^{82}\) This phenomenon is discussed more fully in Chapters 3 and 4 of this work.
There is an argument that the interaction of global economic integration and concerns relating to rules created by a small group of rich countries will provide an impetus for a more broad perspective of the scope of international taxation. It is noted that the exclusive organisations which in the past arguably have held sway in preserving a narrow perspective are showing signs of potential change, perhaps allowing for the inclusion of more divergent views, albeit on a carefully controlled basis. It remains to be seen whether this exercise alone will be sufficient to produce a set of coherent and dynamic cooperative mechanisms or regimes sufficient to accommodate, let alone satiate, any collective desire for progressive economic integration as well as broad inter-nation equity, efficiency and administrative ease. There are other potential constraints on international taxation as well.

1.5.2 Sovereignty as a Theoretical Limit on the Exercise of Rights to Impose International Taxation?

The right to impose taxation remains one of the most fundamental aspects of sovereignty. From a narrow perspective which considers only sovereignty,

83 Ring (n 5).
competence in relation to taxation may be viewed as a purely domestic concern. It would follow that, absent treaty obligations, a sovereign state enjoys the legal right to impose taxation essentially without regard to any externalities which such taxation may visit upon other states. Similarly, competence would extend to the right to impose taxation without any consideration of global economic efficiency, or inter-nation equity, or the practicability of administration generally, or the availability of international co-operation in securing compliance specifically.

Jeffery has recently provided an overview of sovereignty and jurisdiction in relation to international taxation. Jeffery’s general proposition, that the realities of modern liberalised trade require states to reassess traditional concepts of sovereignty in relation to unfettered rights of taxation, is accepted for purposes of the present work. It is therefore not proposed to rehearse material on this subject in detail. Jeffery’s analysis of equity and neutrality in relation to distortions in international taxation is however scrutinised.

It may be argued from a perspective which identifies competence to tax as a matter of domestic law only, that any fettering of the latitude for taxation which may be exercised by a sovereign state, undermines that state’s sovereignty. As noted by Jeffery, this perspective appears to influence the willingness of states to

86 B Arnold, Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand, the United Kingdom, and the United States (Canadian Tax Papers Canadian Tax Foundation, Toronto 1991), 7, 10.
use restraint in the application of their taxation regimes. In his analysis of sovereignty in relation to taxation rights, Jeffery points out that the cession or restriction of certain aspects of sovereignty, as part of a collective process of cession or restriction of sovereignty, may in one sense increase the empowerment of a state:

[N]ations have two broad policy choices open to them: they can try and cling to the mirage of absolute sovereignty, holding on to all powers and refusing to allow considerations extending beyond national boundaries to have any influence; or alternatively they can regard self-interest as inextricably entwined in the mutual interest in acclimatising to the changes in the global economy which are taking place, through coordinated action at the national and international levels.

Empowerment increases in Jeffery’s analysis, in the sense that through a cooperative process of mutual restriction or cession, a state may enhance its control over its taxpayers through an ability to determine or secure a payment due to the state’s treasury which would otherwise be unidentified or not collectable. This is contrasted with disempowerment, which in Jeffery’s analysis is represented by a lessened or arguably a more expensive means of securing that payment. By extension, the provision of taxpayer specific information by one state to another also empowers the recipient state and the refusal to provide such information disempowers. Similarly, the exchange of taxpayer specific information arguably empowers both states involved in the exchange, assuming that access to such

87 Jeffery (n 57).
88 Ibid, 21.
89 Ibid, 23.
90 Ibid, 22.
information has utility to both and that such exchanges do not otherwise undermine either state’s treasury.

It is also worthy of note that a state’s voluntary restriction of sovereignty as part of a process of collective cession or restriction, if sufficiently robust, may be one indicator of the development of a cooperative process which on Ring’s analysis could be identified as an ‘international regime’ related to this particular aspect of international taxation. This is discussed further in section 1.5.5.

1.5.3 Utility as a Pragmatic Limit to International Taxation

Jeffery’s arguments pertaining to the voluntary limitation of the exercise of sovereignty arguably are essentially utilitarian, focusing on the economic self interest of state treasuries as the justification for the cession or restriction of tax sovereignty, rather than non-economic normative considerations related to global equity or fairness. Other writers have adopted a welfarist and global approach which focuses on the allocation of economic resources without an explicit limitation based on national interest. By way of example, Slemrod has argued that more broad considerations of welfare than those constrained by national borders may be warranted:
Myopic tax policy making in an increasingly internationalised world economy has several pitfalls.... The guardian of global welfare must be aware that each country’s pursuit of its national interest with regard to tax policy will not ensure a rational allocation of resources, as each country ignores the repercussions of its actions on the others. 92

Kaplow has written in support of a welfarist approach to tax policy which may be extended to considerations of international taxation. 93 On the basis of Kaplow’s Pareto efficiency based analysis, 94 no consideration of fairness or equity should guide taxation policy if such consideration might conflict with a welfarist approach. Kaplow acknowledges however that in a practical context, a non-welfarist approach based on certain guiding moral principles such as fairness may nevertheless be welfare enhancing as individuals have limited abilities to calculate the best outcome in complex situations. 95 While Kaplow’s argument and observation are accepted for purposes of the present work, and the relationship between concepts of fairness, neutrality and inter-nation equity are explored more

91 Ring (n 5), 58-60. Ring describes the voluntary restriction on taxing rights in the context of treaty tax treaty negotiations using shared treaty models.


94 A particular distribution of an attribute or thing, whether welfare or otherwise, may be said to be Pareto efficient if there is no other distribution of that attribute or thing in which any entity would have more of the attribute or thing without some other entity having less. Pareto efficiency says nothing about equity. A situation in which an individual has all of a thing may be Pareto efficient since by definition no other individual can have any without the first mentioned individual having less.

fully in Chapters 3 and 4 of this work, a few observations may be useful at this juncture.

1.5.4 Considerations of Equity and Fairness as Constraints on Law Relating to International Taxation

There is no consensus in the academic literature regarding the role of inter-nation fairness in international taxation. Franck writes that fairness, by which he means both procedural fairness, (that element which allows the parties involved in a particular process to view it as legitimate), as well as substantial fairness, (that element which refers to a shared notion of distributive justice), should constrain international law.96 Arguably, if this is true in respect of international law and institutions in general, it should also be true in regard to the international law relating to taxation.

In contrast, Graetz acknowledges the importance of at least some concept of equity in shaping the law of international taxation, but constrains it to a national perspective,97 noting that factors which should none the less be relevant to an individual state's international taxation policy include; global efficiency and,

97 Graetz (n 16), 276 – 280.
International equity, non-discrimination, reciprocity, redistribution, foreign policy, administrability, international cooperation and enforceability', at least to the extent that considerations of such factors contributes to national welfare.\textsuperscript{98} Kaufman on the other hand sees a critical role for considerations of equity from a more broad, inter-nation perspective.\textsuperscript{99} By way of example, Kaufman argues that,

\begin{quote}
The rules governing the extent of a country's competence to tax are essentially an international matter. Internation equity, not interindividuation equity, must provide the foundation for an equitable international tax system.\textsuperscript{100}
\end{quote}

A linkage between the concept of fairness and the process of competition for tax resources has also been recognised in the context of the HTC Initiative which in its later phases has focussed on 'fair competition' among states.\textsuperscript{101}

Other factors which transcend or defy the concept of national borders and arise from tax competition and tax enforcement difficulties also apply practical constraints to the international tax policy of individual states. The activities of multinational enterprise, supranational organisations and other special interest groups by way of examples, arguably limit the latitude for the tax policies of states.

\textsuperscript{98} Graetz (n 12), 39.
\textsuperscript{99} Kaufman (n 64).
\textsuperscript{100} ibid (n 64), 156.
acting alone, as do technologies which facilitate cross-border economic activities.\textsuperscript{102}

1.5.5 The Potential Role of International Regimes in the Coordination of Exchange of Tax Information Arrangements

The implementation by multiple states of compatible tax information exchange mechanisms on either a bilateral or multilateral basis requires a level of coordination which increases in complexity as the number of states being coordinated increases. Understanding the constraining and facilitating factors which affect whether, and if so how, effective coordination occurs requires more than an understanding of the tax rules of the relevant countries. It arguably also requires some understanding of international relations at the intersection of that discipline with international taxation.

There is a significant literature on international regimes which extends well beyond the scope of the present work. However, that literature contains relatively little which deals specifically with international taxation matters.

Similarly, there is relatively little in the taxation literature which deals with international regime theory. Ring has recently proposed that international regime theory offers a basis for exploring how coordination among states in relation to international taxation matters occurs:

As nations devote more attention to the coordination of their international tax activities, our understanding of how these efforts are structured, shaped, and influenced becomes critical. Regime theory from the IR literature offers an important framework for examining the agreement process between and among nations.\(^{103}\)

In Chapters 5 and 6 of this work, the evolution of the HTC Initiative will be analysed, in part to determine whether regime theory affords any insight into that process. In this section, regime theory as it relates to the context of international taxation is selectively explored in overview.

Regime theory in relation to the discourse among nations; 'describes that part of the [international relations] literature trying to answer the question of how and when countries reach agreement – how they cooperate.'\(^{104}\) Krasner provides a relatively broad description of international regimes as; ‘implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge’.\(^{105}\) In Krasner’s analysis, the relevant ‘actors’ do not need

\(^{103}\) Ring (n 5), 71.
\(^{104}\) Ring (n 5), 12.
\(^{105}\) SD Krasner, 'Stephen Krasner, Structural Causes and Regime Consequences: Regimes as Intervening Variables' (1982) 36 International Organizations 2 185 - 205, 185. Krasner also specifies that, ‘Principles are beliefs of fact, causation, and rectitude. Norms are standards of behaviour defined in terms of rights and obligations. Rules are specific
to be sovereign states, but could include non-governmental entities. Arts also sees a strong role for non-state actors in regimes,\textsuperscript{106} a position also supported in the context of the international taxation by the long standing involvement of private sector bodies.\textsuperscript{107}

Keohane defines regimes in terms of the agreement of governments rather than the convergence of expectations of all involved actors, (although in practice there may be little difference as governments may not reach agreement if there is strong private sector dissent); 'Regimes are institutions with explicit rules, agreed upon by governments, which pertain to particular sets of issues in international relations.'\textsuperscript{108}

There are a number of other attributes of international regimes which emerge from the works of Keohane, Krasner and Ring. First of all, regimes relate to specific problems in a field of application. Thus, there is no single regime, with the possible exception of some form of universal all encompassing harmonization, which could be applied to solve all problems of international taxation. Rather,
regimes may come into existence in relation to individual common problems within international taxation. Another attribute of regimes identified by Ring is that they must actually be adopted and applied by states, rather than simply being endorsed by states without more. Ring suggests that the adoption by the member states of the OECD of a common model double taxation agreement and commentary, albeit with certain reservations and variances in interpretation, provides evidence of the development of a regime.

It is important to note at this point that the definition and attributes specified for regimes, permit regimes to be unfair or inequitable. They exist when states agree what will be. Thus, a regime could exist in a context in which expectations converge around the concept that powerful states do not have to comply with certain onerous obligations which the powerful states seek to impose on less powerful states.

Ring has observed that:

The tax rules and decisions of other jurisdictions are crucial to the bottom line for taxpayers with cross border income and for
countries seeking to tax them. Thus, to effectively implement a desired tax policy it may be necessary to persuade other countries to participate in a shared vision, at least to some degree.\footnote{112 ibid, 9.}

Ring's observation of the interdependence of taxation systems in an integrating global economy and the plight of taxpayers with cross-border income is undoubtedly correct as far as it goes, but arguably it does not go far enough. By way of example, one of the justifications advanced for the HTC Initiative was that absent an agreement to suppress what the OECD identified as 'harmful tax practices', it would not only be taxpayers with cross-border income, but all taxpayers and potentially all persons that would be adversely affected.\footnote{113 OECD, (n 4).} That is not to imply that the 'spin' generated in relation to the 'selling' of a potential regime is to be accepted at face value. Dagan by way of example argues that dominant countries may propose instruments for cooperation in international taxation, specifically model tax conventions, in order to extract wealth from less developed countries.\footnote{114 T Dagan, 'The Tax Treaties Myth' (2000) Vol. 32 International Law and Politics 939 - 996, 941.}

The academic international relations literature contains a variety of propositions attempting to explain why and how regimes form in various situations.\footnote{115 The general regime theory literature is broad and evolving. General background may be found in the following texts: V Rittberger, Regime Theory and International Relations (Clarendon Press, Oxford 1993); A Hasenclever and PMaV} Other parts of this broad literature attempt to identify patterns in the interactions of states as they seek to develop systems of cooperation. A rehearsal of
the entirety of this literature is outside the scope of this work. Specific elements are however relevant.

One element relates to the taxonomy of patterns used to attribute motivations or explanations to the observed behaviour of states and their representatives. Haas, by way of example, has proposed four patterns, each of which corresponds to a line of academic enquiry relating to regime theory; a neorealist ‘follow-the-leader’ pattern, an institutionalism (neoliberalism) and bargaining pattern, an epistemic communities and ‘follow-the-leader’ pattern, and an epistemically informed bargaining pattern. Ring characterises these patterns as representing:

[A] power-based model (realism), an interest-based model (liberalism), a modified power-based model where information or knowledge (cognitivist thread) impacts the exertion of power, and a modified interest-based model where the institutional bargaining pursued by the states is significantly impacted by information or knowledge transmitted by epistemic communities.

The regime theory framework used in the present work is that of Ring set out above.


117 *Ring* (n 5), 29.
A second relevant element in international regime theory is the great flexibility permitted in the mixing of these patterns in order to explain observed behaviour. Thus, a particular behaviour may be said to be explained in part by an interest-based model and in part by a power-based model.

A third element in international regime theory which is of particular relevance in the present work may be referred to as path dependence. As noted by Ring:

If an organization (or set of states) makes the first move at resolving an issue (even if that agreement fails to reflect the interests of all possible participants), then the regime, once established, may have a life of its own that effectively constrains the ability of a second generation agreement from gaining the same degree of prominence.\textsuperscript{118}

The strategic implications of path dependence in the context of the OECD’s Harmful Tax Competition Initiative are analysed in Chapters 5 and 6.

\textsuperscript{118} ibid, 70.
2.0 INTRODUCTION

International cooperation in tax matters can take on a myriad of forms, ranging from the adoption of identical tax systems in states undergoing federation, through forms of harmonisation of taxation systems such as exists in the case of indirect taxation within the European Union, to much more limited cooperation in relation to the enforcement of tax systems which may be found in certain treaties. The provision of tax information by one national tax administration to another may be viewed as falling within the spectrum of international cooperation in the enforcement of taxation systems.

The role and perceived importance of the provision of tax payer specific information to foreign tax authorities has changed dramatically over the past 160 years. In its initial application, exchange of tax information was an administrative tool with very limited scope intended to provide tax administrators with information regarding certain types of assets and transactions of their citizens in a neighbouring state that were within the scope of a bilateral tax treaty. How

120 DGD Impots, Conventions Fiscales (Ministere de L'Economie, Des Finances, et de L'Industrie, Paris 1999), 139.
did it then become, as asserted by Keen and Ligthart, the central issue in the formulation of international tax policy at the dawn of the 21st century, and are there any legal principles which can be discerned in that evolution which can be utilised to assist in identifying the way forward in achieving greater international cooperation?

This chapter examines the theoretical justifications for the provision of taxpayer specific information to foreign taxation authorities set out in the literature, and the theoretical bases for the limitation of such provision. It also examines the existing frameworks for tax information exchange.

2.1 PROTOCOLS FOR TAX INFORMATION EXCHANGE

There are three common protocols for the provision of taxpayer specific information to foreign tax authorities which are found in tax related treaties. The first and most common is exchange of information upon request. As the term implies, in the context of exchange of information upon request, the provision of taxpayer specific information is triggered by a formal request submitted by a tax authority to its counterpart in a foreign state. Typically, these requests specify the identity of the relevant taxpayer and the nature of the information which is sought

together with some indication as to which entity is thought to have such information.122 Countries with direct taxation systems commonly have information relating to their taxpayers which is available for production in response to a request. Most countries also have mechanisms which enable them to compel the production of information held by persons within their jurisdiction in response to the requests of foreign tax authorities.123

The second common form which the provision of tax information may take is spontaneous provision. Under international arrangements providing for the spontaneous provision of taxpayer specific information to foreign tax authorities, a tax authority coming into the possession of information which it considers might be of utility to a foreign tax authority will transmit the information to that foreign tax authority for its consideration without any initiating request for such information.124 Spontaneous information received by the foreign tax authority may then be used as the basis for further requests for information under protocols providing for the exchange of information upon request.

The third form which the provision of taxpayer specific information to foreign tax authorities may take is automatic exchange of information. Protocols providing for the automatic exchange of information typically require states to collect and provide all information covered by the protocol to the relevant foreign tax authorities.\textsuperscript{125} The implementation of automatic exchange of information generally requires the use of standardised forms of taxpayer identification and standardised protocols for the presentation of information.\textsuperscript{126} Without such taxpayer identification and standardised protocols, it may be very difficult for the tax authorities receiving such information to efficiently match any information received to the relevant taxpayer.

2.2 \textsc{Theoretical Justification for the Provision of Exchange of Tax Information}

There is no obligation in customary international law for tax administrations to provide tax information to, or exchange tax information with, foreign tax authorities absent any express treaty-based obligation. Exchange of tax

information between or among tax administrations typically occurs on the basis of obligations set out in bilateral or multilateral agreements, most commonly so-called double taxation treaties or agreements. Such agreements are generally voluntary and relatively comprehensive in relation to taxation rights. They also typically partition taxing rights and set out mutual benefits, whether in the form of reciprocal receipt of tax information or otherwise.

The academic legal literature relating to exchange of tax information is well developed, at least as regards utilitarian analysis from a single state perspective of the value of exchange of tax information in the enforcement of residence-based tax systems. From this narrow perspective, the practice of exchange of tax information among tax authorities is generally viewed as desirable, although not all authors accept the utility or necessity of tax information exchange. 127

Keen and Ligthart have recently published a primer on exchange of tax information, in which they examine both the utilitarian perspective of exchange of tax information and the welfare case for it. 128 Keen and Ligthart’s analysis of the utilitarian case for exchange of information may be summed up in the view that

128 Keen (n 121), 84-89.
exchange of information has relative utility as a patch for 'imperfections in enforcement of the residence principle', 129 which given present political realities, implies that exchange of tax information has more utility than tax coordination. 130 As they note in relation to what they view as the less pragmatic alternative of tax coordination:

[A]s a matter of practical politics, coordination of tax rates on capital income has got nowhere: the implied restriction on national tax sovereignty seems, for many countries, to be simply too much to swallow, both for themselves and also, in some prominent cases, as a matter of principle in terms of what they believe they can properly ask of others.... In any event, information sharing may now be the last hope of the residence principle, and perhaps for the taxation of capital income more generally. 131

The academic tax economics literature does provide some further theoretical underpinning for exchange of information practices in the form of an economic efficiency rationale. 132 While a general discussion of the economic theory of optimal taxation is outside of the scope of the present work, it is worth noting that in the context of tax information exchange, Keen and Wildasin have observed that the welfare case for exchange of information is underpinned by the economic concept of production efficiency, the requirements of which are at best,

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129 Keen (n 121), 82.
130 V Tanzi, Taxation in an Integrated World Integrating National Economies: Promise and Pitfalls (Brookings Institute, Washington, D.C. 1995), 82. Tanzi notes that 'The application of the residence principle and the attempt to tax income on a global basis will continue to be possible only if there is full and efficient exchange of information between tax authorities.'
131 Keen (n 121), 84.
unlikely to be achieved in the real world.\textsuperscript{133} Specifically, Keen and Wildasin make the point that production efficiency theory is based on a single country model in which the single government in the model has only one constraint. This model therefore arguably does not fit well in a real world context in which there are multiple governments, each of which has multiple constraints particularly in relation to its fiscal systems.

The tax economics literature also contains a proposition that under certain conditions, countries with similar residence-based capital tax systems have economically rational bases for cooperation, as indicated in the work of Tanzi\textsuperscript{134}. In contrast, Eggert’s work\textsuperscript{135} as well as that of Keen\textsuperscript{136}, show that there are conditions in respect of which it would not be economically rational for countries to exchange information absent some form of incentive to do so. Keen and Ligthart also note a theoretical economic basis for country size and, by inference beyond their analysis, the stage of development of a country, to be factors which might influence the rational choice of exchange of tax information practice:

\textsuperscript{133} M Keen and D Wildasin, 'Pareto-Efficient International Taxation' (2004) 94 American Economic Review 1, 259 - 274. The concept of production efficiency and its relationship to taxation system design is discussed in Chapter 4 of this work. In very general terms production may be said to be efficient if a given number of economic outputs cannot be achieved with any fewer inputs. More specifically, the concept of production efficiency suggests that economic production will be greatest when the availability and cost of inputs of production is not distorted, for example by tax-related rules.


\textsuperscript{136} Keen (n 121).
One further clear implication (and a recurring theme in both this and the wider tax competition literature) is that small countries are likely to have least to gain from information exchange: they are inclined to set lower tax rates in order to attract inward investment (the gains from which can swamp the consequences of any revenue lost from the small domestic tax base... 137

The observation that absent some form of incentive it is not in the interests of small and developing countries to provide tax information to foreign tax authorities has also been recognised by representatives of some developed countries. 138 While developed countries generally have been reticent to extend the benefits of the treaty network to smaller and developing countries absent any significant economic or geo-political advantages for the more developed country, some have recently recognised that access to taxpayer specific information does warrant the provision of certain restricted economic benefits to smaller and developing countries. 139

137 ibid, 87.
2.2.1 The ‘Third Country’ and ‘Last Man Standing’ Problems

The literature on exchange of tax information points to an economic efficiency problem in the theory of tax information exchange, which is known in the literature as the ‘third country problem’.\textsuperscript{140} This problem takes on differing forms dependent on whether a static frame of reference, or a view over time, is adopted. Keen and Ligthorn have focussed on the problem as it exists at a single point in time.\textsuperscript{141} In their analysis, the ‘third country’ problem is that countries which do not exchange tax information have an advantage over those that do, as a result of the tendency for economic activity to migrate so as to avoid the economic costs associated with exchange of tax information, whether in the form of compliance costs or otherwise.

An equally important extension of the ‘third country’ problem, which is generally not considered in the literature, may be seen when the problem is considered over a period of time, rather than from a point in time. This aspect of the problem relates not to the absolute and unwavering refusal by third countries to provide information, but to the deferral by third countries of such information provision. The theory underlying this deferral is that the last country to provide information gets the cumulative benefit of the movement of economic activity

\begin{itemize}
\item \textsuperscript{140} Keen (n 121), 89.
\item \textsuperscript{141} ibid.
\end{itemize}
from all other countries which provide information at a point earlier in time – what
may be called the 'last man standing' problem. A corollary to the 'last man
standing' problem is that once economic activity has moved to the last man
standing, all other things being equal, there is no incentive for the economic
activity to return from whence it came, and therefore the intransigence of the last
man standing is perpetually rewarded from that point in time forward.142

There may also be conditions under which the provision of tax
information by one state to another which has a biased international taxation
system may also have a role in skewing global economic efficiency in the
allocation of both economic resources generally, and the economic resources of
states in the form of taxes. The provision of taxpayer specific information may also
alter the intra-nation fairness which is produced by the interaction of national tax
systems. These potential effects of the provision or exchange of tax information
are discussed in Chapters 3 and 4 of this work.

142 This may explain in part the reluctance of certain EU member states such as Luxembourg and Austria to provide
exchange of information in the context of the European Union directive on the taxation of savings income for so long
2.3 Utility and Economic Efficiency as Factors Shaping the Evolution of Exchange of Tax Information Networks

The pattern of double taxation treaties (DTAs) and tax information exchange arrangements is not random. Early treaties were between neighbouring countries. Later treaties tended to be established between countries with significant existing trade, or geo-political connections such as existed between the United Kingdom and its former colonies.

Double taxation treaties and tax information exchange arrangements have tended to follow rather than lead trade patterns in the sense that, in setting priorities for the negotiation of such treaties or arrangements with other states with which no such treaty or arrangement exists, states tend to give priority to those states with which they have the greatest trade or other connections. States with residence-based taxation systems respond to pressures from their private sectors in putting into place treaties aimed at the elimination of double taxation, which often contain exchange of tax information provisions. Such states also lobby other states for tax information provisions in circumstances in which there is a large trade, particularly in capital.

The present analysis proceeds on the basis that the assessment of a tax liability requires information. The nature of this information and the range of
potential geographic locations in which it may exist vary not only from taxation system to taxation system, but potentially also over time within taxation systems. Countries with exclusively territorial or source-based taxation systems generally are able to obtain any requisite information within the territorial limits over which they exert sovereignty. Countries with residence-based taxation systems generally require access to reliable information from foreign sources in order to ensure compliance with the extraterritorial aspects of their tax systems.

Tax information exchange arrangements are not universally available however. Countries with residence-based tax systems which export capital, in whatever form, directly or indirectly to countries with which they do not have a DTA or other tax information exchange arrangement, face at least a potential audit and compliance enforcement problem. The magnitude of any problem posed by the absence of tax information exchange arrangements is arguably a function of the probability that capital will move to, or through, a jurisdiction from which tax information is not generally available, that is, the probability of a break in the audit trail. This magnitude is in turn a function of multiple factors including domestic and foreign legal, social and economic environments which themselves change over time. By way of example, the probability that capital will move at a given point in time is a function of several factors, including the probability that it can be applied in a different jurisdiction so as to achieve a higher risk adjusted after tax rate of return. As noted by Graetz, the sensitivity of capital to tax factors

143 DGD Impots, (n 120), 139 ; League of Nations (N 119),143 – 300.
varies with the intended application of the capital, with capital intended for foreign
direct investment being less sensitive to tax related factors than capital intended
for portfolio investment purposes.¹⁴⁴

For much of the twentieth century exchange control mechanisms and
other regulations restricted capital movement, and the information which was
required to be provided in order to overcome such restrictions also served as a
source of information for tax administrators.¹⁴⁵ The presence of these restrictions
and the availability of information relating to capital which did move across
borders meant that there was less risk perceived by the tax administrations in
capital exporting countries relating to not having effective exchange of information
arrangements in place with the majority of countries.

This perception of relatively low risk associated with not having tax
information exchange arrangements with many countries arguably may have been
reasonable forty years ago. By way of an hypothetical example, if a given country
belonged to a club in which member countries had exchange of information
arrangements with substantially all members of the OECD together with a few
large developing and transitional countries, then the vast majority of global gross
domestic product would be within the exchange of information net, and tax

¹⁴⁴ MJ Graetz, 'The David R. Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated
compliance would be largely secure. This would be the case as this group of countries could by design cover almost all foreign direct investment (FDI) capacity which was available to even sophisticated investors, and also because it could cover nearly all global portfolio investment management (PIM) capacity.

The exclusion of non-club countries from the tax treaty network by members of the hypothetical club could further reduce the risk of being unable to enforce taxation measures, as this exclusion would utilise the potential for double taxation of investment outside the club. This would bias the distribution of FDI and PIM capacity in favour of club members, making it less likely that information regarding capital income would not be available.

The international taxation related risk management requirements of capital exporting countries may have changed dramatically over the past forty years. Barriers to capital movement have fallen. New patterns and methods of capital movement involving both FDI and PIM increasingly involve highly specialised financial product designers and managers operating in, or utilising, smaller and developing countries with highly developed infrastructure. Such smaller and developing countries were and are often excluded from taxation treaty networks. Indeed in the 1980s a number of tax treaties with small and

146 Graetz (n 144), 312.
developing countries were terminated by developed countries as there were perceived economic competition and risk management advantages available to large and developed countries which kept at least some small and developing countries out of their treaty networks.\(^{149}\) However, with the advent of the instruments of globalisation, the continued exclusion of such countries from tax information exchange networks may have fundamentally altered the risks faced by residence-based tax systems, necessitating an alternative approach.

Recent initiatives such as the HTC Initiative,\(^{150}\) and the European Union’s Directive on the taxation of savings income,\(^{151}\) have stimulated academic comment in relation to exchange of information for tax purposes, albeit that such comment is generally from a developed country perspective. It is important to note at this point that one of the central themes of each of these recent initiatives is the need of tax authorities in countries with residence-based capital taxation systems to control disadvantageous forms of tax competition, and also their need to control tax avoidance and tax evasion.

2.4 The Justification for Exchange of Tax Information Set Out in Commentary to the Model Conventions

There is a considerable literature related to the nature, and the utility of exchange of tax information in the context of the principal model conventions developed for double taxation agreements, specifically the model developed by the OECD, and the model developed by the Ad Hoc Group of Experts operating under the auspices of the United Nations. The scope and justification for exchange of tax information in relation to each of the OECD and UN models are circumscribed on their face. The identical Commentary on Article 26 of the 1997 and 2003 versions of the OECD Model indicates, somewhat tentatively, a utilitarian justification for exchange of tax information:

In the first place it appears to be desirable to give administrative assistance for the purpose of ascertaining facts in relation to which the rules of the convention are to be applied. Moreover, in view of the increasing internationalisation of economic relations, the Contracting States have a growing interest in the reciprocal supply of information on the basis of which domestic taxation laws have to be administered, even if there is no question of the application of any particular article of the Convention.


154 UN, United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York 2001).

155 OECD (n 153), 287.
Both the language of Article 26 and the corresponding section in the associated Commentary, were recently reviewed within the OECD. The OECD's Committee on Fiscal Affairs in its 1 June 2004 recommendations for revisions to Article 26 of the OECD Model decided to make no change to the stated rationale for exchange of tax information. 156

The commentary to the 2002 OECD Model Tax Information Exchange Agreement offers a somewhat different, but once again utilitarian two-state perspective, indicating that the justification for broad exchange of tax information is as follows:

Article 1 defines the scope of the Agreement, which is the provision of assistance in tax matters through exchange of information that will assist the Contracting Parties to administer and enforce their tax laws. 157

The observations in the manual which was developed by the UN's Ad Hoc Group as an aid to the implementation of the UN Model convention, in respect of Article 26 of that UN Model, also indicates a utilitarian justification for an exchange of information article as follows:

Experience has shown quite clearly that a tax administration which relies only on the information available to it within its national jurisdiction is not equipped to deal effectively with the problems posed by tax evasion.... Obviously cooperation on the exchange of information is also helpful in

It can thus be seen that in the most widely used models, the exchange of tax information is justified in a two country context as having utility in the enforcement of national tax systems and treaty provisions. As will be discussed in Chapters 3 and 4 of this work, the lack of consideration to other aspects of tax information exchange may be an unfortunate oversight.

2.5 THE EVOLUTION OF TAX INFORMATION EXCHANGE - SELECTIVE OVERVIEW OF EXCHANGE OF TAX INFORMATION FROM 1843 TO 2006

Exchange of tax information arrangements between sovereign states, whether contained within more broad tax related treaties, or in stand alone agreements, are primarily concerned with securing the enforcement of tax related national laws or international agreements. In a modern context, securing enforcement arguably has three components. The first involves the provision of information which will allow for tax authorities to identify and quantify taxes payable by their taxpayers. The second involves the creation of deterrence effects, that is, taxpayers with knowledge of exchange of tax information agreements may be deterred from failing to report foreign income. The third involves the verification opportunities which exchange of information provides to treaty partners which enable them to

158 UN (n 154), 136.
confirm that treaty obligations are being fulfilled by the other party to the treaty. This relatively broad utility of tax information exchange provisions has not always been the case.

2.5.1 Tax Information Exchange in The Period from 1843 - 1920

There were very few international agreements providing for the exchange of tax information prior to efforts to minimise double taxation in the 1920’s.\textsuperscript{159} The first appearance of an exchange of tax information protocol within a bilateral tax treaty between sovereign states is that which is found within an 1843 treaty between France and Belgium.\textsuperscript{160} This treaty provided for the restricted exchange of tax information in the sense that it specified certain types of documents which were to be exchanged. On its face, the exchange of information was intended to do no more than to allow the tax authorities in the signatory states to verify that the treaty was being properly applied by each party. The relatively few exchange of information provisions entered into prior to the advent the League of Nations had similar scope.

\textsuperscript{159} The League of Nations Experts Committee identified only twenty such instruments as of 1927. \textit{League of Nations Economic and Financial Commission} (n 119), 143.

\textsuperscript{160} \textit{DGD Impots.} (n 120), 139.
2.5.2 Tax Information Exchange in the Context of the League of Nations and the Expansion of the Tax Treaty Network

The activities of the League of Nations from the early 1920's to 1946 provided a forum in which taxation authorities from both member and non-member countries as well as representatives of commerce could engage in wide ranging discussions regarding matters of taxation. One of the matters discussed over the more than two decades during which the Committee was active, was administrative cooperation between taxation authorities.

The 1927 Report of the Experts Committee appointed by the League of Nations noted that at that time there were only "20 conventions or groups of conventions [which] deal with double taxation and administrative and judicial assistance."\(^{161}\) By 1935 the Committee was able to report that with respect to treaties providing for the elimination of double taxation;

\[\text{[I]n all, fourteen general Conventions have been concluded in the five years which have elapsed since June 1930.\ldots\text{ It is a remarkable fact that in the fiscal domain \ldots\text{there was a growing tendency towards the conclusion of general agreements denoting a clear intention to alleviate excessive taxation.}}\]^{162}\)

\(^{161}\text{League of Nations Economic and Financial Commission (n 119), 143. Also of note MJ McIntyre, 'Developing Countries and International Cooperation on Income Tax Matters: An Historical Review' (2005)}\text{<http://www2.let.uu.nl/solis/cim/multimedia/taxreforms/mcintyre_intl_cooperation.pdf?/search=%22OECD%20model%20convention%20history%22> accessed 3 October 2006. 1. McIntyre notes that early "income tax treaties were adopted by Prussia around the start of the twentieth century. Its first treaty was with Austria, signed in 1899. Soon thereafter, it entered treaties with Bavaria, Saxony, and Baden, followed by treaties with Luxembourg and the city of Bale. Other continental governments soon followed the Prussian lead. Hungary and Austria concluded a treaty in 1909."}

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That same year the Committee also observed that; “These general Conventions concluded in recent years are not as a rule confined to taxes on income. Several of them deal with administrative assistance.”

At its 1936 meeting the Committee observed the connection between unjust (double) taxation and tax evasion:

[While in 1923, when the League of Nations called together the first meeting of tax experts, very few conventions existed in the field of double taxation, more than a hundred and forty are now in force. Since taxpayers are now protected from unjust taxation, a higher standard of conscientiousness can be expected from them. Moreover, the States are in a position, prior to the application of measures to prevent tax evasion, to conclude conventions for the abolition of double taxation; this would make it easier for the taxpayer to bear the burden resulting from the measures set forth hereunder.]

It is worthy of note that the Committee alluded to the desirability of eliminating double taxation as a condition for seeking cross-border cooperation in tax administration. They did not go so far as to suggest that tax evasion was justified by double taxation, but they implied that administrative cooperation required to give effect to ‘unjust’ taxation was perhaps not justified.

The Experts Committee of the League of Nations saw wisdom in developing conventions providing for administrative assistance in each of the assessment of taxes and the collection of taxes separate from conventions

162 League of Nations Economic and Financial Commission (n 119), 293.
163 ibid, 291.
providing for the elimination of double taxation. Administrative cooperation was primarily aimed at the elimination of tax evasion. They noted in particular, the problem of tax evasion with respect to movable capital, and saw the solution in bringing about greater cooperation among states. As they noted in 1936:

States hesitate to apply stricter internal control, because they fear that more lenient neighbouring States will benefit thereby and will drain off the main flow of capital. From the technical point of view, the principal States, realising these common dangers to which they are all liable, would have to adopt simultaneously similar methods of control for both national and international transactions. Is such simultaneous action possible? 165

The observation some seventy years ago of what is now generally referred to as the 'third country problem', 166 that is, that efforts to control capital tax evasion on a bilateral or even a limited multilateral basis may simply displace capital seeking to avoid taxation to countries which are not part of the bilateral or multilateral solution, provides some indication of how intractable these issues are.

The solution identified by the Committee was one of enhanced cooperation, a solution which is strikingly similar to, if more broad in scope, than that proposed by the European Commission some eighty years later. 167 The Committee's suggestion was that:

In each of the contracting States, rules shall be laid down that persons or companies who, in the course of their business, pay out income derived

164 ibid, 305.
165 ibid, 306.
166 Discussed in Section 2.1 of this work.
167 European Council (n 151).
from movable capital must report every payment made to a person not resident in the State in which this payment is effected. The notice in question shall be given to this latter State, which shall transmit it to the State in which the recipient resides.\textsuperscript{168}

The rationale offered by the Committee in their 1936 Report for the automatic exchange of information mechanism,\textsuperscript{169} is also strikingly similar to that suggested in relation to the European Union’s 2003 Directive on the Taxation of Savings Income.\textsuperscript{170}

On the basis of this proposal, a survey of League of Nations member and non-member states was undertaken to identify how many would be prepared to alter their laws so as to give effect to the proposal for a general sharing of tax information among states. Sixty-one states were invited to indicate whether they would support a proposal which, as part of the obligations of a multilateral treaty, would require them to change their domestic legislation in order to facilitate exchange of information among tax administrations on an automatic basis. Only twenty-nine responded. Those responses indicated only limited support for the Committee’s proposals.\textsuperscript{171}

As a second line of enquiry by the Committee, information was also sought from states as to whether it might be possible to use existing sources of

\textsuperscript{168} League of Nations Economic and Financial Commission (n 119), 307.
\textsuperscript{169} ibid.
\textsuperscript{170} European Council (n 151).
information already maintained by the tax administrations in the member states which would assist in administrative cooperation, including exchange of tax information. The results released in 1938, did not encourage the pursuit of a multilateral arrangement.\(^\text{172}\)

Following the end of the Second World War, discussions under the auspices of the League of Nations were revived. In 1946 two versions of a revised model convention providing for the exchange of tax information were presented. These models continued the practice of separating conventions for administrative cooperation from conventions for the elimination of double taxation, although it is apparent that it was intended, or at least contemplated, that agreements based on the conventions and providing respectively for the elimination of double taxation and administrative cooperation, would be signed simultaneously.

Article 1 of the 1946 London model convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Taxes on Income, Property, Estates and Successions provided:

With a view of assuring, in the interest of Governments and taxpayers, an effective and fair application of the taxes to which apply the Conventions....each of the contracting States undertakes, subject to reciprocity, to furnish on special request such information in matters of taxation as the competent authorities of each State have at their disposal or are in a position to obtain under their own revenue laws and as may be of use to the competent authorities of the other State in the

\(^{171}\) League of Nations Economic and Financial Commission (n 112), 317.
\(^{172}\) ibid, 324.
assessment of the above-mentioned taxes and to lend assistance to the competent authorities of the other State in the collection of such taxes. 173

The explicit recognition of a dual objective for administrative cooperation, specifically fairness and effectiveness, was combined with equally explicit limitations on the scope of the convention. The application of administrative assistance was circumscribed by the taxes covered by the convention. This contrasts with recent versions of the OECD model convention, 174 and the 2002 OECD Model Agreement on Tax Information Exchange, 175 in which administrative assistance is not limited to the taxes covered. Further, Article V of the 1946 London model convention provided relatively wide grounds for the refusal of administrative assistance. 176 In contrast, there are more limited grounds for the refusal of a request for tax information set out in recent versions of the OECD Model Convention and the 2002 OECD Model Agreement on Exchange of Information. 177

173 ibid, 441.
174 OECD (n 153), 41.
175 OECD (n 122).
176 League of Nations Economic and Financial Commission (n 119), 443. Article V. Refusal was permitted:
A. If they involve the obligation to obtain or supply information which is not procurable under the legislation of the State applied to or that of the applying State;
B. If they imply administrative or judicial action incompatible with the legislation and practice of either contracting State;
C. If compliance involves violation of a professional, industrial or trade secret;
D. If the request relates to a taxpayer who is a national of the State applied to;
E. If, in the opinion of the State applied to, compliance with the request may compromise its security or sovereign rights.
177 OECD (n 153), OECD (n 122).
It is arguable that the development of tax information protocols during the League of Nations process as well as today were driven to some extent by the agendas of a relatively few geo-politically influential states.\textsuperscript{178} It will be recalled that the four countries from which the group of four economists involved in the initial League of Nations process originated arguably were among the dominant nations of the day.\textsuperscript{179} That does not imply that the aspirations of geo-political powerful states always come to fruition.

In the period from May 1926 to April 1927, a group of 'experts' appointed by the League of Nations, together with advisors representing commercial concerns in the then developed countries, considered a variety of issues related to international taxation, including administrative cooperation between taxation authorities.\textsuperscript{180} The members of the League of Nations Experts Committee were chosen from a somewhat broader group of countries than were the initial group of four economists who began the League of Nations work in this area.\textsuperscript{181} These experts recommended that the issues of international double taxation and international cooperation could best be dealt with through the bilateral adoption of


\textsuperscript{179} League of Nations Economic and Financial Commission (n 119), 1. The four economists who made up the original committee were Prof. Bruins (Commercial University, Rotterdam), Prof. Senator Einaudi (Turin University), Prof. Seligman (Columbia University, New York), Sir Josiah Stamp, K.B.E. (London University).

\textsuperscript{180} ibid, 112.

\textsuperscript{181} The 1926 'experts group' was made of representatives from Argentina, Belgium, Czechoslovakia, France, Great Britain, Italy, Japan, Netherlands, Poland, Switzerland, the United States of America, and Venezuela. It is noted that all of these
four related treaties, two of which dealt with double taxation of income and capital and administrative cooperation among taxation authorities for the purpose of limiting tax evasion. The experts viewed the subject of double taxation and the subject of tax evasion as linked:

[A]ny excessive taxation, by its very burden, brings in its train tax evasion, the nature and grave consequences of which have been emphasised on earlier occasions; the suppression of double taxation is therefore closely connected with the measures for the systematic prevention or checking of such evasion. 182

The scope of the model 'Bilateral Convention on Administrative Assistance in Matters of Taxation' which was submitted to the League of Nations by the Committee in 1927 had the following scope and object:

With a view to obtaining a better apportionment of fiscal burdens in the interest both of Governments and taxpayers, the Contracting States undertake, subject to reciprocity, to give each other administrative assistance in regard to all matters required for the purpose of tax assessment.

Such assistance may consist in:

(a) The exchange of fiscal information available in either of the contracting countries. The exchange will take place following a request concerning concrete cases, or, without any special request, for the classes of particulars defined in Article 2;

(b) Co-operation between the administrative authorities in carrying out certain measures of procedure. 183

It is important to note that while 'better apportionment' may suggest both an issue of equity as well as administrative efficiency, there is no evidence to

countries with the exception of Argentina and Venezuela which over the decades have declined as relative economic powers in the world, remain involved in the taxation related processes of the OECD.

182 ibid, 114.
183 ibid, 131.
suggest that 'better apportionment' in this context referred to any form of inter-
nation formulary apportionment as set out in modern literature.\textsuperscript{184} Rather, it almost
certainly referred to the intra-nation allocation of tax burdens among taxpayers of
individual signatory states.

The preamble section of the Commentary to the 1927 Draft Convention is
also useful in illustrating the rationale which underlay the provisions of the
Convention. In the preamble it is stated that:

[T]he Committee realised the necessity of dealing with the
questions of tax evasion and double taxation in co-ordination
with each other....

[W]here relief is sought by a taxpayer in pursuance of
arrangements made between two countries for the avoidance of
double income tax, it is clearly necessary that the country
granting this relief should have full information in regard to the
assessment and the amount of tax paid in the other country, and
provision to this effect has generally been made in the
conventions which have hitherto been concluded.\textsuperscript{185}

The role claimed for administrative cooperation between taxation
authorities in the form of exchange of information in the 1927 Model is
remarkably similar to that claimed for exchange of information in modern
writings. What arguably is a fundamental difference which distinguishes the 1927
Model from the 2002 OECD Model,\textsuperscript{186} is that the Committee saw the need for

\textsuperscript{184} LC Celestin, 'The Formulary Approach to the Taxation of Transnational Corporations: A Realistic Alternative?'

\textsuperscript{185} League of Nations Economic and Financial Commission (n 119), 133.

\textsuperscript{186} OECD (n 122).
treaties providing for administrative cooperation in the form of exchange of tax information to be part of a set of reciprocal arrangements which involved three other forms of treaties providing for the allocation of taxation rights and the provision of mutual benefits.

In contrast with the 1927 League of Nations model, the 2002 OECD tax information exchange model intended by the OECD for use in the context of the HTC Initiative, was not designed to accommodate such allocation of taxation rights, or the provision of mutual benefits, although it does not exclude these possibilities. The distinction may lie in the fact that the set of treaties contemplated by the League of Nations Committee were developed by a set of states operating on the basis of a degree of equality, and intended to be used in a context in which the states which were parties to the sets of agreements were considered sufficiently equal members of the international community to deserve such treatment. As will be discussed in Chapter 5, it is not entirely clear that at least at the outset of the process leading to the development of the 2002 OECD Model, that the countries targeted by the OECD were viewed as equal to the OECD member states.

Finally it is noted that there is no suggestion in the materials published in the context of the League of Nations 1927 Model, that the Experts Committee thought that there was any obligation for states to exchange tax information other than in the context of associated agreements providing for the partitioning of taxation rights and the elimination of double taxation. How then has exchange of
information progressed in the six decades since the end of the League of Nations process?

2.5.3 The OECD and UN Tax Information Exchange Models

Arrangements from 1963 to 2006

The tax information exchange arrangements incorporated into model tax treaties reflect the economic interests of the states which endorse such models. These arrangements are also dynamic, reflecting the changing nature of international commerce and the taxation issues related thereto. The non-binding nature of such models also reflects the diversity of interests of the states involved in drafting the models and the need to ensure the preservation of that degree of flexibility which is needed to ensure that interfaces can be created between the divergent national taxation systems of the relevant states.

In 1955 there were only 70 agreements providing for the elimination of double taxation among the membership of the OECD's predecessor, the OEEC. Most of these agreements reflected various versions of the model conventions

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187 OECD (n 148).
drawn up by the League of Nations.\textsuperscript{189} However, the League of Nations models and in particular the 1943 Mexico version and the 1946 London version were not as comprehensive as some of the membership of the OEEC desired.\textsuperscript{190}

The adaptation and modification of treaty models generally lag changes in commercial practices. By way of example, the OECD published an early version of what is now Article 26 of its Model Convention in 1963. In 1977 it published a revision to the exchange of information provision set out in Article 26, primarily to clarify ambiguities in the 1963 text and to add a provision allowing any information exchanged to be divulged in court proceedings and therefore made public. However, despite the advent of globalisation and removal of non-tax barriers to international commerce, there was no revision to the OECD Model Convention during the 1980s.

Perhaps one of the most significant changes to the content of Article 26 of the OECD Model occurred in 2000, when the scope of taxes in respect of which information could be exchanged changed from taxes covered under the Convention to include taxes not covered, and in particular indirect taxes including sales taxes.\textsuperscript{191} Despite the general trend toward allowing greater information flow between tax administrations, the non-binding nature of the OECD Model means


\textsuperscript{190} ibid.

\textsuperscript{191} ibid.
that OECD member states are free to modify any article. By way of example, Switzerland has specified a reservation to the effect that it limits exchange of tax information to that which is necessary to carrying out the provisions of the Convention.\(^{192}\) That, together with domestic legislation which in effect limits exchange of information in most of Switzerland’s treaties to matters of tax fraud and the like,\(^{193}\) means that relatively little information may in fact be exchanged. The divergent frameworks for exchange of information which persist in practice among OECD member states are described more fully in section 2.6.

The UN Model convention was arguably drafted on the basis of a different reality from that experienced by the member states of the OECD. As noted in a 2003 UN publication:

The United Nations model does have a somewhat broader exchange-of-information article than does the OECD model convention. Unfortunately, developing countries have had mixed success in obtaining information from the developed countries through that article. For example, the developing countries have not been able to use that article to prevent capital flight by their residents who seek to avoid tax in their home country by taking advantage of tax-free investment opportunities available in the developed countries.\(^{194}\)

\(^{191}\) OECD (n 153), 290.
\(^{192}\) OECD (n 153), 294.
\(^{193}\) OECD (n 123), 96.
The form of the UN Model Article 26 evolved in a manner similar to that of the OECD model. There are however differences such as the inclusion in paragraph 1 of the UN model of a reference to the purpose of exchange of information being, ‘in particular for the prevention of fraud and evasion of taxes’ and a requirement that if information was regarded as secret by the requested country then it should be treated as such by the receiving country. Efforts to amend the exchange of information provisions of the UN Model are ongoing, lead in large part by representatives of OECD member states and the OECD itself. Part of the objective behind the modification appears to be to harmonise the provisions in the UN Model with those in the OECD Model. While this will undoubtedly increase administrative convenience, it is by no means certain that it will increase information flow to developing countries from all developed countries. As noted in a recent UN paper:

The United States declines to provide developing and transitional countries with information on the United States bank-deposit interest income earned by their residents, although an exchange of such information would appear to be required under many United States bilateral tax treaties.\(^{197}\)

2.6 CURRENT LEGAL AND ADMINISTRATIVE FRAMEWORKS AND CONSTRAINTS ON TAX INFORMATION EXCHANGE

The League of Nations Committee of Experts observed more than sixty years ago that the legal and administrative frameworks adopted by countries in the context of exchange of tax information varied greatly.\(^{198}\) Limitations within the legal and administrative frameworks providing for tax information exchange, and the non-uniformity of these frameworks among OECD member states and other states engaged in the international financial services sector with which OECD member states are in competition, more recently arose in the context of HTC Initiative.\(^{199}\)

In June 2004 participants in the OECD’s Global Forum on Taxation, recognising that the contents of models such as the 2002 OECD Model Tax Information Exchange Agreement and the current versions of Article 26 in each of the OECD and UN Model Conventions may bear little relation to the legal and

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\(^{197}\) UN (n 194), 9.

\(^{198}\) League of Nations Economic and Financial Commission (n 119), 324.

\(^{199}\) OECD (n 150). Discussed further in Chapter 6 of this work.

The benchmarking of existing frameworks was part of an agreed process designed to assist in achieving the Global Forum's stated objective of moving towards a level playing field in a manner which would promote fair competition among states engaged in the international financial services sector.\footnote{201}{ibid.} The agreed first step was the delineation of the extent to which there was a level playing field for tax information.

It is worthy of particular note that the exercise was not designed to identify what countries did in practice, but rather to identify the extent to which such legal and administrative frameworks permitted or prevented tax information exchange in theory. That is to say, the exercise was not intended to identify whether exchange of information was "effective" within the meaning of the HTC Initiative,\footnote{202}{OECD (n 150).} but rather was intended to provide limited information regarding the more formal structures which permit, limit or obviate tax information exchange.
The benchmarking exercise involved the use of a questionnaire which more than 80 countries were asked to complete. The information sought in the questionnaire included details of domestic legislation and administrative provisions as well as any tax information exchange arrangements that each country had in place as at 31 December 2005, whether in the forms of double taxation treaties, tax information exchange agreements or otherwise.

Countries invited to participate in the study were selected on the basis of three principal criteria. All members of the OECD were included, as were those small and developing countries targeted in the HTC Initiative. The third group of countries included were those identified as having a significant position in the global trade in financial services which were not within either of the first two mentioned groups.203

The information sought in the questionnaire was divided into four categories; exchange of tax information, access to bank information for tax purposes, access to ownership, identity, and accounting information for taxation purposes and the availability of beneficial and legal ownership and identity information and related accounting information. The results were published in May 2006 in a document entitled, '2006 Assessment by the Global Forum on Taxation', (the 2006 Assessment). In the following sections in this chapter a summary of the

203 OECD (n 200).
results of the survey will be set out together with an analysis of what the results demonstrate.

2.6.1 Legal and Administrative Frameworks for the Exchange of Information for Taxation Purposes as at December 2005

The first part of the benchmarking exercise was intended to collect information regarding the nature of the legal bases for the provision of tax information to foreign tax authorities, as well as the scope of such bases and any limitations applicable thereto. The 2006 Assessment notes that legal or administrative frameworks or both were in place in the vast majority of the countries surveyed, but that there was a wide variance in the number of double taxation conventions (DTCs) and tax information exchange agreements (TIEAs) in place:

The number of DTCs entered into by individual countries range from 0 to 109, with larger and developed countries typically having the greatest number of DTCs. The number of TIEAs entered into by individual countries range from 0 to 19 with 6 countries being signatories to more than half of all TIEAs. 204

Analysis of the 2006 Assessment data by Stoll-Davey has identified that OECD member states enter into relatively few DTAs with small and developing countries;

204 OECD (n 123), 15.
The use of DTCs is typically found to be used between OECD countries, and between OECD countries and countries with large dynamic economies, geo-political influence or scarce natural resources.... An exception to the pattern of granting DTCs may exist in relation to the historical treatment by certain geo-politically powerful countries of former colonies...

Stand-alone TIEAs by comparison are a recent development and appear to remain the domain to which small and developing countries are relegated.205

Stoll-Davey also observed that:

There are 46 TIEAs identified in the 2006 Assessment, almost two-thirds of which have the United States of America as one party.206 Most of the small number of TIEAs to which the US is not a party, exist in parallel with a conventional tax treaty which provides mutual economic benefits.207

The results also indicate that far from the exchange of tax information between tax administrations being the global norm, only a very few countries have bilateral tax information exchange arrangements with even one half of the 191 sovereign countries which currently exist, let alone their dependent and associate territories. In fact, a review of the information presented in the 2006 Assessment shows that the mean and median number of double taxation conventions entered into by the reviewed countries is 30 and 17 respectively, while the mean and median number of tax information exchange agreements entered into is 2 and 0 respectively.

205 Stoll-Davey (n 148), 50.
206 OECD (n 123), 17, para 31.
207 Stoll-Davey (n 148), 55.
A number of countries providing information indicated that in the absence of double taxation conventions and tax information exchange agreements, and in relation to certain criminal matters which have a taxation component, they are able to provide tax information to foreign tax administrations through the operation of mutual legal assistance agreements (MLATs). Further, some fifty-six countries indicated that provisions within domestic law enabled them to provide assistance to foreign tax administrations. Almost half this number do so by virtue of their obligations under European law.

2.6.2 – The Scope of and Limits to Exchange of Information

Countries frequently provide tax information to, or withhold it from, foreign tax authorities dependent upon the purposes for which tax information is sought by foreign authorities. The most clear example of this arguably is the distinction which is made between information sought by foreign tax authorities for the enforcement of criminal tax laws as opposed to civil or administrative tax laws:

A consolidation of all the mechanisms that permit information exchange shows that 70 of the 82 reviewed countries have one or more exchange of information relationships covering all tax matters; 44 countries have one or more exchange relationships covering certain civil tax matters, and 80 countries have one or

208 OECD (n 123), 15 – 16.
209 OECD (n 123), 16.
more exchange of information relationships covering certain criminal tax matters.\textsuperscript{210}

The 2006 Assessment also makes a distinction between exchange of tax information provisions within double taxation conventions which limit the exchange of information to that which is necessary for the application of the relevant treaty, a ‘limited exchange clause’, from those that permit the exchange of information more generally for purposes of the enforcement of the taxation laws of a requesting country generally, a ‘broad exchange clause’. The 2006 Assessment notes that while broad exchange clauses are now the most common form used by the countries involved in the study, in relation to certain treaties entered into by two OECD countries, Switzerland and Austria, the distinction between broad and limited may fade. Specifically, although the language used in the relevant treaties entered into by these countries suggests that a ‘broad exchange’ of information is possible, in one instance, that of Switzerland, exchange is generally limited so as to exclude cooperation in non-criminal matters, whereas in the other, Austria, certain treaties in effect exclude cooperation in relation to certain criminal tax matters.\textsuperscript{211}

The exchange of tax information may also be limited by requirements in domestic legislation or treaty provisions which limit the collection and exchange of information to that which is required for purposes of the domestic tax law of the

\textsuperscript{210} OECD (n 123), 17.
country called upon to provide information. This limitation was documented in a number of countries participating in the study. Of particular note is the fact that none of them were within the group of countries targeted by the OECD as 'tax havens' in the HTC Initiative.\(^{212}\)

A requirement that the matter to which the information sought relates must constitute a criminal offence in both the requesting and requested countries, a so-called 'dual criminality' requirement, was documented in both OECD and non-OECD countries. This may also act as a limitation on the exchange of information.

Virtually all of the arrangements for the bilateral exchange of information upon request identified in the 2006 Assessment define further conditions under which a requested state may refuse to provide information which is requested by a foreign tax authority. The most commonly used forms of these grounds for refusal of assistance are set out in Article 26 of each the OECD Model Convention and the UN Model Convention.\(^{213}\) In the 2003 version of the OECD Model Convention, states requested to provide tax information are not required to do so if it would require the requested state:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

\(^{211}\) OECD (n 123), 17.


\(^{213}\) OECD (n 153); UN (n 154).
b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public). 214

A distinction has been proposed by the OECD between limits to the exchange of information within its membership on one hand, and limits which would apply as between OECD members and non-members which are not deemed to be deserving of inclusion in the treaty networks of its members. This latter form is found in the 2002 OECD Model Agreement on Exchange of Information on Tax Matters. Correspondingly, the 2002 Model Agreement provides:

Article 7
Possibility of Declining a Request

1. The requested Party shall not be required to obtain or provide information that the applicant Party would not be able to obtain under its own laws for purposes of the administration or enforcement of its own tax laws. The competent authority of the requested Party may decline to assist where the request is not made in conformity with this Agreement.

2. The provisions of this Agreement shall not impose on a Contracting Party the obligation to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process. Notwithstanding the foregoing, information of the type referred to in Article 5, paragraph 4 shall not be treated as such a secret or trade process merely because it meets the criteria in that paragraph.

3. The provisions of this Agreement shall not impose on a Contracting Party the obligation to obtain or provide information, which would reveal confidential communications between a client and an attorney, solicitor or other admitted legal representative where such communications are:

(a) produced for the purposes of seeking or providing legal advice or

214 OECD (n 122), 41.
(b) produced for the purposes of use in existing or contemplated legal proceedings.

4. The requested Party may decline a request for information if the disclosure of the information would be contrary to public policy (ordre public).

5. A request for information shall not be refused on the ground that the tax claim giving rise to the request is disputed.

6. The requested Party may decline a request for information if the information is requested by the applicant Party to administer or enforce a provision of the tax law of the applicant Party, or any requirement connected therewith, which discriminates against a national of the requested Party as compared with a national of the applicant Party in the same circumstances.

As can be seen, one of the principal distinctions between the OECD Model Convention language and that of the 2002 Model Agreement relates to the absence of an administrative limit in the latter. The presence of administrative carve-outs in the tax information exchange provisions which OECD member states adopt in treaties between OECD member states takes on particular relevance in relation to the administrative restrictions on tax information exchange applied by OECD member states as described below.

2.6.3 Access to Bank Information as a Limit to Exchange of Information

A tax authority’s access to information held by banks has particular importance in relation to the taxation of mobile capital and the limitation of tax competition in
relation to mobile capital. However, information held by banks has traditionally been viewed as distinct from other information which may be used for purposes of tax administration. Confidentiality is a critical element in a bank’s relationship with its clients. The significance of confidentiality is reflected in the fact that all of the 82 countries involved in the 2006 Assessment enforce legal obligations requiring banks to maintain such confidentiality, and almost three quarters of them have statutory bank secrecy rules.216

The 2006 Assessment indicates that only 50 out of the 82 countries involved in the 2006 report; ‘give their authorities access to bank information for all tax purposes, including for the purposes of exchanging such information under tax treaties and tax information exchange agreements’.217 A further 17 countries, ‘grant access to bank information only for the purpose of responding to a request for exchange of information in criminal tax matters.’218 Among the 17, some add a further requirement related to ‘dual-criminality’. The countries which limited their tax administration’s access to bank information for purposes of exchange of information included both OECD and non-OECD countries.

215 OECD (n 122).
216 OECD (n 123), 19.
217 ibid, 20.
218 ibid, 21.
2.6.4 Access to Identity, Ownership and Accounting Information as a Limit to Exchange of Information

The ability of a tax authority to provide information sought by a foreign tax administration is limited by that authority’s ability to access the requested information. In states with income tax systems such information may already be held by the tax authorities in the form of returns submitted by its taxpayers. In instances in which it is not, a tax authority will generally require some type of legal authority to obtain or compel the production of the requested information in order to comply with a request for tax information submitted by a foreign tax administration.

The 2006 Assessment notes that out of the 82 countries included in the study; ‘67 countries may obtain information in both criminal and civil tax matters to respond to a request for exchange of information’, provided that the information is; ‘kept by a person subject to record keeping obligations which may be invoked to respond to a request for exchange of information’. 219 In relation to persons not subject to such record keeping obligations set out in the laws of the country requested to provide information; ‘57 countries have reported that they can obtain information to respond to a request in both criminal and civil tax matters.’. The 2006 Assessment also notes that even in the cases of countries that are included among those that are able to access information for purposes of a request from a

219 ibid, 23.
foreign tax administration, there are certain types of information that may nevertheless not be accessible.\textsuperscript{220} This limitation applies both within and outside of the membership of the OECD.

Access to information for purposes of tax information exchange may also be limited by the use of financial instruments in bearer form, by way of example bearer bonds or bearer shares. It may be very difficult to identify which entity is in possession of bearer securities, and which entity is the legal or beneficial owner of these securities over time and at any given point in time after issuance. As a result, access to tax information relating to the ownership or transacting of such instruments may be difficult to obtain.

The 2006 Assessment indicates that 52 of the 82 countries in the study permit bearer debt instruments, while 48 of the 82 permit bearer shares.\textsuperscript{221} Many, but not all, of countries which permit each type of bearer security are OECD member states.

It is possible to use mechanisms to limit the legal transfer of possession and ownership of such instruments so as to provide for greater access to information, and indeed as noted in the report, Recommendation 33 of the G7’s Financial Action Task Force specifies that;

\textsuperscript{220} ibid 23.
Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures. 222

It is therefore noteworthy that of the 10 countries identified in the 2006 Assessment as permitting bearer securities and having taken steps to immobilise or to restrict the holding of bearer shares to authorised custodians, none is an OECD member state and indeed, none is an FATF member. 223

2.6.5 Availability of Identity, Ownership and Accounting

Information in Relation to Companies, Partnerships, Trusts and Foundations

The fourth section of the 2006 Assessment deals with the availability of information which may be required for tax purposes, particularly in relation to companies, partnerships, trusts and foundations as well as other entities and relationships which may be used in, or be participants in, financial transactions or the holding of assets. In the absence of statutory obligations to maintain

221 ibid, 25.
222 ibid, 24 - 25.
223 ibid, 25.
information regarding such legal entities and other relationships, it may not be possible for tax authorities to access information needed for tax purposes. At the same time, it may be impractical for certain types of legal entities, and in particular publicly traded companies with very large numbers of shareholders and with shareholders which frequently change, to maintain records of ultimate beneficial ownership of shares.224

The 2006 Assessment notes that in the case of companies,225 77 of the 82 countries reviewed indicated that with some exceptions, legal ownership as distinct from beneficial ownership information, is available either from government sources, whether the relevant tax authorities or otherwise, or from the company itself.226 Further, among the 82 countries involved in the study, where such information is required to be maintained by companies, it is required to be held for at least five years except in the United States of America which has a minimum three year retention period for federal tax purposes.227

224 Ultimate beneficial ownership refers to the right of some natural person to enjoy the benefits of, or exercise control over, the ownership of some thing.
225 While the precise legal nature of bodies corporate varied across the countries participating in the study, for purposes of analysis the report appears to accept as 'companies', those legal entities which any of the participating countries viewed as a company for its domestic purposes.
226 OECD (n 123), 28. An exception to this availability exists in the context of bearer shares.
227 Ibid, 28.
In the case of partnerships, as is the case with companies, unavailable information cannot generally be accessed for purposes of tax information exchange. 68 out of the 82 countries involved in the study indicated that they permitted partnership structures. Two-thirds of countries with partnerships required all partnerships to submit information to government registries, whereas one-third, which includes both OECD and non-OECD countries have no such requirement. 51 of the 68 indicated that anti-money laundering requirements would apply to partnerships and that this would be a basis for assuming that tax information would be available in relation to the relevant partnerships.

The availability of tax information relating to trusts is problematic. Although trusts developed primarily within common law legal systems, they have proven to have such utility that they are now used within many states irrespective of their legal systems. However, states which do not recognise the legal concept of a trust do not have any domestic trust law and therefore may not have a framework from which to impose any obligation to maintain records with respect to trusts which are administered within their borders. Indeed, as noted in the report, 18 of the 28 countries which indicated that they did not have domestic trust law also indicated that their residents were able to act as trustees for foreign trusts. Most of these relied on anti-money laundering legislation to ensure that information held by a trustee within their borders would be maintained. Two countries, both OECD

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228 While the precise legal nature of partnerships varied across the countries participating in the study, for purposes of analysis the Assessment appears to accept as partnerships, those legal entities which any of the countries viewed as a partnership for its domestic purposes.

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member states, indicated that while they recognised trusts, they did not have any specific mechanism to identify either settlors or beneficiaries of foreign trusts. It is foreseeable that trust practitioners might use this type of lacuna for purposes of regulatory arbitrage.

Foundations can be established in 37 of the 82 countries in the 2006 Assessment. Of these, 7 countries all members of the OECD or the EU, do not impose record keeping requirements in all circumstances. Table D5 of the 2006 Assessment indicates that gaps in the information which is maintained in relation to beneficiaries of foundations in both OECD and non-OECD countries.

Forms of legal entity or relationships other than companies, partnerships, trusts and foundations were identified in a total of six OECD and non-OECD countries involved in the study. While there is limited detail in the 2006 report, it would appear that information for tax purposes is generally available with respect to these relatively uncommon entities and relationships.

229 ibid, 34.
230 ibid, 33.
231 ibid, 35.
232 ibid, 200 - 204.
233 ibid, 35.
2.6.6 Analysis of Tax Information Exchange based on the 2006 OECD Assessment

The 2006 OECD Assessment is primarily factual rather than analytical in nature. One of the principal observations which can be derived from the study is that the underlying frameworks for tax information exchange in place as at the end of 2005 are not significantly different when one compares OECD member states as a group with other countries involved in the international financial services sector and participating in the study, including those targeted in the HTC Initiative. A second is that bilateral tax information exchange outside of the context of double taxation conventions is an aberration. A third is that OECD member states, and in particular the richest OECD member states, and those most involved in international trade, tend to have more double tax conventions and therefore more tax information exchange provisions in place, than small and developing countries.

It might be suggested based on these three observations that should OECD member states wish to have greater access to tax information which may be located in the non-OECD countries which participated in the study on which the 2006 Assessment is based, then the obvious answer would be to enter into double tax conventions with these countries. However, such a suggestion would ignore the competitive advantages available through participation in treaty networks. 234 It

would also fly in the face of efforts over the past forty years to exclude small and
developing countries involved in the international financial services sector from
treaty networks.  

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CHAPTER 3 - INTER-NATION EQUITY IN THE ALLOCATION OF TAX RESOURCES

3.0 INTRODUCTION

A World Bank publication has recently observed, 'One predetermined circumstance that most powerfully determines a person's opportunities for leading a healthy and productive life is his or her country of birth.' Arguably, one contributing factor in this regard, is the level of taxation resources available. Absent some minimal level of taxation resources, the opportunities within any given state for leading a life consistent with the exercise of even the most basic human rights may be reduced. However, factors determining an equitable global distribution of taxation resources have received relatively little attention in the international taxation literature.

The second of the three elements in the nexus under consideration in the present work is inter-nation equity in the allocation of taxation resources. This chapter outlines the taxation law literature relating to inter-nation equity, and delineates for purposes of the present work the concepts of inter-nation equity, and taxation resources. It also provides in overview a comparison of selected concepts.

of distributive justice and fairness in resource distribution as developed in other parts of the academic literature.

The Musgraves have noted that what may have been the first writings involving a concept of equitable distribution of taxing rights were produced in the thirteenth century.\textsuperscript{237} As economists, writing some seven hundred years later, they set the boundaries for their considerations of inter-nation equity in the proposition that; 'Inter-nation equity deals with the allocation of national gain and loss.'\textsuperscript{238} That is to say, the economic concept which lies at the heart of inter-nation equity in the allocation of taxation resources, is that of national wealth.

National wealth is comprised of the wealth of the state treasury plus the aggregate wealth of juridical and natural persons within the jurisdiction.\textsuperscript{239} By virtue of this inclusive concept of national wealth, transfers within a state, whether between persons and the treasury, or otherwise, do not affect national wealth. Specifically, achieving greater or lesser inter-individual equity within the borders of a single state through the use of tax-related mechanisms does not alter inter-nation equity. Absent the creation of wealth, the only transfers which affect national wealth are therefore those which occur across national boundaries.


\textsuperscript{238} ibid, 164.
An analysis of inter-nation equity in the allocation of taxation resources also requires a frame of reference for the concept of taxation resources. In theory, the scope for elements that might be included within the tax bases of individual sovereign states, and which therefore might be said to form at least the potential taxation resources of such states, is limited only by the imaginations of legislators. For purposes of the present work however, the concept of taxation resources will be limited to factors linked to economic production such as income and capital in their various forms. It is accepted for purposes of the present analysis that states engage in tax competition which operates together with other factors to influence the global distribution of economic production and therefore the distribution of taxation resources.240

The Musgrave's construct for inter-nation equity offers the advantage of a clearly defined metric which can be used to assess inter-nation equity at specific points in time. It also provides a tool for assessing the likely outcomes of potential interactions among states. By way of example, a set of rules for economic competition among states which are biased so as to firstly, decrease the probability that wealth will be transferred to or generated within poorer or disadvantaged states, and secondly increase the probability that such wealth will go to or be produced in rich states, may be viewed as unlikely to advance inter-nation equity.

239 ibid.
3.1 INTERT-NATION EQUITY, FAIRNESS AND DISTRIBUTIVE JUSTICE

The concepts of inter-nation equity in the global allocation of taxation resources, distributional justice in relation to the distribution of taxation resources among nations, and fairness in relation to the same distribution, appear only sporadically in the taxation law literature. In the present work, selected constructs relating to these concepts as utilised in both the taxation law and broader academic literatures are considered.

3.1.1 A Selective Survey of the Concepts of Inter-nation Equity, Fairness and Distributive Justice in a Multi-state Context

Constructs of fairness, equity and distributive justice in single society models typically consider process, or outcome, or both. By way of example, Varian distinguishes an equitable allocation from a fair allocation on the following outcome related basis:
An allocation $x$ is called equitable [if and only if] no agent prefers another agent's bundle to his own....An allocation $x$ is called fair [if and only if] it is both equitable and Pareto efficient. 241

This analysis, while linking the concepts of equity and fairness to clear parameters, arguably may be limited in that it focuses on subjective assessments of the end state of a particular allocation, rather than the allocation process per se. Specifically, Varian's construct does not appear to take into account the more than semantic point that an allocation based on a competitive process may be subjectively viewed as equitable by all participants in circumstances in which the process leading to that allocation is accepted as legitimate or consistent with procedural fairness as that concept has been developed by Franck. 242 Thus in the drawing of lots, the end state allocation of the 'short straw' in a non-biased process may be viewed as 'fair' even by the person receiving the short straw, even though she may prefer someone else's straw.

That is not to say that Varian's construct is without utility in all competitive circumstances. By way of example, an allocation of taxation resources which is based on the pursuit by powerful states of their own relative advantage

241 HR Varian, 'Two Problems in the Theory of Fairness' (1978) 5 Journal of Public Economics 249-260. A given resource allocation is said to be Pareto efficient if there is no rearrangement that can make anyone better off without making someone else worse off. The concepts of Pareto Efficient and Pareto Optimal are interchangeable. Thus, a given resource allocation is said to be Pareto optimal if there is no rearrangement that can make anyone better off without making someone else worse off.

242 T Franck, Fairness in International Law and Institutions (Oxford University Press, Oxford 1995), 7-9. In Franck's construct a particular distribution may be deemed to be fair if firstly, the process which gave rise to that distribution is perceived by participants as legitimate, and secondly, the outcomes or end states of that distribution are just according to a shared notion of what such a distribution should be. Similarly, re-distribution so as to achieve a fair or just distributive outcome may be conceptualised as
rather than optimizing global economic efficiency,\textsuperscript{243} is likely to be 'unfair' in Varian's construct and arguably in the real world as well.\textsuperscript{244} This follows from the observation that a process which facilitates the allocation of taxation resources on the basis of global economic efficiency would be more likely to produce greater global wealth which would at least potentially be available for distribution, arguably an outcome yielding a higher probability of a Pareto-superior result.\textsuperscript{245}

Concepts of distributive justice,\textsuperscript{246} equality of resources,\textsuperscript{247} or justice as fairness,\textsuperscript{248} based on conceptions of rights and obligations within a single state frame of reference, arguably may not translate comfortably into multi-state models because of the dissimilarities of notional social relationships within, as opposed to across, borders. Specifically, while persons within states may be assumed to be under some obligation to cooperate at least to some extent, a similar level of remediation for an historically imperfect process of distribution, that is, a second step following a unjust or unfair prior process of distribution, or an integral part of an continuous and iterative process of fair or just distribution.

\textsuperscript{243} A process may said to be economically efficient if a given amount of economic output cannot be achieved with a lesser amount of economic inputs. It follows that when global economic efficiency is increased the amount of wealth that is available from a given amount of global resource is increased and so is global welfare to the extent that this is a function of wealth.


\textsuperscript{245} An outcome 'A' may be said to be Pareto superior to an outcome 'B' if no member would prefer 'B' to 'A', and any member prefers outcome 'A' to outcome 'B'.


cooperation is not expected among states. Frost has noted that in the context of norms in international relations:

For the purposes of the modern state domain of discourse it is settled that the government of a sovereign state's first duty is to protect the interests of its own citizens. The well-being of its own citizens must be considered more important than the well-being of people elsewhere in the world. 249

Frost's observation, while not denying the possibility of moral influences on the pursuit of self interest by states, does not provide any explicit limits to the pursuit of such self interest. However, even the great realist Hans Morgenthau understood the scope of allowable pursuit of self interest by states to be circumscribed by moral principles rather than unrestricted. 250

Rawls has written from a single state perspective that:

[In justice as fairness distribution takes place in accordance with legitimate claims and earned entitlements. These expectations and entitlements are specified by the public rules of the scheme of social cooperation.....there is no criterion of a legitimate expectation, or of an entitlement, apart from the public rules that specify the scheme of cooperation. Legitimate expectations and entitlements are always (in justice as fairness) based on these rules. 251

While Rawls notes that his conception of justice as fairness was designed in relation to the special case of the basic structures within a single modern


democratic society and is not a comprehensive doctrine in the sense that utilitarianism is, he claims that a political conception which is capable of accommodating both justice within a modern domestic society and just relations among societies can be built upon a framework of his conception of justice as fairness. However, it is questionable whether Rawls' construct is applicable to the allocation of taxation resources in the real world of the early twenty-first century, as there is at best a global social order in which the attributes which Rawls describes as requisite are both limited and inconstant in their application.

Social cooperation to the extent that it exists in relation to the global allocation of taxation resources tends to be based on rules, not set in a process which is fair for all as required in Rawls' construct, but rather by rules designed and controlled by a small group of rich countries to the functional exclusion of other countries, which obviate any true reciprocity and mutuality. Rawls refers to rule setting of this type in a single state context as, 'To persons according to

251 Rawls (n 148), 72.
252 ibid, 14.
253 ibid, 6. The requisites which Rawls described are:
a) Social cooperation, '[G]uided by publicly recognized rules and procedures which those cooperating accept as appropriate to regulate their conduct.'
b) Fair terms of cooperation which, '[S]pecify an idea of reciprocity, or mutuality: all who do their part as the recognized rules require are to benefit as specified by a public and agreed-upon standard.' and,
c) The idea of each participant's rational advantage which, '[S]pecifies what it is that those engaged in cooperation are seeking to advance from the standpoint of their own good.'
254 ibid, 15.
their threat advantage.' The parallel phrase in a multi-state context, which arguably would be something like; ‘To states according to their threat advantage’, may be apt in the existing international setting in which each country’s expectations, if not their perceived entitlements in the context of the global allocation of taxation resources, tends to have more to do with power relationships than other considerations.

Powerful states arguably tend not to accept any supranational rules or procedures as appropriate to regulate their conduct, other than those they themselves specify from time to time and on an ad hoc basis. Less powerful states, rarely have that luxury. Nevertheless, the concepts of legitimate expectation and entitlement as normative influences, arguably do modify the rhetoric, and occasionally the behaviour, of more powerful countries which may not always fully consider the externalities which their actions may occasion for other countries.

256 Rawls (n 148), 16.
257 T Blair, ‘Speech to George Town University’ (2006) <http://www.number10.gov.uk/output/Page9549.asp> accessed 26 May 2006. Prime Minister Blair in relation to the influences of multilateral institutions on the activities of the dominant states; ‘Let me be blunt. Powerful nations want more effective multilateral institutions - when they think those institutions will do their will. What they fear is effective multilateral institutions that do their own will.’
Franck’s construct indicates that ‘fairness’ connotes both legitimate process and a notion of equity in the end point distribution.\(^{259}\) In the context of rules assigning taxation resources to states, Franck’s approach arguably would imply that such rules:

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\text{[W]ill be judged, first by the degree to which the rules satisfy the participants’ expectation of justifiable distribution of costs and benefits, and secondly by the extent to which the rules are made and applied in accordance with what the participants perceive as the right process.}\(^{260}\)
\]

What then might be the basis for an expectation of equity in the distribution of taxation resources?

### 3.2 The Theoretical Justification for Inter-Nation Equity in the Distribution of Taxation Resources

A theoretical justification for inter-nation equity in the allocation of taxation resources may be derived from a cosmopolitan approach to distributive justice.\(^{261}\) Such an approach would suggest that the rights of sovereign states to structure their economies generally, and their taxation systems specifically, ought be circumscribed by considerations of some sort of equitable distribution of some global pool of taxation resources.

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\(^{259}\) Franck (n 242), 7.

\(^{260}\) ibid.

Caney observes that 'persons have a human right to subsistence', and that, ‘persons of different nations should enjoy equal opportunities: no one should face worse opportunities because of their nationality'.²⁶² As further noted by Caney, 'The logic underpinning equality of opportunity entails that it should be globalized.'²⁶³ If then the individuals who make up each nation ought to enjoy equality of opportunity, then arguably nations, which in one sense are, at their core, collectives of individuals, ought also to have such equality of opportunity.

3.3 CONCEPTS OF INTER-NATION EQUITY IN THE INTERNATIONAL TAXATION LAW LITERATURE

Most late twentieth century legal descriptions of inter-nation equity in relation to taxation are written from the perspectives of those from developed countries. Such descriptions are generally based on what are essentially hybrid models incorporating firstly, legal considerations of the nature of equity in the global context, and secondly tax economics. While Vogel noted that considerations of equity have traditionally been viewed as falling within the realm of legal scholars

²⁶² ibid, 122.
²⁶³ ibid, 123.
whereas purely economic issues have not, the acceptance of economic scholarship and the contributions of economists such as the Musgraves have provided the basis for much of the research in this area.

There are divergent views as to what inter-nation equity in the distribution of taxation resources might require in practice. Some may be viewed as proposing weak versions of inter-nation equity. Schäfer and Spengel, by way of example, have provided an economic perspective of what the concept of inter-nation equity entails together with a theoretical justification from a tax economics perspective:

The principle of inter-nation equity calls for an equitable allocation of the international tax base between different countries. The apportionment of the taxable income is considered to be equitable if every country has the right to tax all profits having their source within its borders. The source of profits is defined as the location where the profits are created.

Generally, weak versions of inter-nation equity suggest either that some degree of tax sovereignty is sufficient for inter-nation equity, or that a state need only take inter-nation equity into consideration to the extent that it increases the welfare of persons within that state, irrespective of taxation produced.

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externalities. Such weak versions, which arguably parallel the description of the art of taxation attributed to Jean Baptiste Colbert in a single state context, would seem to have at least as much to do with self-centred utility as they do with considerations of equity, fairness or justice. In contrast, a stronger version of inter-nation equity may focus on process, requiring that degree of neutrality in taxation systems which would afford competition for taxation resources under equal and unbiased conditions.

There is also an intermediate version of inter-nation equity in the allocation of tax revenues which would constrain tax measures capable of producing or exacerbating that level of poverty in foreign states which is unacceptable to those in the state imposing the relevant taxation measures. This intermediate version arguably may be seen in the operation of tax sparing treaty policies and in applications of some double taxation treaties based on the UN Model Convention.

Kaufmann has related fairness and inter-nation equity to the global distribution of competence to tax, noting that: ‘[F]airness exists in the international tax system only when states distribute among themselves the competence to tax in

268 Colbert is reported to have stated that, '[t]he art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.'
269 ITIO, ‘Levelling the Playing Field’ (2005) ITIO policy paper
a way that conforms to prevailing views of justice internationally – internation equity.\textsuperscript{271} She has also noted that:

Internation equity... is fundamentally a question of economic justice among nations – the distribution of competence to tax and, ultimately tax revenues among nations. The limits of a particular country’s tax base and the identification of its taxpayers in a multijurisdictional setting, although sometimes treated as matters of domestic concern, primarily affect the distribution of the competence to tax and tax revenue among nations. Hence, they are internation equity concerns. A just international tax system cannot be said to exist until each nation limits the scope of its tax base and identifies its taxpayers in a manner that effects internation equity.\textsuperscript{272}

Kaufman identifies two of the essential conditions which must be met in order to secure inter-nation equity, namely the limitation of firstly national tax bases, and secondly the scope of taxpayers which are claimed as potential contributors to such tax bases. If the limitation of tax bases is understood as requiring a limitation of competitive measures which are used to attract and retain the factors of production which produce tax bases, then arguably Kaufman’s analysis is correct. In the absence of this condition it is arguable that Kaufman’s construct would permit all competition for economic activity among states, however brutal and whether taxation modulated or otherwise. Limits on competition for the factors of production arguably are required as firstly, tax competition may affect the location of tax bases, and secondly, production


\textsuperscript{271} NH Kaufman, 'Fairness and the Taxation of International Income' 29 \textit{Law & Policy in International Business} 2 145 - 204, 154.
efficiency theory would suggest that unless and until taxation biases are limited so that global economic production is maximized over time, the wealth that is available to be shared equitably among nations will be less than it ought to be, arguably an unjust situation.

Arnold and McIntyre in comparison, have linked the concept of fairness to what in their view, the goals of international tax rules ought to be, noting that:

A major goal of international tax rules should be to provide each country of the world with a fair share of the tax revenues available from income generated by transnational activities of domestic and foreign taxpayers.273

While the specific objective cited arguably ought to be part of the objective, it is also arguable that it is not sufficient as it does not take into consideration the fact that domestic taxation biases and other tools of tax competition may influence whether, and if so to what extent, such transnational activities occur.

Easson has described the forces shaping inter-nation equity in the distribution of taxation resources in a multilateral context in the following terms:

There is no real agreement as to what would be a proper division of the [global] tax base, nor is there any obvious principle of fairness that can be invoked to justify any particular distribution of revenue. The present division has been a more or less accidental result of the attempt to eliminate double taxation, and is principally a product of the various model double taxation treaties that have been adopted over a period of

272 NH Kaufman, (n 271), 188.
some 60 years. Since the principal architects of these model treaties have been the major capital-exporting countries, it seems reasonable to suppose that, to the extent that the existing arrangements are inequitable, they operate to the prejudice of countries that are primarily importers of capital... and as the great majority of lesser-developed countries fall into this category, there is the further consideration that some redistribution in favour of source countries would on balance be desirable and would promote a form of vertical equity among nations. 274

It is not accepted that there are no obvious principles of fairness that can be considered in relation to particular distributions. 275 However, it is accepted that Easson’s observation of existing biases is likely correct. It is also noted that Easson’s observation that tax rules are likely to benefit the countries which develop them, arguably is consistent with observations in the general regulatory competition literature to the effect that powerful actors prefer limits on competition which favour their interests, 276 and Keohane’s observation that states seeking to form international regimes may purchase consensus among key actors through biasing the distribution of benefits and burdens to their advantage. 277

Arnold’s work on tax discrimination and his analysis of tax equity as it relates to the treatment of non-nationals and non-residents, arguably provides

275 Franck’s concept of fairness is suggested as a possible exception. Franck (n 242).
another perspective on inter-nation equity.\textsuperscript{278} Arnold adopts the classical single state view that equity has two components, a so-called horizontal component and a so-called vertical component.\textsuperscript{279} In his analysis, the transposition of the concepts of equity from a purely domestic context to one which includes the treatment of non-nationals and non-residents within a domestic context poses several problems. Arnold assumes that equity requires equal treatment for non-residents rather than differentiated treatment based on any other analysis of what might be equitable. He further indicates that in circumstances in which equal treatment of non-residents would give rise to administrative or collection difficulties, then efficiency in tax collection trumps any requirement for equity for non-residents. This tension between efficiency and equity may also exist in multi-state models.

3.3.1 Inter-nation Equity and the Equity – Efficiency Trade-off

Graetz has observed that, ‘All taxes have efficiency costs; they change incentives to engage in various activities and affect the allocation of resources.’\textsuperscript{280} Each state naturally attempts to mitigate efficiency costs while at the same time preserving whatever preferences for governmental activities and inter-individual tax equity that particular society has adopted or seeks to adopt.

\textsuperscript{278} B Arnold, \textit{Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand, the United Kingdom, and the United States} (Canadian Tax Papers Canadian Tax Foundation Toronto 1991), 15 – 17.
Efficiency in the collection and re-distribution of taxation resources may come at the cost of equity.\textsuperscript{281} The proposition that there is such an equity-efficiency trade-off,\textsuperscript{282} typically assumes a single state closed system, that is, there is an assumption that the tax administration cannot export inequities or inefficiencies. This is not the situation which prevails in the world today. States are not closed and tax measures designed to enhance efficiency or intra-state equity may create externalities.\textsuperscript{283}

States, and in particular, geo-politically powerful states, may be able to shift inequities beyond their borders while creating efficiencies or increments in intra-individual equity within their borders.\textsuperscript{284} In some cases, tax authorities may be able to ‘purchase’ a simultaneous increase in both inter-individual equity for taxpayers within their state, as well as administrative efficiency. However, as will be discussed below, in at least some circumstances, such benefits may come at the cost of decreased inter-nation equity, or decreased global welfare.

\begin{itemize}
  \item \textsuperscript{280} Graetz (n 267), 282.
  \item \textsuperscript{281} J Alm, 'What is an "Optimal" Tax System?' (1996) Vol 49 National Tax Journal 1, 117-33.
\end{itemize}
3.4 INTER-NATION DISTRIBUTIVE JUSTICE

The theory of inter-nation distributive justice has been developed in part in the international relations and political philosophy literatures. While a broad analysis of these non-tax literatures is beyond the scope of the present work, several aspects may contribute to the understanding of inter-nation equity in the allocation of taxation resources.

The notion that there exists any moral obligation to apply any concept of distributive justice outside of a single state model has not been universally accepted among either political philosophers or writers within the field of international relations.\(^{285}\) As noted by Caney;

One of the striking features of much traditional political philosophy until recently was that it assumed that principles of distributive justice should operate at the state level...Duties of distributive justice thus apply within states or nations but do not apply globally.\(^{286}\)

Within the relevant political philosophy literature, the concept that distributive justice is applicable primarily within states or other systems of cooperation,\(^{287}\) has come under increasing pressure. Caney, by way of example, convincingly argues that there are logical gaps in the reasoning of those who argue that distributive justice obligations are somehow limited by national boundaries particularly in the

\(^{284}\) Discussed in the following sections in this chapter.
\(^{285}\) Caney (n 261), 122. Also Rawls (n 148).
\(^{286}\) Caney (n 261), 102.
\(^{287}\) Rawls (n 148)
context of fundamental human rights which are accorded without reference to borders.288

Caney argues that it is necessary for any theory of distributive justice to identify which entities are the rights-holders and duty-bearers in respect of any assertions of a right to distributive justice.289 In the context of the global distribution of taxation resources, a concept of distributive justice would imply that it would be necessary to identify whether for example, given that states rather than individuals were the duty-bearers, a given state would be obligated to manage its affairs so as to effect a certain distribution to all individuals on the planet (a constitutive model), or alternatively it would be obligated to manage its affairs so as to facilitate, or at least to not impede, some requisite level of taxation resources being available to all other states (a statist model). Arguably, as the Musgraves' construct of inter-nation equity is based on the economic concept of national wealth which encompasses the aggregate wealth within the public and private sectors of a state, then irrespective of whether equivalent distributions of taxation resources as between states and foreign individuals or as between states and other states are contemplated, the net national wealth of states under consideration would not be significantly affected by the selection of either a constitutive or statist model. For present purposes, a statist position in respect of both rights and duties is adopted, that is to say that states rather than individuals bear both duties and rights in relation to distributive justice.

288 Caney (n 261), 102 – 147.
The practices of states arguably have shown correspondingly greater attention to issues of global distributive justice over the past few decades that at any time in the past.\textsuperscript{290} Chandler has argued that such attention may be based, at least in part, on politicians' senses of self-interest in being seen to be doing the right thing, rather than based solely on concern for distributive justice.\textsuperscript{291} However, this argument requires the assumption of actual concern for distributive justice among the body politic which the relevant politicians represent.

It should also be noted that equity based arguments for distributive justice and efficiency arguments are not mutually exclusive. A recent World Bank Report suggests that the case for achieving greater global distributive justice is based not only on considerations of equity, but also that utility, which acts to the advantage of rich as well as poorer states, is a factor.\textsuperscript{292} If correct, this combination of equity and efficiency based arguments may make it increasingly unlikely that distributive justice obligations will be seen by states as stopping at national borders.

\textsuperscript{289} ibid, 103.
\textsuperscript{290} \textit{The World Bank} (n 236), 217.
\textsuperscript{291} D Chandler, 'Rhetoric without responsibility: the attraction of 'ethical' foreign policy' (2003) 5 British Journal of Politics and International Relations, 3 295-316.
\textsuperscript{292} \textit{The World Bank} (n 226), 206 - 225.
3.4.1 Inter-nation Distributive Justice, Social Contracts and Cooperation in Tax Administration

In a model in which there are multiple jurisdictions which are democratic, the citizen-voters of individual jurisdictions which allow their citizen-voters to vote with their feet as well as at the ballot box, may be assumed to have consented to whatever form and level of taxation operates within their borders from time to time. Some would go so far as to state that such a citizen-voter’s ongoing residence within a particular state indicates a tacit acceptance of the fairness of that state’s taxation system and creates or affirms a social contract which carries with it certain moral obligations in respect of the payment of taxes imposed by the relevant jurisdiction. Social contracts in this context are defined by reference to political boundaries. The effects of taxation are however not constrained by political boundaries. Arguably, there is unlikely to be any social contract requiring the acceptance of externalities by those on whom they are imposed.

293 The concept of a democratic state is used in the sense that the Member States of the European Union have a collection of common attributes that would generally be thought of as conferring that designation.
295 T Hobbes, Leviathan or the Matter, Forme, & Power of a Common-Wealth Ecclesiastical and Civill (1651) http://www.gutenberg.org/dirs/etext02/lvthnl10.txt accessed 9 October 2007; H Eichel, ‘Address by Hans Eichel, Federal Minister of Finance, at the opening of the OECD Global Forum on 3 June 2004 in Berlin’ (2004) German Ministry of Finance <http://www.bundesfinanzministerium.de/cln_01/nw_546/DE/Aktuelles/Reden/24544.html> accessed 1 June 2005. Eichel arguably uses social contract reasoning to argue for international cooperation to combat breaches of such contracts: ‘A small circle of taxable persons, while enjoying the benefits afforded by our political organisation, takes advantage of the international financial system to avoid paying the dues required from them by our laws. We owe it to our law-abiding taxpayers to make a joint effort to tackle this problem, which cannot be resolved by any one state acting in isolation.’
There is a further argument which may be applied. Specifically, a case may be made that systems of cooperation among states require some common sense of distributive justice commensurate with the level of cooperation required to secure a given distribution or distributive process. That is, to the extent that there exists some continuum of potential degrees of cooperation within systems of cooperation among states, then there exists or ought to exist, corresponding levels of distributive justice among states which are necessary to implement and maintain each level of cooperation over the long term. In this model, any incremental increase in the degree of cooperation among states which is required in order to produce any given potential gain in welfare for a particular state or group of states, would require a commensurate increment in distributive justice among the cooperating states. By way of example, it is arguable that in the context of globalisation and free trade pursued by the now wealthiest states, some common notion of distributive justice arguably would assist, if these states are to secure the cooperation of the less prosperous states.\footnote{Acknowledgement of this concept of linkage arguably may be seen in the juxtaposition of objectives set out in the G7 communiqué of February 2007. G7, 'Communique of G7 Finance Ministers ' (2007) <http://www.bundesfinanzministerium.de/lang_DE/DE/Internationale_Beziehungen/Informelle_Gremien_der_Zusammenarbeit/G7__G8/007b,templateId=raw,property=publicationFile.pdf/007b> accessed 12 February 2007.}

A linkage between cooperation and distributive justice has not always been made however. It is arguable that in the context of certain recent efforts to constrain aspects of tax competition which some developed nations have found disadvantageous, there has been an advancement of the proposition that such
efforts were justified on the basis of preserving the global status quo and enforcing certain concepts of intra-nation, (as opposed to inter-nation), distributive justice.  

3.4.2 Is There Any Obligation to Treat Foreign States or Their Residents Fairly?

There is no consensus answer to the question of whether, and if so to what extent, states ought to show restraint in relation to producing tax related externalities in foreign states. Similarly, there is no consensus in relation to how states ought to respond to externalities produced by the taxation systems of foreign states. However, constitutive theories of international relations arguably create a basis for an assertion that there ought to be obligations protecting non-residents from at least some externalities. In essence, such theories advance the concept that all human beings ought to take into consideration certain rights possessed by all other human beings, such as the right to life, to the extent that the observance of obligations associated with these rights limits the range of permitted activities of all. To the extent that taxation systems might infringe these rights enjoyed by all human beings, then such theories would specify an obligation on states to ensure that their taxation systems are designed so as to not infringe on the basic rights of

297 S Kondo, 'Opening Remarks of Seiichi Kondo, Deputy Secretary General of the OECD at the High Level Consultations on the OECD’s Harmful Tax Competition Initiative, Barbados’ (2001) OECD.
298 A general description of constitutive theories has been provided by Frost. Frost (n 249).
persons in other states. What then of less extreme circumstances? Do states or their citizens have any right to be treated by foreign taxation systems in a manner which they view as fair absent any threat to the fundamental rights of natural persons? If they do have some such right, how is such a right to be understood in practice?

In a single state model the inter-individual fairness or lack thereof produced by a taxation system may be seen as a function of a shared or overlapping set of subjective assessments of the distribution of the economic burdens and benefits which the system produces. 299 However, things arguably become more complex in a multi-state model.

Consider a two state model. If the taxation systems adopted by each of the states produce no externalities and are consistent with the perception of fairness held by each state's residents, then both systems are likely to be seen as fair within that universe. However, in a different fact situation using this two state model, the residents of the state 'A' impose a taxation system knowing that their taxation system imposes negative externalities on the residents of state 'B', and the residents of state 'B' view such externalities as unfair, whereas the residents of 'A' view their tax system as fair. 300 In the absence of any shared understanding of what is fair and what is not fair, is the imposition of externalities fair, indeterminate or unfair as viewed from the perspective of the entire two state universe? Franck's

299 Franck (n 242), 14.
analysis would indicate that in the absence of consensus, it could not be said to be either fair or unfair.\(^{301}\)

3.4.3 Are there Competing Claims for Fairness which may Arise as a Result of Tax Related Externalities?

Franck relates fairness to; ‘an agreed formula located at a conceptual intersection between various plausible formulas for allocation’.\(^{302}\) Implicit in this construct is a requirement that those agreeing have a frame of reference in common.

The objective of intra-individual fairness within a single state has been cited as a theoretical justification for claims that foreign governments ought to provide tax administration assistance in the form of access to tax information located within their control.\(^{303}\) However, such claims appear to assume that such assistance would not adversely affect fairness in any other frame of reference, and in particular inter-nation fairness. How then might inter-nation fairness be adversely affected?

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\(^{300}\) Perhaps in the sense that the moral burden of the collateral damage inflicted on non-residents is viewed as acceptable in the context of the domestic benefits created for residents by the taxation system.

\(^{301}\) Franck (n 242), 14.

\(^{302}\) ibid, 14.
It would seem probably or at least arguable that the majority of provisions in most countries' taxation systems have few if any significant cross-border effects. That is, they may alter the work versus leisure and saving versus expenditure choices of taxpayers within a given state to some extent, but they are unlikely to determine which country a particular taxpayer conducts economic activity in, or otherwise measurably affect welfare in foreign states. In relation to provisions without cross-border effects, tax information exchange with foreign tax authorities is not likely to produce or give effect to negative externalities. However, it is foreseeable that there may be exceptions, and any such exceptions would have implications for tax information exchange.

If, the negative externalities of a given taxation system involve distortions in the global allocation of resources which reduce economic efficiency and thereby reduce welfare in the country providing information and globally, (arguably an unfair outcome), then arguably providing information would be 'Pareto inferior' to not providing information. 304 This conclusion would suggest that restricting the provision of information to that which does not produce negative externalities is to be preferred at least in some circumstances. This differs from the observation of

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303 Eichel (n 295); Kondo (n 297); OECD, Harmful Tax Competition - An Emerging Global Issue (Organisation for Economic Cooperation and Development, Paris 1998). This argument has been used throughout the OECD’s HTC Initiative.

304 An outcome ‘A’ may be said to be Pareto inferior to an outcome ‘B’ if any member of the relevant group would prefer ‘B’ to ‘A’ and no member of that group would prefer ‘A’ to ‘B’.
Keen and Ligthart who argue that full information exchange is Pareto superior to less than full information exchange:

[T]he equilibrium with full information exchange is likely to be Pareto superior to that without (so long as the two countries are not too dissimilar), the policy problem in these models is not that the efficient outcome is not an equilibrium…. but rather that it is not the only one.  

Given that as Franck maintains, fairness is based on a consensus of subjective opinion, there would appear to be no objective basis for concluding that one country's moral claim for assistance in maintaining or increasing the 'fairness' within its borders outweighs another country's claim of a right to deny such assistance in circumstances in which the provision of such information would be perceived as 'unfair' within its borders, or perhaps globally.

It may therefore be suggested that any morally based claim by states for taxation related administrative assistance from other states is not only questionable, but also that to the extent that any such claim may be maintained, that it would also be circumscribed by equally valid competing claims. This proposition arguably is supported by the work of Brooks who undertook an analysis of whether there might be a moral obligation on the part of developed countries to protect the tax incentives of low income countries in the context of tax

306 Franck (n 242), 14.
sparing treaties.\textsuperscript{307} It is also noted that while the 1998 OECD paper underlying Brooks analysis did not recognise any overriding moral basis for developed countries to give effect to equity enhancing incentives of developing countries, in that same year the OECD raised fairness arguments to suggest that developing countries ought to protect the incentives and biases of OECD countries through tax information exchange.\textsuperscript{308}

\section*{3.5 Tax Competition and the Limits of Models of Inter-Nation Equity}

Matters of inter-nation equity in international taxation are not confined to issues affecting pairs of countries existing in isolation from the rest of the global community. Neither are they static. However, they are treated as such in most of the existing academic literature.\textsuperscript{309} The competition for tax revenues arguably involves all countries to a greater or lesser extent, simultaneously and over time. A
static two country perspective is therefore unnecessarily limiting and a dynamic multi-state model is to be preferred.

Many of the inter-nation equity issues which affect more than pairs of countries in isolation, relate to considerations of tax neutrality from a global perspective. While these issues are more fully discussed in following sections of this chapter, a simple illustration of these issues is provided here. Consider, by way of example, a scenario in which X, an investor and resident of country A, has alternative potential investments in countries A, B and C in a context in which A's domestic tax legislation is not neutral, that is, it biases the probability that X will invest in a certain way. In this scenario A's domestic tax legislation is firstly biased in providing a lesser aggregate tax burden, (tax paid plus compliance cost expenditure in relation to tax), for domestic as opposed to foreign investment, and secondly is biased as between investments in B and C, arbitrarily providing a lesser aggregate tax burden, if X invests in B rather than C. It is foreseeable that, all other things being equal, the investments made by X and any tax revenues they produce, are more likely to go to A rather than either of B or C, and similarly are more likely to go to B than C, irrespective of what a distribution based on inter-nation equity would produce.

Musgrave alluded to the importance of tax based economic competition for economic factors of production as an element in considerations of inter-nation
equity when she noted that, "Issues of inter-nation equity arise in two situations. One comes about as the result of factor movements and the other where a business transacts in more than one jurisdiction." In the present work it is posited that it would perhaps contribute to accuracy to add an additional qualifier to Musgrave's observation in relation to factor movements. This qualifier is designed to cover inter-nation equity issues arising in the context of the absence of movement of factors, rather than the presence of factor movements. To illustrate the need for this additional qualifier, consider the scenario in which a lack of neutrality in the domestic taxation regime of country A in relation to countries B and C, arbitrarily deters factor movement to country B in circumstances in which that given factor movement would increase inter-nation equity. In that situation an issue of inter-nation equity arises, due to non-movement of factors, a situation arguably outside of Musgrave's paradigm. Thus, for purposes of the present work, it is accepted that firstly, tax induced movement of economic factors of production, secondly the tax induced non-movement of economic factors of production, and thirdly transactions with cross-border effects, may each affect inter-nation equity.

Schäfer and Spengel's approach as noted above, links inter-nation equity to the right to impose source-based taxation in a multi-state model. However, this approach arguably fails to take into consideration the potential for tax competition to distort the global distribution of economic activity and therefore the

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310 Discussed in Chapter 4 of this work.  
311 Musgrave (n 237), 159.  
312 Schäfer (n 266).
location of tax bases over time. Simply put, tax competition may influence which country investors invest in over time, and even whether they invest in something which contributes to a tax base. That is, tax competition arguably alters the probability that certain potential tax base elements such as taxable profits will come into existence within a particular country’s borders or at all. Unless it is assumed that all competition for tax bases, whether based on taxation measures or otherwise, is consistent with an equitable allocation of taxation resource, then Schäfer and Spengel’s approach is suspect.

If it is the case that not all competition is consistent with inter-nation equity in the allocation of taxation resources, then it is arguable that a dynamic analysis of inter-nation equity in the competitive allocation of taxation resources should include consideration of the rules for tax competition and how such rules affect the allocation of economic activities from which tax bases are derived.

3.6 INTER-NATION EQUITY, TAX COMPETITION AND THE CREATION, DENIAL AND UTILISATION OF ECONOMIC OPPORTUNITIES

Opportunities for states involved in competition are determined not only by natural endowments and other purely domestic factors, but also by the fairness of any rules applicable to such competition. Just as taxes tend to affect economic
decisions, so tax competition may have the potential to affect both the location of economic activity, and the nature of economic activity undertaken over time. To the extent that national wealth, the economic metric at the core of inter-nation equity within Musgrave's construct of such equity is affected by tax competition, then at least potentially so is inter-nation equity. That is to say, tax competition may shift wealth across borders and alter the probability that wealth will be created within borders in such a way as to increase or decrease the relative wealth of nations and thus inter-nation equity.

Jeffery has noted that tax induced distortions in the global allocation of economic factors of production may alter national tax bases. 313 Such distortions arguably are inherent in non-harmonised taxation and do not necessarily arise from tax competition in the sense of purposeful competition for taxation resources, but may simply arise as a result of differing national preferences. It is also worthy of note that under certain conditions tax competition may in fact tend to induce the convergence of taxation regimes and the reduction of distortions to the extent that distortion is a function of divergence. This may occur when information regarding the preferences of controllers of mobile factors of production emerges, allowing taxation regimes to converge on these preferences. States may also add

313 Jeffery (n 264), 3-10.
inducements, whether tax related or otherwise, which change preferences and thus potential preference-related convergence points related to tax competition.\textsuperscript{314}

The difficulties for national tax authorities posed by tax competition and the potential effects of tax competition on inter-individual equity within single states, at least from the perspective of developed countries with residence-based taxation regimes, have been identified in the literature.\textsuperscript{315} However, relatively little has been written on the effects of either tax competition or efforts to restrict tax competition on inter-nation equity as viewed from a global perspective.

It is accepted by a variety of governments and many economists that at least certain types of tax competition may have benefits at both the national level and the global level.\textsuperscript{316} In 2001 by way of example, dozens of economists

\textsuperscript{314} DD Murphy, 'Interjurisdictional Competition and Regulatory Advantage ' (2005) 8 Journal of International Economic Law 4 891-920.


\textsuperscript{316} C McCreevy, 'Ireland: Making the Most of the Internal Market' (2005) <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/785&format=HTML&aged=0&language=EN &guiLanguage=fr accessed 8 October 2006 also found at http://www.entemp.ie/trade/marketaccess/singlemarket/05serv593.doc> accessed 8 October 2006. McCreevy, the European Commissioner for Internal Market and Services has noted that; 'Tax competition exists when people can reduce their tax burden by shifting their resources – whether financial capital, intellectual capital, physical capital, or labour – from a high tax jurisdiction to a low one. The ability of people and companies to shift their resources in this way imposes a discipline on profligate governments. Tax competition is critical in the world economy of today and is being embraced by many of the most successful economies in Europe, including many from the former Soviet block who want to be a magnet for capital and labour to drive forward economic growth. Of course high tax countries don't like tax competition. And they work through bureaucracies of all kinds to try and dampen it. But Governments everywhere should realise, to quote Milton Friedman "that competition among national governments in the public services they provide and in the taxes they impose is every bit as
including several Nobel Laureates wrote an open letter in favour of tax competition which they considered was under threat by the OECD. Where there is less agreement, is in relation to the existence of particular conditions under which tax competition may be viewed as objectively ‘harmful’ from a global perspective. How then might tax competition be viewed from a global perspective which gives preference to inter-nation equity, rather than a perspective which gives preference to other political objectives?

One possibility is to view the path to the equilibrium end state of inter-nation equity as having components derived from each of opportunity and exploitation. In this construct, various forms of tax competition may be seen as either creating or denying opportunities for nations to enhance inter-nation equity through their own efforts. Similarly, various restrictions on tax competition may be seen as either creating or denying opportunities to enhance inter-nation equity. That is not to say that the realization of an enhancement to inter-nation equity necessarily follows from an opportunity to enhance such equity.

Opportunity may be seen as requisite but not sufficient to bring about progress toward inter-nation equity. In a model which envisages dynamic competition among states, it is for the state presented with an opportunity to take productive as competition among individuals or enterprises in the goods or services they offer for sale and the prices at which they offer them”.

advantage of such opportunity in order to enhance its national wealth. A corollary to this proposition is however, that states which are denied an opportunity, or have that opportunity significantly restricted by any rules relating to tax competition, are less likely to be able to enhance national wealth at least in respect of that opportunity. Similarly, denial of an opportunity to a state which has multiple alternative opportunities as a result of natural endowment or otherwise, may ultimately affect the potential achievement of inter-nation equity less than a similar denial to a state which has few or no alternative opportunities.

Opportunities may not only be created or denied in an absolute sense, they may also be rendered more or less realizable through competitive mechanisms. In the tax competition context, the instruments of competition generally operate to alter probabilities rather than to absolutely create or deny opportunities, although in the extremes they may have absolute effects. How then might this concept of opportunities to enhance inter-nation equity in the allocation of taxation resources be utilised?

3.6.1 Fairness in Taxation Resource Distribution and Restrained Tax Competition

318 Tax expenditures used as inducements in tax competition have costs. States may therefore be expected to design such inducements so as to bear the least cost necessary to achieve the desired level of competitive advantage.
Considerations of what ought to be in relation to tax competition and fairness in the distribution of taxation resources, are relevant to the way in which at least some states organise their affairs, in the positive sense that the relevant political institutions within such states want to do 'the right thing', and also in the sense of wanting to be seen to be doing 'the right thing', or at least not wanting to be seen to be doing 'the wrong thing'. The manner in which the political directorates of such countries may be seen to espouse moral stances in order to garner domestic and international political support, and also the manner in which countries utilise propaganda tools, invoking moral arguments to shape the domestic and international perceptions of what is 'the right thing' prior to doing such things, arguably provide evidence of the fact that considerations of what ought to be, have some importance.

Consistent with this assessment, equity and fairness based arguments have been used by politicians and their agents in relation to matters of taxation and tax competition. Various forms of inter-nation tax competition are claimed to be fair or unfair, or harmful or not harmful, rather than merely advantageous or disadvantageous to some subset of persons or states.
In the context of recent international dialogue on tax competition and international cooperation in tax administration, fairness with respect to the treatment of one group or another has frequently been raised by those who seek greater access to taxpayer specific information located outside their borders, as well as those who argue in favour of qualifying such access. Fairness is also raised to challenge the existing taxation related practices of states in statements concerning current implementations of residence and source principles of taxation and the priorities to be given to competing claims based on each.

3.6.2 Constrained Tax Competition, Fairness and the Level Playing Field

Constrained competition among nations for taxation resources in the absence of any independent supra-national authority charged with dynamic redistribution,
arguably requires among other things some level of common understanding of, firstly any rules in such competition, secondly how such rules are created and modified, and thirdly how the rules of the game of tax competition are to be interpreted. Absent such understanding, it is arguable that there is unlikely to be significant constraint over time.

The concept of the ‘level playing field’ is one expression of a constraint which may be applied in deciding which potential tax competition rules are legitimate, how such rules are to be created or modified, and how other rules relating to fairness and reasonableness in inter-nation tax competition are to be interpreted. The level playing field, as it has emerged in multi-lateral dialogue relating to tax competition, encompasses the notion that rules relating to tax competition, should not be interpreted in a manner which would bias competition so as to give advantage to one or more competitors. In essence, the same non-biased rules and rule making procedures should apply to all competitors. Further, a level playing field constraint arguably trumps claims which assume entitlements to taxation resources based solely on existing allocations.

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324 R Dworkin, *Taking Rights Seriously* (Harvard University Press, Cambridge Massachusetts 1978) 101. Dworkin argues that even in games with highly defined rules such as chess, points arise which require interpretation of the express rules and that such interpretations are constrained based on the common understanding of the nature of the game held by the participants.

325 OECD, 'Outcome, conclusion of the meeting of the OECD Global Forum on Taxation in Berlin, 3-4 June 2004.'

326 ibid
It is therefore perhaps worthy of note that in the arena of tax competition, the validity of some concept of a level playing field is accepted by countries with very different views of entitlement.\textsuperscript{327} The failure to endorse, let alone the public rejection of, the validity of a requirement for competition on a level playing field arguably would be seen in western democracies as inconsistent with the requirement to be seen to be doing 'the right thing'. On that basis, it may be predicted that states averse to any implementation of a level playing field would seek to re-define, subvert or obfuscate the meaning of the concept in any given context, rather than reject it in an outright fashion.

3.7 \textbf{INTER-NATION EQUITY, OPPORTUNITY AND THE LEVEL PLAYING FIELD}

In his work on the nature of equality of resources in a single state model, Dworkin noted that:

\textsuperscript{327} ibid
Equality of resources is a complex ideal. It is probably... an indeterminate ideal that accepts, within a certain range, a variety of different distributions. 328

The tax legislation of most countries reflects an unequal concern as between residents and non-residents. To the extent that tax legislation biases the global distribution of economic activity away from optimal production efficiency, it is both predictable that some global citizens will be made comparatively worse off, and if the nature of the bias is known, which global citizens will likely be made less well off by those laws. Arguably, calls from small and developing countries for a level playing field in the area of tax competition reflect their observation that concerns over the effects of negative externalities visited on them by the taxation laws of developed countries have been compounded by the developed countries' drive to win in the tax competition game. 329 It also arguably reflects an aspiration for competition among states in which lesser developed countries can fairly participate in the global economy with a view to achieving greater inter-nation equity through their own efforts rather than international aid. 330

In the context of a level playing field in the global competition for taxation resources, it is arguable that the opportunity to participate in defining the

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rules of competition and the opportunity to compete on terms no less favourable
than other states, is itself a resource. Not all states would necessarily accept the
proposition that such opportunities are among the resources which all states may
legitimately expect in tax competition.\textsuperscript{331} It is suggested however, that
justifications advanced by geo-politically powerful states in favour of the biasing
of rules and the exclusion of the majority of states from the process of designing
the rules of tax competition, may amount to nothing more than self-serving pre-
analytic dogma.

Equality of opportunity is also relevant in relation to that aspect of tax
competition which relates to decisions by countries regarding whether or not to
enter tax treaties. As noted by Genschell and Rixen, treaty networks in one sense
institutionalise certain forms of tax competition.\textsuperscript{332} A recent survey conducted in
the context of the OECD's Global Forum on Taxation indicates that only a very
small percentage of states have tax treaties with even half the other countries in
existence, but that the richest states do have tax treaties with each other.\textsuperscript{333} Further,
small and developing countries tend to have relatively few treaties. To the extent
that tax treaties provide the economic advantages which they are intended to, and
that they are less available to small and developing countries, it seems logical to

\textsuperscript{331} Horner (n 323). Horner notes that the rules relating to international taxation are set without the input of developing
<http://www.law.wayne.edu/McIntyre/text/Treaty_Class/UN_institutional_framework.pdf#search=%221963%20OEC
D%20Convention%20Taxation%20%22exchange%20of%20information%22%22> accessed 3 October 2006.
conclude that tax treaties may serve in some sense to maintain the advantages enjoyed by the advantaged.

The conventional wisdom of geopolitically powerful states appears to have been that only states which can provide significant benefits in one form or another should receive preference in terms of inclusion in the group of states to which treaties and their benefits may be extended. An exception which arguably did consider distributive justice relates to the adoption of tax-sparing double taxation treaties by some developed countries particularly during the post-colonial ‘Cold War’ period. However, these types of treaties were infrequently offered, and it is now the position of some developed states, and the recommendation of the OECD, that such treaties should be reconsidered and perhaps not offered even to the most disadvantaged developing states.\(^{334}\) An interesting juxtaposition is that the same developed countries apparently see no distributive justice problem in entering into double taxation treaties with countries which do not in fact levy taxes on income or capital, provided that such countries have oil, or at least oil money.\(^{335}\)

At the end of the day, if poorer, less developed and less geo-politically powerful states are denied the opportunity to compete with more powerful states on an equitable or at least equal basis in relation to the advantages conveyed by tax treaties, then disadvantaged states are likely to remain disadvantaged. That


\(^{335}\)
arguably would be inconsistent with both inter-nation equity and optimal cooperation in taxation matters.

335 The United Arab Emirates has entered into 25 tax treaties, including treaties with the majority of the G7 states. OECD (n333); IBFD, 'Tax Treaties Database on CD' (IBFD Amsterdam 2006).
CHAPTER 4 - NEUTRALITY AND INTER-NATION EQUITY

4.0 INTRODUCTION

The concept of neutrality in relation to taxation systems in a multi-state model provides the third component in the nexus which locates the present work. Neutrality is, at its historical core, an economic concept. Very generally, a taxation system may be said to be neutral if it does not affect the investment, consumption and other economic choices of taxpayers.

Neutrality has developed into a normative concept in taxation system design through association with the concept that optimal economic efficiency is achieved through the neutrality of taxation systems. 336 Arnold has written that;

A neutral tax system is a desirable policy goal because it promotes the most efficient allocation of resources. Although neutrality is generally accepted as an objective of a tax system, most tax systems contain many departures from neutrality. Tax incentives and preferences for various types of activity abound; indeed, they have become one of the primary avenues for government intervention in the economy. 337

336 B Arnold, Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand, the United Kingdom, and the United States (Canadian Tax Papers Canadian Tax Foundation, Toronto 1991), 17.
337 ibid.
Easson also relates neutrality to the efficient allocation of resources, and similarly, Jeffery notes that the underlying concept in most if not all articulations of neutrality is economic efficiency.

It is generally considered in the economics literature that the end state of complete neutrality of taxation systems in a multi-state model cannot be achieved without complete harmonization of taxation systems. In the absence of harmonization, and in recognition of the unlikelihood of complete harmonization, much of the academic debate on neutrality has shifted to descriptions of various approximations of neutrality which can be used to guide taxation policy objectives. By way of example, Hettich and Winer have linked tax neutrality in a multi-state model with harmonisation of the manner in which cross-border income is taxed in various countries:

One system of interjurisdictional harmonization that has developed over many years... is one that combines the residence principle for the taxation of international income from capital for residents of a country with source taxation of nonresidents and a foreign tax credit by the nonresidents' home country. Under the residence principle, the capital income of citizens is taxed in the same way no matter where in the world it is earned. This is an example of tax neutrality in the international setting.

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340 Arnold (n 336), 18.
Desai has observed that in relation to the movement of capital across borders, the neutrality of taxation systems has traditionally been assessed against three divergent standards:

Economic theory offers three benchmarks for assessing the desirability of tax systems and reforms. The concepts of “capital export neutrality” (CEN) and “capital import neutrality” (CIN), introduced by Richman (1963), and which she refined in Musgrave (1969), are mainstays of the welfare analysis of international tax reform. These principles characterize tax systems directed at maximizing global welfare, while “national neutrality” (NN) is characteristic of home-country tax systems directed at maximizing home-country welfare. 342

The objective of capital export neutrality is to ensure, “the equal treatment of investors, whether they invest at home or abroad”. 343 The objective of capital import neutrality on the other hand, is to ensure that the overall taxation treatment of local and foreign investors in a particular country is the same. 344 As noted by Ring:

[T]ax theorists identify two major ways in which international tax rules may distort behavior and undermine worldwide economic efficiency: (1) favoring investment either at home or abroad (violating “capital export neutrality” (CEN)), or (2) favoring certain investors in a single economic setting, thereby distorting savings decisions and potentially impacting competitiveness of businesses (violating “capital import neutrality”(CIN)). 345

343 Easson (n 326), 11.
344 ibid, 11
Given sufficient information, a state may be able to implement capital export neutrality within the geographic space it controls simply by ensuring that the aggregate tax paid by its residents is the same no matter which country they invest in. On the other hand, a state with a residence-based taxation system may be unable to implement capital import neutrality unless it has the cooperation of other states with respect to the taxation of those other states’ residents who choose to invest in the first mentioned state.

There is no evidence that any state which has adopted a residence basis for its taxation system, whether in whole or in part, has ever reached the standards required for capital export neutrality and capital import neutrality. That does not mean however, that the application of specific versions of neutrality are mutually exclusive within taxation systems. Indeed, it may be possible to identify specific elements within national taxation systems which are consistent with each of capital import neutrality, capital export neutrality and national neutrality.

346 Easson (n 338), 11.
347 Easson (n 338), 15.
The objective of national neutrality as noted by Desai, is maximizing welfare within a particular state rather than globally. By way of example, a country may seek to achieve national neutrality through policies which include restrictions on, or disincentives with respect to, capital export. Desai has also recently proposed a new paradigm which involves what Desai refers to as capital ownership neutrality and national ownership neutrality. Capital ownership neutrality is described as; 'the principle that world welfare is maximized if the identities of capital owners are unaffected by tax rate differences', whereas national ownership neutrality is the; 'principle that national welfare is maximized by exempting foreign income from taxation'.

Each of these five versions of neutrality related principles is intended to highlight certain taxation policy issues. It is arguable that the variety of neutrality related principles which have been proposed and the ongoing debate over which are important in the taxation policies of various states, provides evidence that while there is general agreement that neutrality is good for global economic efficiency and arguably global welfare, there is no consensus in relation to how much global welfare is best for individual states.

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351 Brumbaugh (n 349).
352 Desai (n 350), 4.
Arguably, there are other neutrality related principles which may contribute to the understanding of the relationship of neutrality to economic efficiency and inter-nation equity, particularly in areas related to the activities of multilateral organisations which seek to coordinate the taxation systems of states through the promotion of standards and otherwise. One of these is competition neutrality.

Competition neutrality has been defined as follows: ‘[I]t is the concept that competition should be fair between different classes of market participants so that there is a level playing field.’ Benink and Llewellyn have described the concept of competition neutrality in the context of cross-border regulatory cooperation in the financial services sector as follows:

It implies international collaboration in those aspects of regulation (e.g., conduct of business rules) that have the potential to affect the competitive position of suppliers of financial services in different countries. The premise is that all forms of regulation have a potential impact on the cost of providing services.  

In a single state model, the principle of competition neutrality in relation to taxation is used to suggest that entities providing the same function ought to be treated the same manner irrespective of their state of residence in order to achieve

efficient allocations.\textsuperscript{355} How then might the concept of competition neutrality be applied to multilateral proposals for coordination relating to tax competition?

In the following analysis, the admonition of Jeffery to avoid "trespassing upon the terrain of economists"\textsuperscript{356} and the advice of Vogel to the effect that lawyers should "rely largely on arguments of qualified economists",\textsuperscript{357} are accepted. A dynamic frame of reference which assesses the neutrality of national taxation systems according to the extent to which they provide for maximum global efficiency is adopted.

\subsection*{4.1 Non-Neutrality and International Taxation}

Neutrality as a static end state in relation to taxation systems implies economic efficiency. It also implies that all of the provisions in individual taxation systems, and in addition, all of the interactions of different countries' taxation systems collectively, produce neutrality. In the event that one or more provisions of a state's taxation system, or the interactions of taxation systems of different states

\begin{footnotesize}
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\item \textsuperscript{355} ibid.
\item \textsuperscript{356} Jeffery (n 339), 4.
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are incompatible with neutrality, then these measures or interactions may be said to represent non-neutralities.

A condition of neutrality does not require inter-nation equity in the distribution of taxation resources among states. That is, a theoretical static end state of neutrality arguably requires harmonization of taxation systems, but does not specify a particular content within the harmonized systems. There is an infinite range of possible content for such a harmonized system, some of which arguably may be inconsistent with inter-nation equity in the distribution of taxation resources. By way of an extreme example, a harmonized system of international taxation which had the effect of perpetually allocating ninety per cent of global wealth to the residents of the same small group of states representing 10 per cent of the global population and leaving the remainder in poverty would meet the conditions required for neutrality, but arguably would not meet most standards of inter-nation equity.

Brand described neutrality in the context of international taxation as that condition which permits “competition under equal conditions”.

However, there is good evidence that the currently deployed taxation systems of developed

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countries tend not to be neutral. Similarly, there is reason to suspect that the OECD's model tax convention which influences the interaction of taxation systems, and which arguably contributes to the harmonization of certain aspects of international taxation at least among the dominant states, may also contribute to non-neutrality, in the sense that the treaty model may be biased in favour of the interests of developed countries.

4.2 NEUTRALITY AND TAX COMPETITION

Arnold has noted that the pursuit of self interest in obtaining tax revenues is seen by many as the main task of tax law. States also tend to implement taxation systems which are thought appropriate to achieve specific political rather than theoretical economic ideals. They engage in tax competition and typically do not prefer the pursuit of global welfare over either utility in collection of national tax

361 Hettich (n 341), 13.
362 FM Horner, 'Do We Need an International Tax Organization?' (2001) taxanalysts
363 Arnold (n 336), 18; M Graetz, Foundations of International Income Taxation (Foundation Press, New York 2003), 32 – 33.

revenues or horizontal or vertical inter-person equity within their borders. States may also attempt to restrain, or reduce the effects of, tax competition measures deployed by other states.

Placing boundaries on tax competition is generally viewed within the academic tax literature, and by multilateral organisations representing developed countries, as most effectively done through multi-lateral cooperation, at least in relation to implementation.\(^{365}\) However, all regulatory cooperation, including the curtailment of tax competition, has at least the potential for associated costs.\(^{366}\)

The principle of competition neutrality would require that any costs incurred or gains realized associated with rules of cooperation are allocated on a basis which does not bias the distribution of economic activity. In the context of the OECD’s efforts to limit tax competition in the financial services sector, an

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\(^{364}\) By way of example, so-called ‘sin taxes’, typically consumption taxes on cigarettes and alcohol, are intended to both raise revenue and to dissuade consumers from making a choice to smoke or drink. M Aldestam, ‘EC State aid rules applied to taxes - an analysis of the selectivity criterion’ (Doctoral Thesis University of Uppsala 2004) 230 – 232.

acknowledgement of the importance of this type of neutrality may provide one explanation of repeated expressions of the idea that the implementation of tax information exchange should not displace financial services activity to countries which are unwilling to cooperate with the OECD. Of course an efficiency-based explanation is also possible. That is, that simply shifting the location of capital without enhancing access to tax information would not assist in the enforcement of residence-based taxation of capital.

4.2.1 Competition Neutrality and the Level Playing Field

Competition neutrality may also provide a metric for states to use in assessing whether to accept or reject particular terms for cooperation with other states, or indeed regulatory measures proposed by so-called ‘international standards setters’ in general. Quite simply, if cooperation is sought on particular terms, then those terms could be assessed based on whether or not they meet at least the conditions of competition neutrality. If they do, then given an acceptance of a ‘level playing field’, cooperation could reasonably be given, all other things being equal. If they

366 Benink (n 354).
368 The G7 countries have designated certain exclusive multilateral organisations, some of which they have established, as so-called ‘standards setters’ in issue specific areas of the services sector. These include the Financial Stability Forum, the Financial Action Task Force as well as the OECD.
do not, and particularly if the proposed form of cooperation is likely to introduce or give effect to biases which in their application distort tax competition in a manner which disadvantages the universe of states, or even just the country being requested to cooperate, then arguably cooperation could reasonably be withheld. How then might such non-neutralities come into existence?

4.3 THE CREATION OF NON-NEUTRALITY THROUGH DOMESTIC LEGISLATION IN A MULTI-STATE FRAME OF REFERENCE

The range of possible non-neutralities which may be created by domestic legislation is virtually limitless. As noted by Arnold, tax incentives and preferences can be found in most country’s taxation systems. While the spectrum of potentially non-neutralities is vast, the manner in which non-neutralities may be created in practice is perhaps best shown by simple example.

4.3.1 Domestic and Foreign Preferences as Non-Neutralities

Consider a dynamic scenario in which there are three countries A, B and C, three time periods (identified simply as one, two and three), and a simple residence-
based corporate income tax. In the first time period, A has an enforceable taxation system without domestic preferences or incentives in which the world wide income of its tax residents is taxable and capital export neutrality exists. All other things being equal, an investor who is a taxpayer of A is indifferent in relation to investments in countries A, B and C, as each will face the same tax outcome.

In time period two, A changes its tax policy and introduces a very simple controlled foreign companies (CFC) regime in which it imposes tax on its residents calculated on the basis of undistributed profits in all foreign, but not domestic, companies in which any number of its taxpayers have aggregate investments of more than 50%. This accelerates the timing of taxation for foreign investments meeting the CFC criteria to a point at which profit or income may not have been received by taxpayers. The CFC regime thereby creates a timing of taxation non-neutrality which may bias investment towards domestic investment and away from investments in B and C, all other things being equal.

In time period three, A introduces a refinement to its CFC regime in which it sets out a list of foreign countries to which the CFC regime will not apply, (a “white list”). A includes B on this list, but not C. In so doing A restores neutrality as between A and B, but introduces a non-neutrality which potentially biases investment by taxpayers of A in relation to investments in B and C. It can

369 Arnold (n 336), 18.
thus be seen that non-neutralities can relate not only to domestic preferences, but also third country preferences.

4.3.2 Non-Neutralities Resulting from the Operation of Tax-Related Treaties

The removal of double taxation arguably enhances the neutrality of taxation systems. However, the operation of bilateral and multilateral tax-related treaties in combination with domestic legislation may also create non-neutralities. By way of example, double taxation treaties based on the OECD Model Convention may operate to give advantage to developed countries over developing countries as suggested by Easson, Horner, Dagan and others. While prior analyses have tended to focus on non-neutralities in terms of the parties to tax treaties, some non-neutralities may give rise to negative externalities for countries which are not parties to the relevant treaty provisions. This is also perhaps best illustrated by a further example.

Consider a hypothetical dynamic scenario in which there are five countries A, B, C, D and E, three time periods, and a simple tax on dividend

370 Hettich (n 341), 13.
371 Easson (n 338), 20; Horner (n 362); Dagan (n 362); UN, (n 362).
income with no unilateral credit or exemption scheme which would mitigate the
effects of double taxation. In time period one, A has an enforceable taxation
system in which there is no credit or exemption system in place with respect to
foreign tax paid outside of its treaty obligations. A does not apply capital export
neutrality, with domestic dividend income being subjected to a lower tax burden,
(effective rate of tax plus compliance costs), than any corresponding dividend
income arising in any of B, C, D or E. It has treaty arrangements with B, C and E
in which there are 5% source country withholding taxes applicable to dividend
income. A has no treaty arrangement with D however, which by virtue of each
countries domestic legislation results in a situation in which A and D each apply a
source country tax of 30% on relevant dividends.

In this scenario, for any given pre-tax risk adjusted rate of return, the
taxpayers of A would prefer to invest in B or C or E rather than D, all other things
being equal. Irrespective of any country's objectives in entering into the
hypothetical treaties identified in this example, in effect, A has collaborated with B
and C and E to create a situation in which investment decisions by taxpayers of A
with respect to D are not neutral, but rather are biased by the treaty agreements to
which D is not a party. Similarly, the taxpayers of A would be indifferent as to
investments in B or C or E for any given pre-tax risk adjusted rate of return, all
other things being equal, because of the relative neutrality of the treatment of A
afforded to B, C and E.
In time period two, Country A and Country B decide to amend their treaty by adding a single clause, (which for present purposes can be called "the MFN clause"), to the section of their treaty dealing with the dividend withholding tax. The MFN clause does not amend the withholding tax rate, but simply states that if either A or B ever gives a rate of less than 5% to any third country, then the state providing the lower rate will automatically extend that rate to the other party. By so doing, A and B create a further non-neutrality by creating a possibility that investments in B by taxpayers from A will be able to achieve a lower withholding tax rate at some point in the future. Therefore, all other things being equal, taxpayers from A would prefer to make investments in B rather than C or E from the time of the amendment of the treaty between A and B. There is also a further level of non-neutrality as between B and D which would require a greater risk adjusted pre-tax rate of return in D to justify an investment in D as opposed to B. In effect, this time period two agreement between A and B renders investment decisions with respect to non-parties to the treaty, C and E, non-neutral, and with respect to D even more non-neutral.

In time period three, A and E amend their treaty so as to remove any bias towards domestic investment in cross-border investments between their two countries and remove the 5% withholding tax, replacing it with a 0% rate. By so doing, A and E create capital export neutrality as between A and E, and improve the neutrality between A and B (by virtue of the operation of the MFN clause in the amended treaty created in period two). They also create a new level of non-
neutrality with respect to the investment in C, as the domestic preference of A in relation to potential investments by its taxpayers in C remains, as does the 5% rate of withholding tax. In time period three therefore, an agreement between A and E creates a number of effects including greater neutrality as between A and B, and new levels of non-neutrality for investments as between B on the one hand and C and D on the other.

It can be seen from the above that neutrality, in the sense of competition under equal conditions as envisaged by Brands, particularly as it relates to the ability of third countries to attract capital, may be adversely affected by both the domestic tax legislation of foreign states and also by provisions in bilateral and multilateral treaties to which the relevant countries are not parties. Having set out the nature of non-neutrality here, it is next necessary to consider whether there is any theoretical basis for postulating that under any given set of conditions, the provision or exchange of tax information might positively or negatively affect neutrality or inter-nation equity.

372 Vogel (n 358), 38.
4.4 THE PROVISION OF TAX INFORMATION AND ITS EFFECTS ON THE 
OPERATIONAL NEUTRALITY AND INTER-NATION EQUITY OF 
INTERNATIONAL TAXATION SYSTEMS

It has been argued that the maintenance of sovereign control over the design of tax systems and such inter-taxpayer 'fairness' as exists within the borders of individual states, is a sufficient justification for the exchange of taxpayer specific information between states:

Exchange of information is the key to better international tax co-operation, which is needed if OECD and non-OECD countries alike are to maintain effective sovereignty over the design of their tax systems and if the tax burden is to be shared fairly between citizens.373

The proposition in the above quotation that tax information exchange is the key to better tax cooperation, appears to incorporate a number of questionable assumptions and ambiguities. The meaning of tax cooperation in this context is itself ambiguous. In the narrow language of the OECD's Harmful Tax Competition Initiative, tax cooperation may be taken to mean the proposals of the OECD in relation to certain restrictions on tax competition for mobile financial and other services.374 In that narrow sense, tax information exchange may indeed be the key to limiting certain forms of tax competition. However, if the concept of tax

374 OECD (n 365).
cooperation is considered from a more broad perspective, and arguably a more customary usage, then the assertion becomes less tenable.

Arguably, the key to tax cooperation is fairness in deciding the parameters of tax competition and the mechanisms for securing those parameters. Following the logic of fairness described by Franck, cooperation would require that such parameters are established in a broadly representative forum and not by a small group of geo-politically powerful countries. The notion that tax information is the key to broad tax cooperation would also appear to ignore the possibility that the provision of tax information may in certain cases actually impair the information providing country's freedom to design its own taxation system, and decrease welfare within the information providing state and globally as discussed in the following section.

4.4.1 Might the Provision of Tax Information Amplify the Effects of Non-Neutrality under Certain Conditions

Central to the analysis of the relationship between tax information exchange and the neutrality of tax systems, is the observation that arrangements for the exchange or provision of information between or among tax authorities function, at least in part, as tools which add efficacy. That is, tax information exchange adds efficacy to information dependent provisions contained in the tax systems of states which are the recipients of such information. This added efficacy is derived from a variety of factors including the deterrence of tax avoidance and evasion, and the removal of benefits related to unlawful tax avoidance and evasion.

The efficacy afforded by tax information arguably is unaffected by the neutrality of the underlying tax legislation. Tax information exchange can be used to enhance or detract from global economic efficiency and inter-nation equity, dependent upon whether the tax provisions which are given added efficacy have the potential to enhance or undermine inter-nation equity or global economic efficiency. By way of example, a tax provision with the potential to add to inter-nation equity or global economic efficiency will be less likely to have this effect to the extent that it is unenforceable. Similarly, a tax provision which has the potential to undermine global economic efficiency and inter-nation equity is less likely to have this effect to the extent that it is unenforceable. Might then the refusal to provide tax information be justified in circumstances in which the

376 Vogel (n 358), 38. For purposes of this analysis, neutrality will be defined as competition under equal conditions, and a tax system which includes taxation on the basis of residence will be assumed.
specific tax provision to which the tax information relates is equity or welfare reducing from a global or national perspective?

4.4.2 Non-Neutralities and the Setting of International Rules for Cross-border Taxation

It was recognised in the 1930's in the context of the League of Nations process, that tax information exchange which facilitated double taxation was potentially 'unjust'.\footnote{League of Nations Economic and Financial Commission, 'Report on Double Taxation: Document E.F.S.73. F.19; April 5, 1923' (1923) League of Nations <http://setis.library.usyd.edu.au/pubotbin/toccer-new?id=brulegi.sgml&images=acdp/gifs&data=/usr/ot&tag=law&part=1&division=div>, 305 accessed 8 July 2004.} Arguably, this remains true today. Tax information exchange which facilitates double taxation facilitates inefficiency in the global allocation of taxation resources, an undesirable outcome. It may also be argued more generally that tax information exchange which facilitates measures which produce distortions in the allocation of factors of production, or which decreases international equity, is inappropriate or unjust.

Arguably it would also be inequitable for any single nation or group of nations to manipulate the rules for tax competition among states away from competition neutrality so as to secure or preserve advantages for themselves to the
disadvantage of poorer nations. This proposition is unaffected by whether the manipulation involves the use of non-neutralities in domestic systems for international taxation, a system of tax treaties, or otherwise.

The existing international taxation literature suggests that non-neutralities in taxation systems may at present adversely affect inter-nation equity. Easson in particular, has commented on potential effects of non-neutralities in international taxation and its effect on inter-nation equity. Other writers have also noted that international tax structures promoted by the OECD do not necessarily contribute to inter-nation equity. Horner, by way of example, has observed that:

The existing rules, at least as applied to direct income taxation, have been designed to benefit the rich countries, those “first to the table” in international commerce. The “last to the table” developing countries face a system decidedly tilted against their interests, with the most fundamental and important questions of tax policy routinely “off the table”, i.e. not open to discussion.

A recent paper produced by McIntyre and published by the United Nation came to a similar conclusion.

378 Ring (n 345), 17. Ring however indicates that a neo-realist perspective would suggest that seeking to preserve or enhance relative competitive advantage is exactly what powerful countries might be expected to do.
379 Dagan (n 362).
380 Easson (n 338), 20.
382 UN, (n 362).
Decisions regarding tax information exchange may be relevant to states which give priority to self-interest, as well as those which consider other factors including global welfare. In this context, to the extent that any relevant provision of the taxation system of a country to which tax information may be provided is economically neutral in the sense that it does not distort the allocation of factors of production, then the provision of information should not adversely affect global economic efficiency, and may potentially increase global welfare to the extent that it is a function of global wealth. Further, to the extent that a given country applies competition neutrality in relation to its taxation system, then another country considering whether to provide tax information may be assured that it will not be disadvantaged relative to any other third country, at least in terms of tax treatment, by virtue of providing tax information. States may also elect to restrict the provision of tax information to foreign tax authorities so that information is only provided in relation to elements of the foreign tax system that are not biased, or at least not biased against the state providing the information relative to some set of other states.

4.4.4 Interactions of Tax Information Exchange and Non-Neutralities

– Illustrations

Three scenarios may be used to illustrate a range of potential interactions between tax information exchange and non-neutralities. These are:

Provision of information to a state with a neutral tax system and treaty network, that is, a state which from a tax perspective offers competition under equal conditions, a “level playing field”; 384

Provision of information to a state which has a tax system which is biased toward domestic investment, but neutral as to the allocation of investment as among foreign countries; and

Provision of information to a state which has a tax system which is biased toward one or more third countries materially in competition with the state considering the provision of information.

In the first scenario, which envisages competition under equal conditions, 385 a state providing taxpayer specific information arguably does not damage its own economy, other than in some marginal sense relating to whatever

384 The concept of the ‘level playing field’ will be discussed further in Chapters 5 and 6 of this work.
385 Vogel (n 358), 38.
administrative costs it agrees to accept in its arrangements with the state to which it provides information. The state receiving information may be able to increase administrative efficiency and intra-state equity and increase state revenue to the extent that information received has utility, at no cost other than those associated with the administrative arrangements necessary to obtain any information requested. Providing tax-payer specific information in this context does not undermine production efficiency and may in fact enhance inter-nation equity and global welfare to the extent that these are a function of production efficiency.

The second scenario involves the provision of information to a state with a bias in favour of domestic economic activity in the form of capital retention, that is, a national neutrality bias, but no bias as among foreign states. The 'playing field' in this context is not level, but rather may be thought of as having an obstacle or barrier built into its topography. That is, only foreign investment opportunities which have an intrinsic rate of return sufficiently in excess of the tax bias barrier will be made by rational investors resident in the state requiring information, all other things being equal. In this context, the state considering the provision of tax information faces administrative costs as in the first scenario, as well as having reduced access to capital occasioned by the domestic bias of the state requesting information. It must weigh these costs against any benefit associated with providing information. It may also wish to weigh any costs to global welfare associated with the domestic bias, and may be selective in respect
of which taxes and under which circumstances it wishes to provide information so as to minimize adverse effects. The state having the domestic bias and requiring information to enforce the bias must calculate, in addition to administrative costs, the economic and other benefits the bias achieves versus the decrease in global welfare, and the probability that some portion of its taxation system may not be fully enforceable if its domestic bias is found to be particularly unattractive by the country from which it seeks information.

The third scenario, the provision of information to a state which has a tax system which is biased toward one or more third countries materially in competition with the state considering the provision of information, does not provide an intrinsically level playing field. In this scenario, a country considering the provision of information must calculate not only the administrative costs, but also the fact that in providing the information sought, it would give effect to biases which would potentially allocate resources contrary to global economic efficiency, and indeed to its competitors contrary to its own interests. The state having such a third country bias must calculate not only the administrative costs of obtaining information, but also the potential allocation of resources contrary to global welfare and the probability that part of its taxation system which gives benefits to a foreign state may become or remain less than fully enforceable or enforceable only at a higher cost than would be the case if it had access to foreign source tax information.

It can be seen from the scenarios set out above that if non-neutralities which undermine global welfare are rendered enforceable by virtue of the provision of tax information by other states, or have greater effect in undermining global welfare by virtue of the provision of tax information by other states, then the provision of tax information in effect aids and abets the undermining of global welfare to the extent that such welfare is a function of production efficiency. On the other hand, to the extent that a particular state operates a neutral taxation system, the provision of tax information to that state by other states may enhance global welfare and intra-state equity to the extent that such information is required to achieve intra-state equity and that global welfare is a function of such equity.

These observations suggest that in addition to decisions which would permit or refuse all tax information exchange with a given country, a continuum of alternatives would exist which would permit selective tax information exchange. That is, a state may choose which information to provide and under what circumstances, based on a variety of factors including the neutrality or non-neutrality of specific provisions and the actual effects of particular aspects of a requesting states’ taxation system.

The approach set out above arguably offers an alternative to revenue sharing which has been suggested by Keen, particularly in circumstances in which the provision of tax information to foreign states in and of itself does not produce reciprocal positive effects for the countries concerned.

4.5 - LIMITATION OF EXCHANGE OF INFORMATION IN THE CONTEXT OF NON-NEUTRALITIES

Rawls has observed that what is rational from the self-interested perspective of a single person, group or state may not be reasonable when viewed from an alternative or more inclusive perspective. Rather, the concepts of what is 'reasonable' and what is 'rational' as these concepts relate to social cooperation; 'are basic and complementary ideas entering into the fundamental idea of society as a fair system of social cooperation.' If then we are to conceive of an integrating global society, what would a fair system of social cooperation permit in respect of tax information exchange in the context of taxation biases? Alternatively, it might be asked, would a fair system require that states protect those biases and incentives in other state's taxation regimes which undermine global welfare or inter-nation equity?

The exercise of sovereignty in the design of taxation systems, at least from a traditional perspective, did not require the sovereign exercising such authority to consider the externalities produced by the design of its taxation systems. Such an approach may have been rational and perhaps even reasonable in an era with relatively little cross-border economic activity and territorial taxation systems. Arguably it is neither rational nor reasonable in a context of global economic integration and residence-based taxation systems.

Cooperation among national tax authorities through the provision or exchange of taxpayer specific information irrespective of national biases has been proposed as a rational response to problems of cross-border enforcement of biased national taxation systems by a number of countries. Noting again for purposes of emphasis Rawl's distinction between what is rational and what is reasonable, a reasonable response to non-neutralities which bias economic activities arguably is to acknowledge that, while exchange of tax information may have a role to play as a patch on imperfections in enforcement of the residence basis of taxation, any such exchange or provision of taxpayer specific information might need to be circumscribed so as to lessen externalities produced by individual states' international tax systems. The alternative of side payments of compensation to

389 Keen (n 387), 2.
encourage tax information exchange as suggested by Keen and Ligthart,\textsuperscript{390} is problematic in that although the state providing information receives a direct economic benefit, it is arguable that no consideration is given to any decrease in global welfare or broad inter-nation equity that might be involved. A better, although perhaps utopian alternative, would be for non-neutralities in such international tax systems to be significantly reduced so as to afford a more 'level playing field' for countries cooperating through the provision or exchange of taxpayer specific information.

The suggestion to restrict tax information exchange in the face of inequitable treatment is not new. Existing instruments of cooperation arguably do permit countries to insulate themselves in a limited manner from some externalities through the refusal to provide information required to administer some externalities. By way of example, the OECD Model Convention prohibits certain forms of tax discrimination and permits states to refuse to provide information relating to the enforcement of a discriminatory provision that has the effect of discriminating against their nationals in certain circumstances.\textsuperscript{391} Arguably this basis of permitted refusal of exchange of information within a cooperative framework could be said to be related as much to narrow inter-nation equity as efficiency in international commerce. As noted in the OECD's tax information exchange implementation manual:

\textsuperscript{390} ibid.

\textsuperscript{391} OECD (n 360), Article 24.
48. A competent authority may refuse to supply information in cases involving discrimination of a national of the requested Party. This rule is contained in Article 7, paragraph 6 of the Model Agreement. In the context of the Model Convention the rule flows from the first sentence of Article 26 paragraph 1 ("... insofar as the taxation thereunder is not contrary to the Convention.") read in conjunction with Article 24, paragraph 1. This issue should only arise in exceptional circumstances and, thus, should be of little practical relevance. 392

It is suggested that while the assertion that discrimination against foreign nationals is exceptional in relation to the dealings among OECD member states may be accurate, there is less reason to assume it to be as accurate in the relations between developed and developing states. 393 There is an extension to this argument to the effect that in the future, and as a result of a technological divide in which only developed countries are able to apply information technologies to tax information exchange, opportunities for discrimination against developing countries may increase. This is discussed in section 7.2 of this thesis. For present purposes it is noted that implementing tax information exchange with limitations designed to enhance inter-nation equity and global welfare may be one means by which the potential for discrimination may be reduced. Whether this would be viewed as acceptable by the geopolitically dominant countries is an open question. However, the analysis of the OECD’s Harmful Tax Competition Initiative set out in the following chapters suggests that it may not.


PART 1

5.0 INTRODUCTION

The OECD records that:

In May 1996 Ministers called upon the OECD to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998”. In response to the Ministers’ request, the OECD’s Committee on Fiscal Affairs launched its project on harmful tax competition. 394

The quotation set out above may be viewed as what Radaelli refers to as ‘policy narrative’. 395 Arguably, it reflects the political endorsement of a plan of action for dealing with those perceived potential effects of tax competition which were seen as adverse to the interests of the OECD member states. The mandate given by the

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393 Dagan (n 362); Easson (n 338), 20; Horner (n 362), 20; UN (n 362).
OECD Ministers was vague and broad, potentially requiring consideration of a wide variety of tax measures ranging from tax expenditures in the forms of grants and below market cost governmental loans, through to tax holidays and focussed reduced rate of tax regimes. As noted by Sommerhalder,\textsuperscript{396} it was also vague in the sense that it did not specify how 'harmful tax competition' was to be distinguished from tax competition which was not harmful.

Such vagueness arguably was not out of place in this type of political statement. One of the attractions of policy narrative is that it allows politicians to exhibit leadership in identifying the means by which solutions may be found, and in providing reassurance without the necessity of understanding the precise nature of the issues involved.\textsuperscript{397} How then is this assignment to the OECD to be understood?

The OECD has a well deserved reputation for excellence in many of the functions it performs, including its technical analysis of taxation matters. However, it also has a role as a political instrument, a role which has the potential to restrict objectivity and impartiality in its technical functions. Further, as noted

\textsuperscript{396} RA Sommerhalder, 'Harmful Tax Competition or Harmful Tax Harmonization' (1999) 4 EC Tax Review 244 - 251.
\textsuperscript{397} ibid, 247.
by Horner, the approach of the OECD and its member states to matters of international taxation has not always been entirely without bias.\(^{398}\)

In this chapter and the next, the OECD’s Harmful Tax Competition Initiative (HTC Initiative) will be examined as a case study in order to assess; firstly, whether considerations of fairness, inter-nation equity, and neutrality as these concepts are identified in preceding chapters of this work, influenced the evolution of the HTC Initiative, and secondly, whether international regime theory as described in Chapter 1 of this work, affords a useful approach to understanding how consideration of these principles influence regime formation in taxation matters.

5.1 THE OECD AND THE DEVELOPMENT OF REGIMES RELATING TO INTERNATIONAL TAXATION

The evolution of existing principles, norms, and systems of cooperation relating to international taxation has not occurred in a vacuum, but rather is shaped at least in part by various processes including geopolitics, economics and epistemic
communities of opinion. The OECD has played a key role in this evolution, at least over the past thirty years. It is also the organisation which according to at least one writer, '[I]s the main organisation which has input in the development of international taxation law'.

The OECD is an exclusive multilateral intergovernmental organisation established in 1961. Most of its thirty members enjoy economic conditions substantially better than those experienced by the majority of countries, to the extent that the OECD is frequently referred to in the popular press and in some academic writing, as the club of rich countries. Even the OECD has acknowledged this designation.

401 The membership of the OECD as at 1 January 2005: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland Turkey, United Kingdom, United States.
403 OECD 'Overview of the OECD' (2005) OECD <http://www.oecd.org/LongAbstract/0,2546,en_2649_201185_2068050_1_1_1_1,00.html>
The non-inclusive club-like nature of OECD processes arguably is a key factor in shaping international taxation debates. Gstöhl has noted that the OECD may in some contexts be viewed as an instrument of the Group of Seven leading industrial nations, also known as the G7.\textsuperscript{404} An analysis of the circumstances in which the G7 is likely to use the OECD as an instrument of their collective will in the context of international taxation is beyond the scope of the present research. However, it is worth noting that a consensus within the G7 as to the existence and nature of a particular international taxation issue, together with a shared view of how the OECD ought to be used as an instrument to address such an issue, may be a good indicator of the course of action likely to be adopted by the OECD in respect of that issue.

Consensus requirements afford OECD member states a level of procedural fairness and equitable outcomes, or at least a presumption of consent to any deficit in, or absence of, these elements in the activities of the OECD. OECD member states generally see themselves as bound by formal decisions of the OECD which they have accepted without reservation or abstention. Similarly, they generally adopt the form, assumptions and interpretations implicit in instruments designed within the institution of the OECD and approved by the member states, including those related to taxation issues. As an example, the OECD’s Model Tax Convention on Income and Capital,\textsuperscript{405} is designed to provide compatibility with,

\textsuperscript{404} Gstöhl (n 402). The G7 states are the United States of America, the United Kingdom, France, Italy, Japan, Germany and Canada.

and serve the interests of, the member states.\textsuperscript{406} This model or close approximations of it, are used almost exclusively by OECD member states as the basis for double taxation treaties.\textsuperscript{407} As a result, non-OECD countries wishing to have taxation treaties with OECD member states must generally not only agree to accept a treaty based on this Model, but must also have domestic taxation systems which are compatible with the OECD Model.\textsuperscript{408} This arguably constrains the taxation policy design latitude of countries wishing to have economies and taxation systems dissimilar to those of the dominant Western countries which set the tone within the OECD.

\section*{5.1.1 The Objectives for International Taxation and the Aims of the OECD}

The OECD is not the guardian of global welfare. The aims which guide the actions of the OECD do not explicitly refer to considerations of fairness to non-members, 


\textsuperscript{407} OECD member states may also use the UN model Convention in treaties with some developing countries. They US has its own model treaty which is quite similar in most respects to the OECD model.  

\textsuperscript{408} Exceptions do exist in that some OECD member states have historically entered into tax sparing arrangements and UN model based treaties. Similarly, some member states of the OECD have entered into treaties with countries with zero rates of effective direct taxation such as the United Arab Emirates and Bahrain when it suited their energy or other interests to do so.
inter-nation equity, or neutrality in the design of international taxation systems.\textsuperscript{409} Rather, they refer to promoting the economic interests of member states and contributing to world trade on a basis which requires non-discrimination only to the extent that such non-discrimination is, ‘in accordance with international obligations’\textsuperscript{410}. Given that such obligations are in general quite limited and voluntarily assumed, at least in the cases of geo-politically powerful states, it is conceivable that any pursuit of non-discrimination or competitive neutrality as between members and non-members may be minimal.

What then is the basis of the authority of the OECD outside of its membership, and how do the member states of the OECD seek to achieve their aims by means of the OECD, particularly in relation to international taxation? In answering the first part of this question, the international relations literature offers some assistance. While a general discussion of international relations theory as it relates to intergovernmental organisations in general is outside the scope of this paper, the present analysis is assisted by specific work within that literature.

5.1.2 The Role of the OECD as an Exclusive Inter-Governmental Organisation in Perspective

\textsuperscript{409} OECD, 'Convention on the Organisation for Economic Co-operation and Development' (1960) OECD

\textsuperscript{410} OECD, 'Convention on the Organisation for Economic Co-operation and Development' (1960) OECD
Keohane and Nye have observed that membership limiting intergovernmental organisations such as the OECD may be viewed as clubs formed around issue specific subject areas. According to their analysis, such clubs were conceived of by representatives of the world’s geopolitically most powerful governments as mechanisms for solving problems of governance at a global level:

The solution to the governance dilemma devised by the generation of World War II was the invention of international regimes designed to enable elites in governments jointly to manage interdependence. These regimes were constituted by rules and norms that governed their members relationships in specific areas of international relations. They were typically managed by an international organisation with a specific headquarters and a secretariat.

This view is supported by the work of Gstölhi who has noted the key role of the G7 in creating, tasking, and shaping through funding as well as economic and political influence, the activities and direction of the OECD as well as other international organisations. Keohane and Nye have also observed that, ‘The club model was very convenient for officials negotiating agreements within issue-areas since in two ways it kept outsiders out,’ and further that:

Under the club model a lack of transparency to functional outsiders was a key to political efficacy. Protected by this lack of transparency, ministers

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410 ibid.
412 ibid, 2.
413 Gstölhi (n 402).
414 Keohane (n 411), 4.
could make package deals that were difficult to disaggregate or even sometimes to understand.415

Keohane and Nye also utilised the concept of ‘issue areas’ to differentiate subject matters assigned to specific international structures:

Traditionally, international regimes have been constructed, within the complex system of the world political economies, as “decomposable hierarchies”....international regimes, with particular states as members, were established to govern “issue-areas,” defined in terms of clusters of issues....These regimes, thus defined by membership and issues, were “decomposable” from the rest of the system. Their members constructed rules – either in the form of traditional international law or as sets of established but less obligatory practices known as “soft law” – to govern their relationships within the issue-area.416

The G7 members of the OECD have consistently preferred the ‘club model’ for policy setting relating to tax policy design rather than the use of existing globally representative bodies.417 The member states of the OECD have sought to establish the institution of the OECD as the international standard setter

415 ibid, 4
in matters of international taxation, a role which at least some within the organisation view as having been achieved.

Ring has noted that states may compete for relative advantage rather than absolute gain, and in that context the ability to limit the competitive positions of other states may be particularly advantageous. A coalition or cartel offers potential advantages for achieving this. It is therefore perhaps understandable that there may be some lack of broad consensus among non-members in relation to whether the OECD is the legitimate international standard setter in matters of taxation. By way of example, the International Monetary Fund (IMF), to which all OECD member states as well as many other states belong, has seen fit to publish bold statements specifying which international organisations it views as being ‘international standard setters’ in various matters. The OECD is not listed by the IMF as a standard setter in relation to taxation matters, although recognition is given to its work on corporate governance.

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418 The OECD has devoted considerable resources to taxation issues including the development of a Model Tax Convention on Income and on Capital. *OECD* (n 405).
419 OECD, 'The OECD Model Convention - reflections and developments. Speech by Gabriel Makhlouf, Chair, Committee on Fiscal Affairs, OECD, delivered to the CIOT European Branch Conference 7 March 2003' (2003) OECD <http://www.oecd.org/documentprint/0,2744,fr_2649_33747_2500996_1_1_1_1,00.html> accessed 17 January 2005; *OECD* (n 394) at paragraph 26, 'Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so. This study is designed, in part, to assist in that regard.'.
420 *Ring* (n 399), 17.
5.2 The Historical Context of Tax Competition

As noted in Chapter 1, tax competition is not a new phenomenon and neither is it a phenomenon of the past.\textsuperscript{423} Gordon cites examples of distortions in economic activity induced by taxation in medieval Europe, well before the development of modern concepts of states and state sovereignty.\textsuperscript{424} Well into the 20\textsuperscript{th} Century, most states accepted a view in which the international competition for taxation resources was appropriately unfettered by any legal constraints other than those set out in domestic legislation and treaties voluntarily entered into. Indeed, to the extent that the proliferation of tax measures designed to attract and retain investment and capital within the member states of the OECD is any measure of such an acceptance, then this approach was widely accepted by OECD member states throughout the 1980's and early 1990's.\textsuperscript{425}

In 1991 Arnold observed that:

\textsuperscript{423} G Searjeant, 'UK's investment regime is no longer leader of the pack' The Times (London, 26 April 2005). Searjeant notes that; 'Gordon Brown walked into a recent meeting of EU finance ministers insisting "we believe that tax competition is the best way forward"...Using taxation to make Britain a more attractive place to invest has been the policy of all British chancellors for the past 20 years. Having been among the leaders, however, the UK is being overtaken. It has fallen out of the top ten in international competitiveness studies and is in danger of rejoining the pack.

\textsuperscript{424} R Gordon, \textit{Tax Havens and Their Use by United States Taxpayers - An Overview} (Books for Business, New York 1981). In comparison the origins of the concept of sovereignty as that term was understood in the 20th century arguably may be traced at least in part to the 1648 Treaty of Westphalia.

\textsuperscript{425} In 2000 the OECD member states volunteered to consider the elimination of dozens of potentially 'harmful' practices among their own members within the narrow scope of mobile financial and other services, that is excluding practices related to direct investment incentives. They could not agree on eliminating tax incentives for foreign direct investment or domestic taxation preferences. OECD, 'Towards Global Tax Co-operation ' (2000) OECD <http://www.oecd.org/dataoecd/9/61/2090192.pdf>, paragraph 11 accessed 27 July 04.
A country's legal authority to levy tax is effectively limited only by practical considerations of enforcement and collection. Rules of public international law or domestic constitutional law restrict a country's jurisdiction to tax only in narrow, relatively insignificant ways. 426

Similarly, Piccioto was of the view that, 'From the point of view of formal sovereignty, there is no restriction on a state's right to tax, and it may be exercised without regard to its effects on other states.' 427 As noted by Qureshi, practical limits rather than theoretical legal limits tend to be those that shape global competition for taxation resources; '[T]he enforcement limitation in international law is in fact the prime regulator of the exercise by a State of its freedom in fiscal legislation.' 428

By the mid 1990s, economic liberalisation and the rising spectre of globalisation affording taxpayers increasing opportunities to choose among states competing for tax bases, had significantly reduced the appeal of unrestrained tax competition for the more influential OECD member states. 429 A preference for laissez-faire was replaced by a view that cooperative limitation of tax competition,

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426 B Arnold, Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand, the United Kingdom, and the United States (Canadian Tax Papers Canadian Tax Foundation, Toronto 1991), 7.
at least in respect of the more mobile factors of production, together with enhanced collective enforcement action by taxation authorities, could minimise the need to re-allocate taxation burdens to less mobile and more politically sensitive elements of the tax base, such as labour. This is also reflected in the positions of the European members of the OECD in the mid 1990’s. 430

OECD member states, like other states, had long biased their taxation regimes so as to attract foreign direct investment and to retain mobile factors of production and the jobs and tax revenues they produce. 431 In order to avoid the ‘third country problem’, 432 OECD member states needed to obtain the acquiescence or cooperation of countries with which they were in direct competition for mobile factors of economic production. The issue which arguably arose was how to persuade the heterogeneous majority of countries outside of the OECD to cooperate with the OECD member states.


432 The ‘third country problem’ is described in Section 2.2.1 of this work.
5.3 LIMITING TAX COMPETITION IN THE GLOBAL FINANCIAL SERVICES SECTOR

Global economic production arguably is a function of many factors including efficient global markets. Market theory postulates that tax competition may increase global efficiencies in the allocation of economic resources, and therefore the quantum of globally available economic resources. To the extent that global welfare is a function of globally available economic resources or wealth, then arguably global welfare should be at its maximal when the maximum available global wealth is available for distribution. On that basis, it is arguable that restrictions on tax competition which have the effect, or are likely to have the effect, of decreasing global welfare arguably ought not to be allowed. It is also arguable on a similar basis that specific forms of tax competition which do have the effect of decreasing global welfare over time similarly ought not to be allowed. Questions therefore arise when individual countries or small groups of countries attempt to limit tax competition without reference to whether such limits enhance global welfare, rather than narrow domestic political interests. Such questions have particular import when countries with dominant positions attempt to limit only some forms of tax competition, and to do so in a fashion which may shift competitive advantage.

434 This has been one of the criticisms of the OECD’s HTC Initiative as will be discussed further in the following sections of this chapter.
Much of the tax competition literature is outside of the scope of this work, however a number of points are pertinent in the present analysis. Firstly, as noted by Sommerhalder; 'It seems to depend largely on an individual's perception, and on the political persuasion of whoever talks about harmful tax competition, whether that person is in favour of it, or opposes it.' This view is supported by Barker:

Those who see some forms of tax competition as harmful view nations that use preferences as "poaching" on the economic activity and the tax base that would have belonged to it. Those who welcome tax competition see taxation as merely one cost factor among many that should be subject to reduction through international competition like any other cost. Framed in this way, tax competition is a question of politics, not economics. One's initial approach depends on one's view of governmental spending, and whether it taxes and spends wisely, maximizing welfare, or whether it overtaxes and spends foolishly. In the latter case, tax, like other facets of life, should be left to the free market and tax competition becomes a successful tool in curbing governmental appetites for revenue.

Raedaelli has made a similar observation:

Tax competition is a variant of regulatory competition. Studies on regulatory competition show that the 'competition of rules' among countries is open to very different results, depending on the socio-political amalgam of politics, ideas and interests. Theoretically, there is the possibility of a disastrous race to the bottom...But the results are also

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435 RA Sommerhalder, 'Harmful Tax Competition or Harmful Tax Harmonization' (1999) 4 EC Tax Review 244 - 251, 244.
sensitive to the assumptions about policy-makers... Empirically, the studies conducted so far come to no definite conclusions...  

5.3.1 The spectre of globalisation

The 1990's were a time of perceived dramatic change in the nature and magnitude of challenges facing the tax administrations of the most developed states. One particular area of concern for OECD member states during this period was the potential for increased competition among states in relation to capital taxation bases arising as a result of the instrumentalities of globalisation. As noted by Norregaard and Owens; ‘[O]ne consequence of this gradual liberalisation and globalization is that international capital flows may have become more sensitive to differences in the tax regimes as between countries’. The potential for movement of capital from within the tax nets of OECD national treasuries to locations outside of those nets, as well as the apprehension of growing competition in the financial services sector from providers in non-OECD countries, arguably provided an impetus for the OECD to act. Concern related to the potential for tax competition to influence the location of financial services activities leading to the potential for such activities to locate or re-locate to jurisdictions with relatively

437 Radaelli (n 395), 663. Radaelli describes the role of policy narratives as 'to underwrite, that is, to 'certify', and to stabilize 'the assumptions needed for decision-making in the face of what is genuinely uncertain and complex.' As such, policy narratives can be 'representationally inaccurate – and recognizably so – but still persist, indeed thrive'.


439 OECD (n 394).
low rates of tax on such activities, seems to have been particularly prominent among European OECD member states.\footnote{Council of the European Union (n 429), 11.}

The actions which followed the perception of challenges to OECD tax bases in the 1990’s arguably were somewhat presumptuous. There was little evidence of actual tax base erosion at that time, at least among the OECD member states that were then part of the European Union, although there may have been contemporaneous shifts in the distribution of tax burdens. The European Commission’s 1992 Ruding Report noted that: ‘the Committee found no convincing evidence that independent action by national governments is likely to provoke unbridled tax competition among Member States and lead to a drastic and undesirable erosion of corporate tax revenues.’\footnote{Ibid, 25.} Similarly, in early 1996 the European Commission noted:

There is little evidence of fiscal erosion affecting the total level of tax and social security revenues so far. Over the last 15 years these have been constant or slightly increasing, as a percentage of GDP in the EU. However, while the taxation of labour has been increasing, the taxation of factors of production other than labour has shown an overall decrease.\footnote{Council (n 430).}

Concerns regarding the potential for adverse effects of tax competition arguably were disproportionate.\footnote{Owens voiced concerns regarding tax competition. Owens (n 431). Gordon and Hines cast doubt on these assumptions. R Gordon and JR Hines, Jr. ‘International Taxation’ (2002) <http://www.bus.umich.edu/otpr/WP2002-2paper.pdf> accessed 23 November 2004.} It is arguable that the relative importance of
taxation as a factor in the location of economic activity may have been significantly overestimated in the formulation of the rational for limiting tax competition.\textsuperscript{444} Further, in the context of uncertainty regarding the potential for what might have been a politically difficult outcome in the form of limitation on social programmes, it seems at least possible, if not likely, that emotionally resonant policy narrative may have been seen as a more useful tool than the gathering, analysis and presentation of fact.\textsuperscript{445} As noted by Radaelli:

Public policy is all about making problems amenable to human action, not about increasing helplessness...Harmful tax competition is also convincing in narrative terms. In fact, it plays out a vivid dramatic scene of villains (avid capitalists who deprive their countries of revenue by investing in morally suspect tax havens), potential victims (the ordinary people who need the welfare state) and heroes (the European governments who decide to take action and protect the welfare state).\textsuperscript{446}

The hypothesis that efforts to limit tax competition in the 1990’s were driven by factors other than clear evidence of decreasing rates of capital taxation is supported by the analysis of twenty years of studies relating to tax competition published by Griffiths and Klemm.\textsuperscript{447} They conclude that the available evidence does not provide a basis for saying that tax competition explains changes in taxation rates over time.

\textsuperscript{445} Radaelli (n 424).
\textsuperscript{446} ibid, 670 – 671.
The absence of any observable "race to the bottom" in rates of capital taxation over the past decade arguably supports the arguments of Basinger and Hallerberg that the theoretical model which proposed a "race to the bottom" in relation to mobile tax bases, and as used by the OECD as a justification for the HTC Initiative, was perhaps overly simplistic.448 As was also noted by Stewart and Webb:

[A] simple descriptive inspection of the data on average tax rates fails to support the popular assertion of a competitive race to the bottom in capital taxation among the developed nations.449

Put more succinctly, Dresner describes the 'race to the bottom' justification as 'a dog that does not bark'.450

While competition among OECD member states for capital may have been the primary focus of some European members of the OECD faced with loss of capital to immediate neighbours, those OECD member states which had developed significant financial services industries catering to non-residents were eager to ensure that competition from non-OECD countries did not threaten their future tax revenues or their financial services sectors. By way of example, Japan as

one of the larger centres for international financial services activity, has been identified as pushing the efforts to limit tax competition coming from non-OECD centres up the OECD’s agenda in 1995. Although only a relatively small percentage of financial services provided to non-residents were in fact rendered outside of the OECD states, there was little enthusiasm for competition from new entrants to the financial services sector.

In March 1996 the European Commission published a report entitled, ‘Taxation in the European Union’. That document contains a call for action in respect of “unfair tax competition”, and a coordinated approach by the EU Member States to achieve that end within the OECD:

[S]ome practical lines of action could help limit unfair tax competition.....Ongoing work with direct tax authorities should be intensified, and in this context a co-ordinated approach by Member States within the OECD would be highly beneficial.

The use of references to ‘harmful’ or ‘unfair’ competition should not be taken as indicating any clear understanding among policy makers of what was meant on any objective basis by such phrases. As noted by Sommerhalder; ‘This was confirmed

452 R Biswas, ‘International Trade in Offshore Business Services: Can Developing Countries Compete?’ in R Biswas (ed) International Tax Competition Globalisation and Fiscal Sovereignty (Commonwealth Secretariat, London 2002), 112. Biswas notes that the IMF estimates that 60% of global offshore activity occurs in the UK, the US and Japan. The total non-OECD component is estimated at less than 20%.
454 Council (n 430) 3.
455 ibid, 13.
by Mr Waigel, the former German Finance Minister, who said in response to a journalist's question 'What is harmful tax competition?', Precisely, I don't know, but when I see it I recognize it.' 456

As will be seen, the subjective 'unfair' which was present in the European Commission's call to arms became the alternative, but no less subjective 'harmful', as policy dialogue expanded to and secured the imprimatur of the OECD.

5.4 NON-TRANSPARENT DESIGN AND THE HTC INITIATIVE

Tanzi has observed that the 1980s and early 1990s constituted a period in which progressive global economic integration was viewed at least by the industrialised countries as generally positive, although the taxation policy options of states with high direct tax rates were perceived as narrowing in relation to the ability to maintain both politically sensitive social programmes and economic competitiveness. 457 The potential responses to such pressures included unilateral

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456 Sommerhalder (n 435), 247.
processes of adaptation and competition, as well as multilateral processes involving coordination or harmonization of tax policies.458

Tanzi notes that:

There is no formal international institution representing all countries that plays a role in the tax area similar to that played by the General Agreement on Tariffs and Trade (GATT) in the trade areas or the International Monetary Fund on exchange rate policy. As a consequence, there has never been a formal attempt at coordinating tax policies in the same way that, say, the GATT has been responsible for carrying through the principles agreed to by the Uruguay Round.459

He also notes that the OECD’s Committee on Fiscal Affairs, the body charged in 1996 with producing a report on “harmful tax competition”, itself produces a, ‘form of tax coordination’ among the OECD member states.460

It is perhaps noteworthy that in 1993, at a stage at which the HTC Initiative was likely a gleam within the eye of some within the OECD if not at an embryonic stage, Jeffrey Owens of the OECD, who played a key role in the launching of the HTC Initiative, advocated the coordination of global tax policies by the OECD rather than any more representative body.461 The use of a closed OECD process arguably would allow the OECD member states to achieve a limited degree of global coordination of taxation policies without the troublesome

458 Owens (n 431). Harmonisation in matters of direct taxation was however not in political favour even within the EU.
459 Tanzi (n 444), 9.
460 ibid, 8.
461 Owens (n 445).
requirements of broad, if not global, representation in the design of such tax policy coordination. It would also provide the OECD members with what Ring refers to as a ‘first mover’ advantage in regime formation.\textsuperscript{462} An exclusive process arguably would also remove the risk that global representation might take tax coordination further, or in a direction away from, that favoured by the OECD membership.\textsuperscript{463}


The time-line of the HTC Initiative provides a framework from which the Initiative may be divided for purposes of the present analysis into five phases defined by what may be viewed as milestones or inflection points in the process and strategies adopted by participants in shaping an international regime for the limitation of tax competition. It also provides a framework from which to analyse evidence as to whether, and if so the extent to which, considerations of fairness, inter-nation equity and the neutrality of taxation regimes played any role in the evolution of the HTC Initiative. The practices applied as between OECD member states, based on full consultation and voluntary agreement as they are and were, will be used as a

\textsuperscript{462} Ring (n 399), 70.

\textsuperscript{463} W Wechsler, ‘Follow the Money’ (2001) 3 Foreign Affairs. Wechsler describes the preference for ‘top-down’ processes which obviated broad consultation among states with particular reference to money laundering.
comparator for the practices applied by OECD member states to targeted non-member economies during this time frame.

In the sections which follow in this chapter, materials from the first two phases of the HTC Initiative are discussed. Specifically, the period prior to the formal political mandate for the Initiative given in early 1996 which will be referred to as Phase 0, and the period from the formal launch of the Initiative in 1996 through to the publication of the Harmful Tax Competition Report in April 1998 which will be referred to in the present work as Phase 1, are discussed. The remaining 3 phases, covering the period immediately following the publication of the 1998 Report and including the multilateral dialogue involving both OECD and non-OECD states from January 2001 to December 2006 will be discussed in Chapter 6.

5. 6 PHASE 0 - THE DECADE LEADING UP TO THE 1996 MINISTERIAL ENDORSEMENT OF THE HTC INITIATIVE

Little public information is available regarding activities related to preparations for the HTC Initiative within the OECD and the tax administrations of its member states during Phase 0. However, the published opinions by prominent personalities associated with the OECD arguably foretold the aspirations for regime formation
in certain quarters.\textsuperscript{464} Phase 0 also represents the period during which the harmful tax competition policy narrative came to the fore in OECD countries. As noted by Radaelli, a critical element in policy narrative is the creation of; ‘the ‘dramatic tension’…between the consequences of inaction and ‘what must be done’. The Doomsday scenario illustrates the consequences of inaction.\textsuperscript{465}

Speculation regarding risks to capital taxation, which with the benefit of hindsight appears to have been at least overblown, was noted by Schjelderup in the following terms; ‘[T]he fear is that capital mobility may lead to capital flight from high to low tax countries in such large amounts that it deprives a nation of its tax base and, as a consequence, its welfare system.’\textsuperscript{466} Writers as far back as Adam Smith had noted that capital taxation was problematic. Later authors noted that the ideal rate of capital tax particularly in small open economies, at least under stringent conditions, is zero.\textsuperscript{467} Tanzi and others writing in the early 1990s noted a theoretical concern that small countries might find it hard to maintain high capital tax rates in the presence of capital mobility, and might be tempted to become ‘tax havens’ which would in turn make it harder for large countries, presumably

\textsuperscript{464} Owens (n 431).
\textsuperscript{465} Radaelli (n 395), 670.
including the OECD countries, to maintain their high rates of capital taxation.\textsuperscript{468}

Tanzi, writing in 1994 about OECD concerns regarding the use of taxation based instruments as tools of economic competition among countries, noted that:

In OECD circles, there has been concern that this situation will lead some countries to shift tax bases artificially from other countries to themselves by, "unfairly" lowering relevant tax rates.\textsuperscript{469}

A concern among the European Community members of the OECD relating to intra-community 'fairness' issues involved in the migration of capital tax bases within the EU and beyond the EU. These concerns had been identified, but not fully analysed in the 1992 Ruding Report.\textsuperscript{470} In response to continuing concerns within Europe the so-called Monti Group was established. This group, made up of representatives of the European Community Member States and the European Commission, reported on what it perceived as "unfair tax competition" in March 1996, shortly before the official launch of the OECD project.\textsuperscript{471} It is worthy of note at this point that a key part in the initiation of the OECD process may relate to the determination of European Member States which made up half of the OECD membership to have what they viewed as 'unfair tax competition' dealt with in the context of the OECD.\textsuperscript{472} Solitander has recently provided further analysis confirming the self-interested bargaining among EU member states in

\begin{itemize}
\item \textsuperscript{468} Tanzi (n 457), 66; R Kanbur and M Keene 'Jeux Sans Frontieres: Tax Competition and Tax Coordination when Countries Differ in Size' (1993) 83 American Economic Review September 877-892.
\item \textsuperscript{469} Tanzi (n 457), 16.
\item \textsuperscript{470} Council (n 429).
\item \textsuperscript{471} Council (n 430).
\item \textsuperscript{472} Solitander.
\end{itemize}
relation to tax competition and the linkages between the EU and OECD processes.\textsuperscript{473}

By the date of publication of the 1998 HTC Report and presumably by 1996, it had apparently become accepted at least for purposes of policy narrative, that tax competition, left unchecked could, at least in theory, produce a 'race to the bottom' in capital taxation, and a threat to the social welfare programmes within the OECD member states.\textsuperscript{474} On this assumption, the conversion of policy makers within the OECD member states and the OECD Secretariat to this perspective, may be seen as the formation of an epistemic community,\textsuperscript{475} which some writers in the field of international relations see as a key element in the development of an international regime.\textsuperscript{476} Arguably, in the present context it would have been an epistemic community based on shared biases and speculations.

Tax rate competition and the potential loss of financial services business were not the only concerns among OECD member states during Phase 0. The member states of the OECD also had growing concerns relating to the tax implications of the emergence of e-commerce, including the potential for the loss of capital tax bases which might be associated with e-commerce activities.

\textsuperscript{472} OECD (n 394); Council (n 430), 13.
\textsuperscript{474} OECD (n 394), Paragraph 43.
response to these concerns they established a special committee, the so-called Sacher Committee, to report on these issues.\footnote{OECD, 'Group of High-Level Private Sector Experts in Electronic Commerce' (1997) OECD <http://www.oecd.org/dataoecd/54/25/1893999.pdf> accessed 28 July 2004.}

A third matter which brought international taxation matters to the fore arguably was the launch by the OECD of its Multilateral Agreement on Investment (MAI) project in 1995.\footnote{OECD, 'Database of MAI related documents' (2002) OECD <http://www1.oecd.org/daf/mai/toc.htm> accessed 4 May 2005.} This highly controversial project, which arguably was primarily aimed at increasing the commercial certainty experienced by multinational enterprises resident in OECD member states when investing in non-OECD countries, ultimately failed to gain support outside the OECD and therefore was abandoned in 1998. However, during the period prior to the launch of the 1996 HTC Initiative, the MAI project was seen as offering the potential for OECD states to expand their tax take in relation to the foreign activities of their residents. Competition with non-OECD 'tax havens' was identified as a cause for concern in the MAI project.\footnote{OECD, 'Commentary to the MAI Negotiating Text (as of 24 April 1998)' (1998) OECD <http://www.oecd.org/dataoecd/37/27/2758531.pdf> accessed 25 November 2006, 58.} It seems highly likely that in the pre-meetings leading up to the May 1996 Ministerial meeting at which the HTC Initiative was launched, all of these matters would have been considered in the context of the emerging harmful tax competition policy narrative.\footnote{University of Toronto G8-Centre, 'G7/G8 Sherpas' Meetings ' (2004) <http://www.g7.utoronto.ca/sherpas/> accessed 3 May 2005. It is also known that matters to be discussed at the May 1996 Ministerial meetings were settled.}
5.6.1 The Roles of Considerations of Inter-Nation Equity, Neutrality and Tax Information Exchange in Phase 0

There is no evidence of any consensus within the membership of the OECD that considerations of broad inter-nation equity ought to shape considerations of what constituted ‘harmful tax competition’, and neither is there any evidence of any consensus within the OECD that the adoption of protocols for the exchange of taxpayer specific information ought to play a role in limiting ‘harmful tax competition’. While concepts of the neutrality of taxation systems undoubtedly existed within the tax administrations of the OECD member states, there is similarly no evidence of any consensus in relation to when and how any particular form of neutrality, (whether competition neutrality, capital import neutrality, capital export neutrality or otherwise), should be applied.

‘Unfair’ tax practices are referred to in the 1992 Monti Report, and Tanzi indicates that ‘unfair’ tax practices were also in the minds of OECD officials at least as early as 1994. However, there is no discussion in that literature as to what made any such practices objectively unfair, if in fact they were. On the surface, it would appear that the usage of the concept of ‘unfair’ tax practices prior by senior civil servants representing the OECD member states at so-called 'sherpas' meetings in February and March 1996.

481 OECD (n 394). The abstention of Switzerland from the 1998 HTC Report is evidence of failure to achieve consensus on these points.

482 These concepts of neutrality are discussed in Chapter 3 of this work.

483 Counsel (n 429).

484 Tanzi (n 457), 16.
to the 1996 Ministerial endorsement indicated no more than that certain tax practices gave a competitive advantage to one state over another state. A complaint by State A of an ‘unfair’ tax practice carried out by State B was in essence a demand from State A that State B not use a particular tax policy which gave State B a competitive advantage.

One fact that is clear, is that by the time of the 1996 ministerial authorisation, there was consensus within the membership of the OECD that if such a report was to be produced, the OECD was the appropriate entity to produce this report. This was arguably a foregone conclusion for a number of reasons including, the OECD’s exclusive nature and dominant position, the commonality of interests and stages of development shared by its members, the OECD’s mandate to promote the interests of its members, the expertise which existed within the OECD Secretariat, and because the gloss of credibility which a report produced by the OECD could borrow from the prior reputation of the OECD could be used to prod other nations into agreement. The subject of economic competition based on tax instruments arguably was likely viewed as simply too important, particularly to the high direct tax rate and capital exporting countries within the

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485 OECD (n 394).

OECD, to be left to any more broadly representative supra-national organisation.\textsuperscript{487}

As noted by Aaron, Bryant, Collins and Lawrence:

When national governments negotiate resolutions to such questions – trying to agree whether individual nations are legitimately exercising sovereign choices or, alternatively, engaging in behaviour that is unfair or damaging to other nations – the dialogue is invariably contentious because the resolutions depend on the typically complex circumstances of the international spillovers and on the relative weights accorded to the interests of particular individuals and particular nations.\textsuperscript{488}

The OECD member states ultimate decision was to entrust the creation of the particular regime that they wanted to their own organisation. Legitimacy was to be achieved not through an inclusive process, but rather the imprimatur of the G7.

As noted in relation to the OECD Ministerial request in the 1998 Report:

This request was subsequently endorsed by the G7 countries, which included the following paragraph in the Communique issued by the Heads of State at their 1996 Lyon Summit...At their 1997 meetings, OECD Ministers and the G7 Heads of State reaffirmed the importance of combating harmful tax competition.\textsuperscript{489}

It may therefore be argued that even within the OECD, power relationships among groups of member states were critical in this early phase of the formation of the proposed harmful tax competition regime.

\textsuperscript{487} Wechsler (n 463). Wechsler indicates a preference on the part the United States and its allies for ‘top-down’ rule imposition.

\textsuperscript{488} Tanzi (n 457), Preface xviii.

\textsuperscript{489} OECD (n 394), 7. The practice of basing legitimacy on geopolitics rather than principle has continued in the HTC Initiative as evidenced by the ongoing reference to endorsements of the G7 and other exclusive multilateral organisations. OECD, Towards a Level Playing Field 2006 Assessment by the Global Forum on Taxation (OECD, Paris 2006), 11.
5. 7 PHASE 1 – FROM THE 1996 MINISTERIAL AUTHORISATION TO 1998 PUBLICATION

It can be seen from the 1996 G7 communique that within the policy narrative adopted, ‘harmful tax competition’ was characterised by the creation of a risk of ‘distorting trade and investment’ that could lead to, ‘the erosion of national tax bases’. Implicit in this narrative was an assumption that the then existing global allocation of tax bases was worthy of protection from redistribution or ‘erosion’, if only on the basis of self-interest. The language chosen also seems to indicate that ‘harmful’ tax competition, as conceived by the authors of the communique, could somehow be distinguished objectively or perhaps subjectively from tax competition which was not harmful. It further assumes that even ‘harmful’ tax competition does not necessarily produce distortion in trade and investment, but rather that it could. Neither does it necessarily produce any erosion in national tax bases. Rather, it is assumed that it merely alters the probability or risk that these outcomes will occur.

It arguably was up to the OECD’s Committee on Fiscal Affairs to set specific parameters for tax competition in a manner consistent with the aims of the organisation, the first of which is to advance the interests of its members. On

490 OECD (n 394), 7.
491 ibid, 3.
this basis, the Committee on Fiscal Affairs needed to accomplish several tasks within the consensus requirements of the OECD, including: firstly, to define harmful tax competition, secondly, to define the tax scope of the exercise, that is to identify whether all or merely some forms of tax competition, and all or merely some components in the broad range of potential tax bases were to be considered, thirdly to define the geographic scope of the exercise, that is which countries would be included, fourthly to identify means of limiting such competition, and fifthly to ensure that the output of their work would appear credible at least to those who initiated the process. Arguably, it was also a task of the Committee to incorporate elements which would facilitate the development of a broadly acceptable international regime limiting tax competition.

5.7.1. Procedural Fairness in the Preparation of the 1998 Report

The report preparation phase of the HTC Initiative was coordinated by the OECD’s Committee on Fiscal Affairs and largely confined to activities among the institution of the OECD, its member states, and its academic advisors. The 1998 HTC Report itself, was developed in meetings of the OECD membership and

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493 Sommerhalder (n 435); RT Kudrle, 'U.S. Defection from the OECD "Harmful Tax Competition" Project: Rhetoric and Reality' (2005) <http://se2.isn.ch/serviceengine/FileContent?serviceID=7&fileid=C6C625FC-18A4-DAAE-63C5-80E5087E1888&lng=en.>, 26 accessed 22 Oct 2006. Kudrle notes that Professor Ault was deeply involved in the HTC Initiative and Sommerhalder also refers to the involvement of Professor Ault in this regard.
Secretariat known as, 'Special Sessions on Harmful Tax Competition'. These 'Special Sessions' were essentially a process of, and within, the club-like structure of the OECD and operated by club rules. While there is no publicly available information as to the specific approach used by OECD and member state officials, it is conceivable that such officials might have perceived that they had no mandate, based on the aims established in the OECD Charter, to do otherwise than to adapt their outputs toward the interests of the OECD member states. As noted by Keohane and Nye, one of the purposes of such club rules is to create non-transparency and to limit any influence of outsiders. Club rules exist to create an environment in which the interests of club members will prevail. Any incorporation of considerations of fairness, inter-nation equity, and neutrality into the process and outcomes of these Special Sessions was therefore likely constrained by the interests of club members and any existing formal and informal club rules.

The non-inclusive nature of the pre-Report phase of the HTC Initiative arguably did not provide for that degree of procedural fairness for non-club members which could be said to provide objective legitimacy as perceived by Franck. Further, there is no publicly available evidence of contemporaneous questioning within the OECD of the legitimacy of such a non-transparent and

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494 OECD (n 394), 74.
496 ibid, 4.
exclusive process in the preparation of the 1998 HTC Report. Rather, it appears to have been largely taken as a given that it was appropriate to adopt what may be viewed as a power relationships based approach in which not only did the end provide justification for the means, but the power disparities themselves provided a means for ensuring de facto acceptance outside the club. As noted by Hartman; ‘[T]he OECD, in a self-referential manner, demands compliance with its own standards but identifies no source, outside itself, which would make them obligatory standards.’

It is clear from the abstentions from the HTC Report of two OECD member states, Switzerland and Luxembourg, and from subsequent comments made by representatives of these states, that achieving consensus on the proposed regime within the OECD was not smooth sailing. It also seems reasonable to assume that the representatives of the OECD member states were not totally indifferent to the geo-politics of selling the message of the HTC Report.

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499 *OECD* (n 394), 74. Formal abstention indicates non-approval of a position adopted by other OECD member states and further indicates that the state abstaining may not adopt the position taken by the non-abstaining OECD member states.
500 Switzerland, 'Taxation of Savings Income - second series of bilateral negotiations' (2003) Swiss Ministry of Finance <http://www.europa.admin.ch/nbv/medien/2003/e/not_030321.pdf> accessed 31 May 2005. As part of the discussions around the EU Savings Directive, Switzerland and the EU members of the OECD agreed that Switzerland would not have to adopt the principles set out in the 1998 Report at any time prior to 2011 and that no pressure would be applied to Switzerland to do so.
outside of their club. From a neorealist theory of international relations perspective in which legitimacy is born from geo-political power rather than procedural fairness, building an international regime among the most powerful states which can then be recommended to or imposed upon the less powerful states may have been seen as pragmatic.

5.7.2 Taxation Related Distortion and Competitive Advantage in the HTC Initiative

There is near consensus in the academic literature that taxes generally, or at least often, distort the allocation of resources and impose deadweight losses on an economy. This observation is not new. The concept of taxation induced distortion may be linked back to David Ricardo’s theory of comparative advantage, and the proposition that free trade among nations will maximise global welfare. On this basis, a tax induced distortion arises when a tax measure causes a different

501 As will be discussed below, there is evidence that certain biases were adopted in targeting the Report, at as regards some of the least geo-politically powerful states.

502 Ring (n 399), 17. Ring notes that from a neo-realist perspective, ‘[R]egimes are created and sustained by powerful actors (power determined in relation to the issue area at stake) and that regimes should “decline” when the founding hegemon declines and power shifts’. As will be discussed below, a change in position by the US first announced at a G7 meeting meant a substantive change in the direction of the HTC Initiative.


504 Tanzi (n 457), 11.

allocation of economic activity on a global basis from that which would maximise global welfare. 506 The distortion referred to in the 1996 authorisation of the HTC Initiative was arguably a very different animal, as suggested by the lack of articulation of any objective basis for what 'harmful tax competition' was in that context. 507

The concept of 'distortion' which arguably is most compatible with the usage of this term found in the context of the HTC Report, is one which refers not to any diminution of global welfare, but rather to limitations in the latitude of taxation system design occasioned by tax related externalities, or what Aaron et al. refer to as cross-border spill-overs of fiscal policy. 508 Put in its most bald form, any non-agreed foreign fiscal or other factor which would constrain the sovereign discretion of OECD states to impose whatever tax policies they choose would be distorting within this interpretation of the usage of this term in the context of the HTC Initiative. Such re-interpretations of language to serve political objectives

506 Discussed in Chapters 3 and 4 of this work.
507 WB Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contradictions' (2002) Vol. 22 Northwestern Journal of International Law & Business 2, 161; HJ Ault, 'Tax Competition: What (if anything) to do about it?' in Kv Raad (ed) International and Comparative Taxation (International Taxation Kluwer Law, International 2002), 1-7. Ault, who according to Kudrle and Sommerhalder was heavily involved in the HTC Initiative, has attempted post-hoc to distinguish 'harmful' from 'non-harmful' tax competition on the basis of firstly a motivation test in which an intent to cause externalities indicates a 'harmful' form of competition, and secondly, on the basis of an absence of ring-fencing. However, the first metric is unworkable in that intent is impossible to identify, and the second is clearly not supported within the OECD. The non-taxation of non-residents' portfolio income practiced by many OECD states refutes the second metric or at least indicates that many of the OECD states are engaged in harmful tax competition. Also M Graetz, Foundations of International Income Taxation (Foundation Press New York 2003) 505 - 506.
508 Tanzi (n 457), preface xvii
arguably illustrates another aspect of what may be termed the HTC policy narrative.\textsuperscript{509}

5.7.3 The Inclusion of non-OECD Countries in the HTC Initiative

The element of the HTC Initiative which dealt with OECD member state competition with certain small countries which were developing financial services capacity outside of the OECD’s membership, (labelled as ‘tax havens’ in the HTC Initiative), was not explicit in the original mandate. The available material suggests that it was added to the Initiative by the OECD’s Committee on Fiscal Affairs some time after the initial mandate was given,\textsuperscript{510} although it is noted that at least one senior official within the OECD Secretariat advocated the coordinated limitation of tax competition, including tax competition provided by ‘tax havens’ as early as 1993.\textsuperscript{511}

An initial ‘member states only’ approach arguably was consistent with past practice of the OECD. The subsequent targeting of selected non-members, might have been predicted from a neo-realist perspective of regime formation,

\begin{footnotesize}
\textsuperscript{509} Radaelli (n 395). Radaelli discusses the harmful tax competition policy narrative in the context of the EU members of the OECD.


\textsuperscript{511} Owens (n 431).
\end{footnotesize}
particularly given the financial services market share of non-members which was potentially 'up for grabs', the very limited geo-political influence of those non-OECD states, and the need to create a core consensus. 512

As a practical matter, the member states of the OECD made up approximately seventy-five percent of the global gross domestic product at the time, and provided eighty percent of financial services to non-residents, the so-called 'offshore' market. 513 The small and developing countries targeted by the OECD accounted for only a portion of the remaining twenty percent of the global 'offshore' financial services market. 514

The narrow scope of the tax measures covered in the ultimate 'product' as set out in the HTC Report, suggests that analysis based on a bargaining game model of regime formation may also be apt. 515 It may also be argued on the basis of the academic tax competition literature of the early 1990's and the activities of the

512 Ring (n 399), 17.
513 Stikeman, (n 453), 10; Biswas (n 452), 112; E Balls, 'The City as the global finance centre: risks & opportunities' Speech by Economic Secretary to the Treasury, Ed Balls MP (2006) HM Treasury <http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2006/press_42_06.cfm> accessed 10 October 2007. According to the UK's Economic Secretary to the Treasury as of 2006 the City of London alone accounted for, 'the natural location for 70% of the global secondary bond market, over 40% of the derivatives market, over 30% of world foreign exchange business, over 40% of cross-border equities trading and 20% of cross-border bank lending.'
514 Biswas (n 439), 112; C Stoll-Davey, Assessing the Playing Field (Economic Papers Commonwealth Secretariat Library, London 2007). Stoll-Davey notes that the economies and GDPs of the countries targeted by the OECD was on average a tiny fraction of the average of the OECD members.
European Commission in the same time period,\textsuperscript{516} that the process by which members were persuaded during Phase 1 fits what Haas has identified as epistemically informed bargaining,\textsuperscript{517} and which Ring has identified as; ‘a modified interest-based model where the institutional bargaining pursued by the states is significantly impacted by information or knowledge transmitted by epistemic communities.’\textsuperscript{518}

However, the statements issued by Switzerland and Luxembourg suggest that they may have been ‘persuaded’ by geo-politics, rather than other forms of logic, to abstain rather than veto the exercise.\textsuperscript{519} It is therefore suggested that a neo-realist model in which states manouevered to secure competitive advantage through a process which involved bargaining constrained by power politics may be the best fit.

The expansion of the territorial scope of the initiative to include non-OECD countries which was welcomed as a new feature by the G7 Ministers in 1997, coincided with the work of a second, overlapping group within the OECD’s Fiscal Affairs unit which was looking at the possible implications of electronic commerce for the taxation systems of the OECD member states. Whether coincidently or otherwise, this second OECD exercise was coordinated by the

\textsuperscript{516} Council (n 429).
\textsuperscript{517} PM Haas, ‘Epistemic Communities and the Dynamics of International Environmental Co-Operation’ in V Rittberger (ed)\textit{ Regime Theory and International Relations} (Clarendon Press, Oxford 1993), 188.
\textsuperscript{518} Ring (n 399), 29.
\textsuperscript{519} OECD (n 394), 74-77.
same OECD official who had the lead in the HTC Initiative from 1998 to 2000, Miss Frances Horner. 520

The electronic commerce group within the OECD's Fiscal Affairs unit, coordinated a private sector committee chaired by Mr. John Sacher, a banker. In June 1997 the so-called “Sacher Report” was published. One aspect of the Sacher Report focused in part on what was perceived to be the potential competition posed by ‘tax havens’. 521 The Sacher Group did not attempt to define which countries were ‘tax havens’. This task was absorbed into the HTC Initiative.

During the same period that the Sacher group was operational, another group working in the OECD’s Economics unit also focussed on the implications of countries which it saw as ‘tax havens’. This unit had its own working definition:

[T]he existence of countries with low or no taxes on foreign-source capital income—so-called “tax havens”—provides a convenient “tax address”, and thus a convenient tax residence for taxpayers who wish to reduce their tax liabilities. 522

This very broad definition of a tax haven, based on rates of tax applied to capital income, did not distinguish OECD from non-OECD countries, implying that a significant number of OECD countries which did not tax at least some income of non-residents could be considered to be tax havens. Such 'off-message' research which was not consistent with the 'harmful tax competition' policy narrative as Radaelli described it, tended to be ignored or downplayed by the OECD within the HTC Initiative.

5.7.4 Building Consensus: Separating 'Them' from 'Us'

The approval, or at least the acquiescence, of both members and non-member countries was requisite if any regime formation objectives related to the HTC Initiative were to be accomplished. Achieving acquiescence and coordination among its member states, each of which arguably was interested in preserving its own competitive position, together with the approval or acquiescence of significant trading partners, arguably required essentially the same techniques. Given the potentially conflicting interests of member states and the plethora of tax

523 Owens (n 431). Owens identified 8 OECD member states which would fall into this category. The practices identified would include entities such as Delaware LLCs and UK companies not carrying on trade within the UK. It would also include the non-taxation of bank or portfolio income owned by non-residents.

524 Radaelli (n 395).
preferences and tax incentives in existence,\textsuperscript{525} agreeing to narrow the scope of the
tax measures under review and avoiding any definitive negative labelling of
member state practices arguably were significant first steps.\textsuperscript{526} The postponing of
any definitive action with respect to, and therefore costs applied to, member state
practices was arguably also very important in preserving consensus. Keohane
argues that providing upfront benefits and deferring costs is important in
international regime formation.\textsuperscript{527} Thus the worst label which would be applied to
any practice of a member state became that of 'potentially harmful'.\textsuperscript{528} Further,
only practices which all states agreed were 'potentially harmful' were be identified
as such, meaning that member states retained a veto over criticism of their taxation
regimes.

Some commentators have placed importance on the utility of an identifiable
‘other’ to fill the ‘bad guys’ niche in the ‘good guys and bad guys’ requirement of the
harmful tax competition policy narrative.\textsuperscript{529} Consistent with this observation, a second
and somewhat overlapping part of the solution chosen by the OECD was to define

\textsuperscript{525}Arnold (n 426), 17; Liebfritz (n 431), 29; Owens (n 431). Tax incentives and other taxation measures used in tax
competition is also acknowledged as common practice within the OECD member states in the HTC Report. OECD (n
394), paragraph 21 and paragraph 57.
\textsuperscript{526}OECD (n 381), paragraph 6.
\textsuperscript{527}R Keohane, 'Institutional Design and Power; Oxford Global Economic Governance Presentation 1 December 2006
December 2006. Keohane argues that providing upfront benefits and deferring costs is important in international
regime formation.
\textsuperscript{528}OECD (n 394), paragraph 44.
\textsuperscript{529}Radaelli (n 395), 671. Radaelli refers to the ‘bad guys’ as villains.
a set of 'others', in this case 'tax havens', in such a way as to include only less geo-politically influential non-OECD competitors of the OECD member states, while excluding all OECD member states, their important trading partners, and all other geopolitically powerful states. The tax competition policy narrative model proposed by Radaelli, together with a neo-realist perspective would imply that the methodology used in assigning certain countries to the 'tax haven' grouping while other countries were not so labelled, did not require analytical rigour or validity, but rather only superficial plausibility. This would have been seen as useful from a neo-realist perspective, as identifying a state with geo-political influence or close alignment to the OECD as a 'tax haven' would have been problematic in regime formation, as it would have created tensions with other relationships involving OECD member states and therefore changed the probability of achieving consensus.

From a neo-realist perspective of international regime formation, the process adopted by the OECD during Phase 1 of the HTC Initiative in order to achieve broad acceptance of the proposed harmful tax competition regime by influential non-OECD states, may be seen as involving several aspects. Firstly, formation of the desired regime would require that geo-politically powerful non-OECD countries with linkages to the more powerful OECD members, had to be

530 JF Avery Jones, 'Finance Act Notes: Information Exchange: Sections 145-147' (2000) 5 British Tax Review 529 - 536. As noted by Avery Jones, the HTC Initiative could be translated as, 'let's bash tax havens'.
531 Radaelli (n 395).
532 Ring (n 399), 18. As noted by Ring, 'realists do not take the structure of the game as a given and argue that power may be employed to determine who is permitted to "play" .... and what rules govern the game process.'
allowed to stay neutral or ideally convinced to endorse the proposed regime. It would seem unlikely that this could have been achieved on the basis of academic argument or any appeal to altruism alone. Both neorealist and game theory models of regime formation would suggest that the indifference of, or endorsement by, non-OECD states would be most likely to be achieved if such states saw potential gain for themselves. As noted by Ring, ‘states created regimes where their common interest included public goods because in such cases the states needed cooperation to further their interests.533

5.7.5 Regime Formation and Differentiation of Treatment of Member and Non-member States

All non-OECD countries arguably were not treated identically in Phase 1 of the HTC Initiative. Rather, it is arguable that the OECD ‘Special Sessions on Harmful Tax Competition Initiative’, operating on a basis consistent with Keohane’s club model of governance,534 divided all sovereign states together with the dependencies of sovereign states into four categories. Further, it is arguable that such subdivision was based not on the specific taxation regimes employed by these jurisdictions, but rather geo-political considerations which were relevant to the implementation of the outcomes the OECD membership desired to achieve. These four categories

533 Ring (n 399), 17.
arguably determined the extent to which countries would be afforded what Franck would identify as procedural fairness.\textsuperscript{535}

The first category comprised states to which procedural fairness would be extended in the form of full participation in shaping the HTC Initiative. This category was comprised exclusively of OECD member states, which by virtue of the consensus nature of the OECD had a veto on all aspects of the HTC Initiative, including its terms of reference, definitions, process and outcomes. The review of tax practices of member states was also initially restricted to self review, although during Phase 1 there were mechanisms proposed for subsequent peer review by OECD member states, but not involving non-members.\textsuperscript{536}

The second category comprised the group of influential and geo-politically powerful non-OECD countries which were to be informed through the use of policy narrative and otherwise, of the scope and objects of HTC Initiative in order to gain support for the process.\textsuperscript{537} Interactions with geo-politically influential non-OECD states also arguably afforded early warnings of potentially contentious matters within the Initiative, while securing non-opposition to the outcomes of the Initiative. Countries falling within the second category would also be excluded

\textsuperscript{534} Keohane (n 411).
\textsuperscript{535} Franck (n 497), 7.
\textsuperscript{536} Sommerhalder (n 435), 246.
\textsuperscript{537} OECD (n 394), paragraph 14. A number of meetings in advance of the 1998 Report are listed by the OECD. Sommerhalder (n 396), 246. Sommerhalder notes the existence of meetings with non-members were underway as of 1999.
from criticism in the Report in order to broaden the appeal of the outcomes of the Initiative. Singapore and Hong Kong, both financial centres with limited exchange of tax information,\textsuperscript{538} and both members of the OECD's sister organisation the Financial Action Task Force, arguably fit the second category.\textsuperscript{539}

It is noted in passing that in 2005 both Singapore and Hong Kong were finally invited to endorse and apply the principles of transparency and tax information exchange on the basis of the standards set out in the 2002 OECD Model TIEA.\textsuperscript{540} Both had by that time arguably profited from non-mention in the 2000 OECD list of 'tax havens'.\textsuperscript{541} As of December 2006, neither had accepted the invitation to apply the relevant standards demanded of less influential countries in 2000.\textsuperscript{542} Indeed, Singapore's financial services regulator has published promotional material touting Singapore's non-adoption of OECD promoted standards and the fact that Singapore was exempted from being named as a 'tax haven' in the HTC Initiative, despite the lack of distinction between its taxation system and exchange

\textsuperscript{539} The Financial Action Task Force conducts peer review of members in relation sensitive and subjective matters such as the adequacy of anti-money laundering regimes, and therefore arguably could not be targeted with the same degree of impunity as would exist in relation to non-influential countries.
\textsuperscript{541} G Parker F Gimbel and J Burton, 'EU tax officials set sights on Asia' Financial Times (London 3 September 2006). T Mitchell J Burton and G Parker, 'HK set to reject EU savings tax demands' Financial Times (London 12 October 2006. While there are no precise figures available, the parallel between the gains attributed to non-participation in information sharing or withholding tax in the context of savings taxation by EU member states suggests likely gains from non-participation in the HTC Initiative. This is reinforced by the invitation extended to Hong Kong and Singapore to participate – albeit 8 years after the start of the HTC Initiative.
of information practices and those of countries identified by the OECD as ‘tax havens’.  

The third category comprised the group of small and developing countries without significant geo-political influence which were competitors or potential competitors of the OECD member states in the financial services and other services sectors. The countries in this third category, many of which like a variety of OECD and non-OECD countries had tax regimes which included aspects which were attractive to non-residents, would not be consulted in the formulation of what constituted ‘harmful tax competition’, rather, they would be labelled as ‘tax havens’. As noted by Sharman, blacklisting whether alone or in combination with the threat of potential sanctions may produce immediate adverse effects particularly in small countries. Such measures may also therefore act as a means of restricting competition, providing a warning to other countries which might be inclined to enter the financial or other services sectors, and a warning to those

542 OECD (n 534).
544 J Sharman, ‘International Organisations, Blacklisting and Tax Haven Regulation’ (2004) Presented at the European Consortium on Political Research Joint Sessions Uppsala, Sweden, 13-18 April 2004 http://visar.csustan.edu/aaba/sharman.html accessed 10 October 2007; BR Hartman, ‘Coercing Cooperation from Offshore Financial Centers: Identity and Coincidence of International Obligations Against Money Laundering and Harmful Tax Competition’ (2001) 24 Boston College International and Comparative Law Review No.2. Hartman notes that the labelling process was particularly problematic; '[W]hile the sanctions are threatened for non-compliance with certain “standards,” only the vaguest attempt has been made to define what those standards might be, and no attempt has been made to identify any source of obligation which would require—as opposed to encourage—compliance.... Moreover, the OECD, in a self-referential manner, demands compliance with its own standards but identifies no source, outside itself, which would make them obligatory standards.’
countries which might be tempted to adopt fiscal policies which might undermine the objectives of OECD member states.

The fourth group was comprised of those countries which were perceived neither as competitive threats to the financial services economies of the OECD member countries, nor worthy of consultation on the basis of geo-political considerations. These countries would be neither targeted nor consulted. They would simply be ignored.

It is the treatment of the third category of countries in comparison with the first and second, and the ultimate development of a dialogue on the provision of taxpayer specific information involving countries in the first and third categories which forms the basis for the analysis set out below. For present purposes it is sufficient to note that this comparison was chosen not only because of the unique dialogue on the provisions of taxpayer specific information to foreign authorities which arose between these groups of countries, but also because the nature and timing of interactions between these groups may be used to assess the process of regime formation which was adopted, and the utility of concepts of fairness discourse in the development of regimes in relation to international taxation. 546

546 Franck (n 497), 11.
The Concept of a Tax Haven

In 1987 the OECD published a report in which it was noted that:

The concept of a “tax haven” is a relative one as any country can be a tax haven in relation to a particular operation or situation.... Attempts to provide a single definition of a “tax haven” are bound to be unsuccessful.... It can be argued that the “tax haven” concept is such a relative one that it would serve no useful purpose to make further attempts to define it.\(^{547}\)

The lack of consensus in relation to what the designation ‘tax haven’ means is also readily available from an inspection of the literature. Avi-Yonah and Slemrod describe a classification for ‘tax havens’ which includes the concept of ‘production tax havens’, that is jurisdictions which use tax measures to attract production activities in the form of foreign direct investment, and ‘traditional tax havens’, jurisdictions which attract financial capital in the form of portfolio investment.\(^{548}\) This type of classification would no doubt have been troublesome for the OECD which wished to limit the suppression of tax competition activities to what they sought to delineate as tax competition for mobile financial and other activities.


Vito Tanzi, Director of the International Monetary Fund’s Fiscal Affairs Department, writing in 1994 noted that in order to qualify as a ‘tax haven’, one of the attributes a country must have acquired is, ‘a good treaty network with important countries so that the incomes channelled to the tax haven country are not excessively taxed at source.’\(^549\) While this characteristic did not in fact describe any of the small and developing countries targeted as ‘tax havens’ by the OECD, it did apply to all of the OECD countries with financial services sectors catering to non-residents on a tax free basis.

Tanzi has also noted that United States tax treatment of savings deposits by non-resident aliens must rate among the most important loopholes for the evasion and avoidance of tax by non-US persons, and that similar tax treatment is used to attract capital by a variety of other OECD countries,\(^550\) countries which collectively account for some eighty per cent of global provision of financial services to non-residents.\(^551\) Owens noted in 1993 that no fewer than 8 OECD member states did not tax non-resident’s portfolio income.\(^552\) Indeed, some writers have determined that the largest contributors to the OECD budget are the largest

\(^{549}\) Tanzi (n 457), 79.

\(^{550}\) ibid, 81.

\(^{551}\) Stikeman, (n 453), 10.

\(^{552}\) Owens (n 431).
‘tax havens’ in the world economy based on the monetary value of non-residents’ assets deposited in the relevant countries but exempted from taxation.  

The appellation of ‘tax haven’, particularly when combined with a novel subjective metric which in application apparently precluded the designation of any OECD or other geo-politically influential country as a ‘tax haven’, arguably would have had appeal as part of the harmful tax competition policy narrative in that it avoided troublesome academic writings on the subject of tax havens which tended to include OECD member states and other influential states. However, the crafting of imprecise subjective distinctions between OECD financial centres and targeted countries arguably also left the OECD open to criticism based, not only on the lack of procedural fairness in the process used in the creation of the metric, but also in the subjective manner in which the metric was employed.

There is also an historical perspective to consider in assessing the concept of ‘harm’ in the harmful tax competition policy narrative as applied to ‘tax havens’. By way of example, some of the small non-OECD countries targeted as ‘tax havens’ and accused of perpetrating ‘harmful’ tax competition, may adversely

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554 Policy narrative is described by Radaelli. Radaelli (n 424). The concept of tax havens and the prior usage of this term is described in the following section of this chapter.

555 M Littlewood, 'Tax Competition: Harmful to Whom?' (2004-2005) 26 Michigan Journal of International Law 411 - 497. Littlewood notes at p420 that; '[W]hen the Committee set out to define “tax haven,” so as to draw up a list of them, it found the concept troublingly elusive. Consequently, as will also be seen, the result was to be less than
affect global production efficiency to a lesser extent than some OECD member states. Some of these countries have territorial taxation systems and never adopted taxation of income or capital. Rather they are or were colonies of European states which had jurisdiction to set their own taxation laws.

The reasoning adopted within Europe in relation to the development of taxation of income and capital on a residence basis did not find favour in these colonies, arguably not for any reasons based on complex economic theory, but for practical reasons. Indirect taxation was, and is, seen as consistent with the social values and the desired level of public services in such countries and is much simpler to administer in small economies. It would therefore appear to be somewhat presumptuous for OECD member states to indicate that the non-adoption of the OECD style taxation systems by non-OECD countries is a critical element in 'harmful' tax competition. However, as policy narrative theory sets no requirement for objectivity and suggests that the utility of such narrative may be maximal when there is a deficiency of objective information, its use in the context of concerns over tax competition is consistent if not predictable.

satisfactory. ' And at 424; ' [I]t appears to have anticipated not classifying any of its own members as tax havens-the apparently clear cases of Switzerland and Luxembourg notwithstanding.'

556 Countries which have taxation systems which are territorial and limited to indirect taxes may be expected to have fewer preferential regimes than OECD countries with complex residence-based direct taxation systems. The limited capacity of small countries to absorb foreign direct investment is also a factor which limits any potential adverse effects on global production efficiency.

557 The Bahamas and the Cayman Islands provide two examples in this regard.

The authors of the 1998 Harmful Tax Competition Report concluded that countries which are 'tax havens' are harmful per se, at least from the perspective of their competitors within the OECD:

48. Since tax and non-tax advantages tend to divert financial capital away from other countries, tax havens have a large adverse impact on the revenue bases of other countries.\(^{559}\)

However, there was far from overwhelming support for such a position, particularly outside of the OECD. As was noted by Tanzi:

If source base taxation were widely used, tax havens would not have much of an effect on the tax rates unless the tax haven countries developed large production bases themselves. It is the combination of tax havens with the application of the residence principle to some incomes that has this depressing effect on the world rate of taxation on capital income.\(^{560}\)

The authors of the 1998 HTC Report acknowledged that the term 'tax haven' has no precise technical meaning,\(^{561}\) an observation which is supported by the literature which includes a prior OECD publication.\(^{562}\) Never the less, the HTC Report set out the following construct for identifying 'tax havens' for purposes of the harmful tax competition policy narrative:

\(^{559}\) *OECD* (n 394), 21. This position apparently changed in the interval between the publication of the 1998 Report and the 2000 update which sets out a distinction between 'cooperative' and 'uncooperative' 'tax havens'.

\(^{560}\) *Tanzi* (n 457), 81.

\(^{561}\) *OECD* (n 394), paragraph 42.

\(^{562}\) *OECD* (n 547), 21.
46. The absence of tax or a low effective tax rate on the relevant income is the starting point of any evaluation. No or only nominal taxation combined with the fact that a country offers itself as a place, or is perceived to be a place, to be used by non-residents to escape tax in their country of residence may be sufficient to classify that jurisdiction as a tax haven. Similarly, no or only nominal taxation combined with serious limitations on the ability of other countries to obtain information from that country for tax purposes would typically identify a tax haven.563

The ostensible bases for identifying countries as tax havens were therefore a subjective perception of motivation test, a purely subjective reputation test and an equally subjective limitation on access to information test, combined with a no or subjectively low rate of direct taxation applied to certain types of income. The list of countries ultimately identified as ‘tax havens’ using these subjective criteria, would appear to suggest that other undisclosed criteria were also used. These additional criteria seem to have been firstly, that the term ‘tax haven’ had to be applied for purposes of the HTC Report so that no OECD member state could be a ‘tax haven’ irrespective of prior analysis to the contrary,564 and secondly, that no geopolitically influential non-OECD member state could be included within the “tax haven” category.565

It is arguable that the application of the ostensible bases for classification is open to question. If a reputational test was in fact used by the OECD in

563 OECD (n 394), 21.
564 Littlewood (n 555), 424.
565 The exclusion of Hong Kong and Singapore provides an example. Nine years after the HTC Initiative began, these countries were politely asked to adopt the same standards demanded earlier of less influential countries. They have so far declined.
identifying ‘tax havens’ pursuant to the application of the 1998 Report, then it is curious that a contemporaneous and widely used 1996 OECD benchmark document, which identified Switzerland and Luxembourg, both OECD member countries, as tax havens was somehow overlooked in the 1998 list of ‘tax havens’ developed by the OECD’s Special Sessions and published in modified form in 2000. Hong Kong, a geo-politically influential entity and member of the OECD’s sister organisation, the Financial Action Task Force, was also excluded from the list of tax havens produced in the HTC Initiative, despite the fact that it was clearly identified by the OECD as a tax haven in another OECD publication.

One interpretation of the OECD’s objective in targeting the weakest competitors in the global financial services sector as ‘tax havens’ is that it was a subtle means of limiting potential future competition for OECD states in this sector. The HTC Report notes that one of the OECD’s intentions was, ‘discouraging the spread of tax havens’. Further, there are indications that at

566 OECD (n 522), 40.
568 OECD (n 522), 40.
570 OECD (n 394), paragraph 4.
least some OECD members wished to ‘eliminate tax havens’, or at least those outside of the OECD.\(^571\)

Apart from the omission of a number of OECD member states from the list of ‘tax havens’, there is also other qualitative information which calls into question the OECD process for selecting ‘tax havens’ which is available through examination of the countries included. In this regard, the cases of Tonga and the Republic of the Maldives make interesting comparators with the situation of Switzerland which the OECD using its Nelsonian eye did not consider to be a ‘tax haven’ for purposes of the HTC Initiative.

The Kingdom of Tonga, a ‘tax haven’ as at 2000 according to the OECD, is a country of less than 100,000 people which had a GDP of less than $US 2000 per person.\(^572\) While Tonga’s economy was primarily subsistence level fishing and farming, it made the mistake of passing legislation in the 1980’s which permitted the existence of financial services facilities for non-residents in order to create the potential for economic diversification. According to reports of a speech made by Tonga’s Minister of Finance addressing a joint meeting of OECD and Commonwealth countries in January 2001, the legislation was never used and as at

\(^571\) E Tuomioja, ‘Perspectives for currency transaction taxes as a part of a new international financial architecture’ (2000) Ministry of Foreign Affairs - Finland


the date on which Tonga was labelled as a tax haven, there was no offshore finance sector in Tonga at all.573 Tonga was eventually removed from the OECD’s list after it agreed to remove the offending, but unused legislation so that it could no longer even potentially provide competition to OECD member states.

The case of another small and developing country, the Republic of the Maldives, is similar. Although somehow identified as a ‘tax haven’ by the OECD on the basis of the 1998 criteria,574 almost 4 years later and after prolonged protests by the Maldives and advocates for small and developing countries, the OECD issued the following rather unapologetic statement:

The OECD is pleased to announce that The Maldives does not meet the tax haven criteria set forth in its 1998 report, "Harmful Tax Competition: An Emerging Global Issue" and will not be considered for inclusion in any list of unco-operative jurisdictions. This determination was made after detailed discussions with the government of the Maldives regarding the current legal, regulatory, and economic situation in the Maldives. The Maldives does not have an offshore sector in geographically mobile activities, such as financial and other services, and is highly transparent. In addition, it has no laws or administrative practices which prevent the effective exchange of information.575

There have been numerous other criticisms of the OECD’s methodology in identifying targeted countries as ‘tax havens’.576 One of the most recent and

574 OECD (n 567), 17.
most comprehensive is that of Orlov, who drew a conclusion similar to that of the OECD officials who criticised the use of the term in 1987, noting that, '[A]t its present stage of development, the concept of tax haven should not be applicable to international law relations.' 577. While this criticism is undoubtedly valid, if the perspective attributed to Ault to the effect that the HTC Report reference to 'tax havens' was a political statement rather than otherwise valid is accepted, then it is arguable that the OECD's position on 'tax havens' was not intended to set out a basis for inclusive dialogue, but rather like other negative stereotyping, was intended as a constraint on dialogue both within and outside of the OECD. If that is the case then the 'tax haven' definition arguably was an attempt to establish pre-analytic dogma prior to any consideration of fairness or inter-nation equity. From an international regimes perspective, such a move could be interpreted as part of a 'suasion' game, 578 or alternatively from a neo-realist perspective, as an attempt to constrain international relations based on power relationships. The latter analysis arguably is supported by the OECD's subsequent statement that they would not engage in substantive discussions with the targeted 'tax haven' countries unless they gave prior political commitments in support of the OECD's position. 579

577 Orlov (n 576), 111.
578 Ring (n 399), 21.
5.8 CONCEPTS OF FAIRNESS IN THE HTC REPORT

A neo-realist perspective of regime theory arguably would not suggest that fairness would be a significant factor in the relationship between the powerful OECD member states and the targeted small non-OECD countries. However, regime theory admits a multivariate approach.

It will be recalled that fairness as conceptualised in Franck’s model has two components, a procedural component which relates to legitimacy, and a substantive component which relates to what is equitable or at least acceptable. In this regard Webb has noted that:

[T]here can be no apolitical criteria for determining which tax policies are acceptable or unacceptable. Consequently, discussions about HTC revolved around the issue of what kinds of tax competition were legitimate. Indeed, the entire series of negotiations since 1996 can be interpreted as an attempt to define the boundary between legitimate and illegitimate tax measures.

The process used in the development of the HTC Report lacked transparency and no complete public record exists of the procedures used. However, the Report itself does provide limited information as to what the

580 Franck (n 497), 7-9.
Committee on Fiscal Affairs indicates, and the member states of the OECD agree, was done. While it is recognised that the publications of exclusive multilateral organisations such as the OECD may be coloured so as to provide a positive image of the organisation and its outputs, it may be possible to distinguish material which may be more or less biased on the basis of such self interest. Given the self interest required by the aims of the OECD, then to the extent that the HTC Report provides evidence that either procedural fairness or substantive fairness, as these may be viewed from a global perspective, were not involved in the development, process or outcomes of the HTC Report, then perhaps such evidence may be accepted as relatively less biased than more self-serving material. Logically, the OECD would be unlikely to indicate that it had ignored fairness if it had not.

Fairness, and more particularly how fairness is affected by what the HTC Report designated as harmful tax practices, did feature in the stated objectives of the Report:

The Report is intended to develop a better understanding of how tax havens and harmful preferential tax regimes, collectively referred to as 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 undermine the fairness, neutrality and broad social acceptance of tax systems generally. Such harmful tax competition diminishes global welfare and undermines taxpayer confidence in the integrity of tax systems.  

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582 OECD (n 394), 8.
While the HTC Report provides statements alleging that certain tax practices were viewed as undesirable by the majority of OECD countries, it provides no explicit reference to how fairness as seen by the OECD was assessed, or any evidence or rationale of how fairness was adversely affected by the practices which the majority of OECD member states disapproved of. Given that the HTC Report is a political document as indicated by Sommerhalder, and an integral part of the harmful tax competition policy narrative as described by Radaelli, this is perhaps understandable. The more clear and substantive a document dealing with a complex and sensitive subject in which there are divergent interests is, the more difficult consensus is.

The territorial scope of the exercise undertaken in Phase 1 plays a pivotal role in the analysis of its procedural fairness, and therefore according to Franck’s analysis, its legitimacy. To the extent that the only countries which would be adversely affected by the HTC Initiative were within the OECD ‘club’ which was undertaking the exercise, and each of these countries was a full and voluntary participant in the exercise and had a veto over it, then arguably the key elements of procedural fairness would likely be satisfied and be seen to be satisfied by all participants without more. However, to the extent that the geographic scope of the exercise and its collateral or intended effect extended to countries which were excluded from the design and implementation of the exercise, then arguably the

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583 Sommerhalder (n 396).
584 Radaelli (n 395).
The legitimacy of the exercise in terms of international standard setting is open to question at best.

The decision taken by the designers of the HTC Initiative to target a group of small and developing countries as 'tax havens' without any prior consultation with these countries, arguably was a fundamental flaw in any claim to procedural fairness within the HTC Initiative. This decision itself may be interpreted in a variety of ways. From one perspective, it may be seen as an 'equity-efficiency trade-off', in which fundamental aspects of equity affecting non-member countries were knowingly sacrificed in order to achieve efficiency in securing the economic objectives of the OECD member states. The critical feature of this particular equity-efficiency trade-off is that the inequity and enhanced efficiency would potentially be experienced in different geographic spaces. That is, the inequities would be 'out-burdened'.

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585 J Owens, 'The OECD work on Tax Havens' Paper presented at The Friedrich Ebert Foundation Conference on "Money Laundering and Tax Havens - The Hidden Billions for Development" July 8 - 9, 2002 <http://www.law.wayne.edu/mcintyre/text/Treaty_Class/oecd_work_on_tax_havens.pdf>, accessed 10 October 2007. The term 'targeted' to describe the OECD's process in relations to the non-OECD countries focused upon, rather than any particular tax practice per se, is used by Jeffery Owens, Head, Centre for Tax Policy and Administration Organisation for Economic Co-operation and Development. All of the countries targeted by the OECD have very small populations, and most are developing countries as noted by Stoll-Davey. Stoll-Davey (n 514).

586 The OECD later admitted that it was open to criticism for this approach. J Owens 'Promoting Fair Tax Competition'-Paper presented at the Barbados Consultation on the OECD's Harmful Tax Competition Initiative 8 January 2001.

587 Discussed in Chapter 3 of this work.

588 Wechsler (n 463).
Other trade-offs between equity and efficiency arguably were also present in the design of the HTC Initiative. The tax scope of the HTC Initiative was limited to exclude tax incentives aimed at distorting the global distribution of foreign direct investment.\textsuperscript{589} Arguably, tax incentive schemes aimed at attracting foreign direct investment were far too embedded in the economies of the dominant OECD member states,\textsuperscript{590} and perhaps more importantly, tended to take the form of economic non-neutralities which tend to favour OECD member states because of their relative wealth. An alternative to this view has been suggested by Sommerhalder:

[A] tactical decision was made at the beginning of the Report to select a relatively narrow area; those countries facing serious problems and developing an institutional structure to deal with those problems, rather than trying to deal with all of the perceived contexts in which tax competition could be a problem.\textsuperscript{591}

The limitation of the scope of the HTC Initiative was not without opposition even within the OECD. Luxembourg abstained from the 1998 Report noting that:

By voluntarily limiting itself to financial activities, excluding industrial and commercial activities, the Report developed by the Special Sessions on Harmful Tax Competition adopts a partial and unbalanced approach: it does not fulfill the 1996 mandate.\textsuperscript{592}

\textsuperscript{589} OECD (n 394), 73-78.
\textsuperscript{590} Arnold (n 426), 18.
\textsuperscript{591} Sommerhalder (n 435).
\textsuperscript{592} OECD (n 394), 74.
An equity-efficiency trade-off arguably was also used in building acceptance of the HTC Initiative within the OECD itself. Specifically it was agreed that while selected non-member practices could be criticised with little if any consideration of objectivity, rudimentary procedural fairness, or definitive economic analysis, no OECD member state tax practices would be identified definitively as harmful tax practices in the initial phases of the Initiative. Rather, an agreed selection of member state tax practices would be identified as “potentially harmful practices”, which would be subject to further political negotiations within the OECD membership. By comparison, the non-member countries which were to be targeted by the OECD, would be identified as ‘tax havens’, and these countries would be given an opportunity to conform their tax practices to those approved of by the OECD or be subjected to certain “collective defensive measures”, 593 that is, sanctions.

There are no explicit statements by the OECD setting out the logic of ignoring procedural fairness. It is arguable that prior consultation with a group of small and developing countries with very different economies and potentially very different perspectives from those within the OECD, might not only have been seen as potentially demeaning by the OECD, but might have been seen as potentially prolonging the achievement of an agreement which could be achieved by ‘suasion’, that is, threats of coordinated defensive measures. 594 More problematic

594 Wechsler (n 463). Wechsler indicates that the United States in particular preferred a top-down approach.
for the OECD, such a dialogue might, if entered into in any meaningful way, have produced a different set of outcomes than that favoured by the dominant elements within the OECD. This would seem to have been a real possibility given events subsequent to the dialogue which began some two years later. 595

Another consideration in relation to the initial targeting of a group of small geo-politically weak countries is whether or not the process was intended to stop with these small countries. It is arguable that by 1998 the OECD had recognised the need to secure cooperation from all, or at least most, countries if their proposed regime for limiting tax competition was to succeed. From an international relations game-theory perspective, suasion in the form of making an example of the weakest non-conforming countries, might make securing the compliance of other states easier. 596

It is also worthwhile noting in the context of the OECD’s use of the concept of fairness in the 1998 Report that, as discussed by Sharman, invoking concepts such as the pursuit of fairness both for purposes of domestic consumption and in the realm of international relations, can make what otherwise would be all too distasteful a process, more saleable. 597 The questionable attribution of ‘unfair’ behaviour to the targeted small and developing countries has also been noted by

595 The concept of providing a ‘level playing field’ for competition which would include the targeted countries appeared in response to the HTC Report and is reflected in the OECD’s 2001 progress report. OECD (n 593). Discussed further in Chapter 6 of this work.
596 Ring (n 399), 21.
Saunders. In the contexts of most OECD countries, arguably gaining domestic approval for the HTC Initiative would have been more likely based on an assertion that actions were being taken in order to crack down on tax evaders who by their actions are unfair to other tax payers, rather than an assertion that a biased process was being used for the purpose of maintaining a competitive advantage over the economies of small and developing countries.

Motivation is difficult to assess in a process as opaque as the one used by the OECD. Scott-Joynt attributed the approach used to a desire to achieve the efficient limitation of competition rather than fairness, indicating that the objective was; ‘to kneecap the opposition and reinforce offshore practices in Europe and the US’. In contrast, Littlewood attributes the methodology selected to indifference to the effects on the targeted countries:

[I]t seems clear that the OECD’s Member States were not concerned with promoting global welfare generally (let alone with the special needs of developing countries trying to attract foreign investment) but with the fate of their own treasuries – for the “national tax bases” to which they referred were presumably not those of the countries (both within and outside the OECD) engaging in “harmful tax competition” but those of its own

597 J Sharman (n 544).
598 R Saunders, ‘The OECD’S ‘Harmful Tax Competition’ Scheme: The Implications For Antigua and Barbuda’ (2001), presented Luncheon Meeting of the Antigua and Barbuda Chamber of Commerce and Industry on Tuesday, 27th March 2001. Saunders refers to the stigmatisation of the targeted countries as a precursor to the intended ‘defensive measures’.
members who were not engaged in "harmful tax competition" (or who, at least, were prepared to desist, if other members did likewise).  

It may have been the assumption of OECD countries prior to the development of the HTC Initiative methodology that the countries to be targeted would not be willing to discuss tax competition issues with the OECD member states. As noted by Jeffrey Owens, Head of the OECD's, Centre for Tax Policy and Administration:

We needed to encourage jurisdictions to come to the table. Our Member countries thought long and hard on what would be the most effective approach and concluded, as did the FATF, that we needed deadlines and a distinction to be made between cooperative and uncooperative jurisdictions.  

Some authors from OECD countries have argued that there would have been no reason for small and developing countries to cooperate in the design of cooperative regimes which allow industrialised countries to maintain high direct tax rates, on the basis that such small and developing countries benefit from using low tax rates to attract capital, or at least must maintain low rates of capital taxation in order to retain capital. However, such an analysis arguably is flawed.

600 Littlewood (n 555), 418.
601 J Owens (n 585), 6. However, the FATF is the OECD’s sister organisation, another creation of the G7, and is housed in the OECD’s headquarters. It is questionable as to whether the assumptions and reasoning applied under one hat differ from those which are applied when the hat is switched.
602 Tanzi (n 457), 65-89 Tanzi describes the nature of this assumption in the period prior to the HTC Initiative.
Small and developing countries engaged in the financial services sector arguably have a strong and long term interest in assisting high tax countries in maintaining their high direct tax rates. Small and developing countries generally have a limited capacity to absorb foreign direct investment. Rather, they generally seek to participate in the international services sector, and frequently the international financial services sector in particular, as a means for economic development. The tax cost differential, contributed to by tax compliance costs, which tends to exist between high direct tax rate industrialised countries and smaller and less developed countries, rather than the nominal tax rate differential arguably provides some of the impetus for the use of the financial services sectors in small and developing countries for international financial structuring. To the extent that any compliance cost differential is undermined by downward pressure on the tax rates or compliance costs in high direct tax rate countries, there is a lessened probability that the financial services sectors in the small and developing countries can survive. Facilitating highly complex and high rate tax systems in other countries arguably is in the interest of small and developing countries. It therefore seems entirely plausible that the argument that small and developing countries would not want to discuss tax competition was either pre-analytic dogma necessary to support the harmful tax competition policy narrative, or self-serving rationalisation. This analysis is supported by the fact that many of the countries targeted by the OECD were subsequently demonstrated to be eager to talk to and

negotiate with OECD member states once a ‘level playing field’ was agreed by the OECD.\textsuperscript{604}

Further, the fact that a number of the countries targeted, and particularly those in the Caribbean, previously had tax information exchange arrangements in double tax treaties with OECD states which were unilaterally terminated by the same OECD states, would cast doubt on any assumption that the targeted countries would not want to talk to the OECD member states.\textsuperscript{605} It seems at least plausible that if fair treaty provisions would have been offered to these countries, that they would have been happy to resume the tax information exchange which the OECD member states indicated they wanted. It is however noted that in 1993, Owens who played an important role in the HTC Initiative, advocated that OECD states devise means of entering into stand-alone tax information exchange arrangements rather than double taxation treaties with countries which he then viewed as ‘tax havens’.\textsuperscript{606}

A failure to engage in dialogue and acting unilaterally against the interests of small and developing countries arguably was not unique to the HTC Initiative. The policy adopted by some OECD countries following the publication of the Gordon Report in 1981 in relation to small and developing countries attempting to

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\textsuperscript{604} Discussed in Chapter 6 of this work.
\textsuperscript{606} Owens (n 431).
\end{flushright}
develop financial services sectors within their economies, was to deny them treaty benefits and to shun them from international financial services environments.\(^{607}\) There were however exceptions to this general rule. States with oil or oil money such as the United Arab Emirates, which as a matter of practice did not tax income or capital of residents, were allowed into the OECD treaty network, despite the effective absence of direct taxes.\(^{608}\)

Fairness can also be questioned in that many of the non-OECD countries targeted in the HTC Initiative had been encouraged by OECD member states to enter the financial services sector.\(^{609}\) Others had reduced their rates of direct taxation or eliminated such taxation on non-resident income in order to avoid the distorting effects of double taxation which resulted from the termination of double taxation treaties by OECD member states.\(^{610}\) Paraphrasing Thomas Moore, there is an argument that OECD member states were first making ‘tax havens’ and then punishing them.\(^{611}\)

The small and developing countries targeted by the OECD in the HTC Initiative, were generally excluded from the treaty networks and other fora

\(^{607}\) Langer (n 605); Gordon (n 423), 170.


\(^{610}\) Stoll-Davey (n 514).

\(^{611}\) T Moore, Utopia (1516) <http://www.underthesun.cc/Moore/Utopia/Utopia2.html> accessed 11 July 2004. Moore commented that the treatment of the poor by the governing aristocracy forced the poor to steal food to survive, implying that in effect the aristocracy first made thieves and then punished them.
for dialogue in tax related matters controlled by the OECD member countries. It is conceivable that they had come to almost accept the isolation imposed on them following the Gordon Report.\(^\text{612}\) It also seems plausible that they would have been caught somewhat unaware by the policy shift within the OECD from one which advocated forced isolation, to one which some commentators saw as designed to disrupt their nascent financial services industries,\(^\text{613}\) or at least to impose new restrictions on them.

The fairness of the ‘spin’ of the HTC policy narrative is also worthy of consideration. As noted by Hale; ‘credibility is a key power resource’.\(^\text{614}\) From a neo-realist perspective it is arguable that the OECD sought to undermine the credibility of the smallest of their competitors in order to secure relative advantage. It seems more plausible however to conclude that the OECD was simply indifferent as to the effects of their ‘spin’ on the targeted countries.

\(^{612}\) Gordon (n 424).

\(^{613}\) Eastmond (n 569).

5.9 THE MEANING OF FAIRNESS AS APPLIED IN PHASE 1 OF THE HTC INITIATIVE

The lack of prior consultation with any of the countries targeted by the OECD together with the process used in designing pejorative definitions so as to exclude OECD member countries and geopolitically influential non-OECD countries, provide a reasonable basis for an assessment that in the OECD’s preparation of the 1998 Report, the OECD failed to meet even the most rudimentary standards of procedural fairness, as this concept is used by Franck, to non-members. That is not to say that there was no consideration of fairness by the OECD. Indeed, a narrow concept of a certain type of “fairness” which is undermined by ‘harmful tax practices’ did feature in the HTC Initiative from at least 1998.

The representatives of the OECD arguably advanced two ‘fairness’ arguments in parallel in this context. The first was that the availability, (rather than the use), of certain tax related incentives which could attract mobile components of the services sector, and in particular the financial services sector, was ‘unfair competition’ in the inter-nation sense, in that it could influence the location of services activities and thus the employment and potential tax revenue which attached to such activities. The second was that a limitation of access to taxpayer specific information made it possible for residents of OECD countries to avoid paying their ‘fair’ share of tax by placing capital in countries with which the

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615 Franck (n 494), 7.
relevant OECD country did not have a treaty providing for exchange of information. This created at least the possibility of inter-individual unfairness within OECD countries.

The OECD’s use of the concept of ‘fairness’ in the context of Phase 1 of the HTC Initiative, while arguably rational in the sense of being a self-serving part of the harmful tax competition policy narrative, may not be reasonable in terms of an objective, or at least broader, perspective of inter-nation equity. This is particularly so given that the OECD member states’ taxation systems, which the HTC Initiative was designed to bolster, themselves bias the global allocation of mobile resources to suite the interests of the relevant member states, and that the taxation related rules and models advocated by the OECD arguably are also biased to benefit the member countries of the OECD. The OECD’s approach seemed to ignore the fact that a number of their own taxation systems were designed to be used by non-residents in precisely the manner in which they complained that their residents were using other countries taxation systems. This second fairness argument may therefore be best understood in the context of the tax administrations of OECD states wishing to maintain the degree of insulation of their fiscal regimes from the effects of cross-border fiscal ‘spill over’ effects which they enjoyed prior to the removal of barriers to capital movement, without

616 OECD (n 394), 8.
617 Liebfritz (n 431); Arnold (n 426), 20.
618 Biswas (n 452), 112; Easson (n 406), 20.
necessarily giving up the ability to inflict on other countries that which they sought to avoid.\footnote{620}

The HTC Report also contains a perspective of what its authors viewed as 'fair competition' on a level playing field.\footnote{621} However, the limitation of the HTC Initiative to considerations of the 'location of mobile financial and services activities' suggests that the OECD's focus was not exclusively on the location of capital in the form of the bank deposits owned by their residents per se,\footnote{622} but rather on the location of services sector activity, including not only financial services such as banking, but also all other services with potentially mobile components.\footnote{623} Indeed as noted in the Report, the tax treatment of bank deposits is explicitly excluded from the scope of the Report, perhaps because of the obvious and numerous special regimes operated by OECD countries and designed to affect the location of banking activities.\footnote{624}

It is also noted that within the 1998 Report, the position is taken that as developed countries are able to provide the services offered by the small and

\footnote{619 Mitchell (553); UN, 'Institutional Framework for International Tax Cooperation' (2003) <http://www.law.wayne.edu/McIntyre/text/Treaty_Class/UN_institutional_framework.pdf#search=%221963%20OECD%20Convention%20Taxation%20%22exchange%20of%20information%22%22> accessed 3 October 2006.}
\footnote{620 Tanzi (n 457), Preface xvi .}
\footnote{621 OECD (n 394), 9.}
\footnote{622 Owens (n 431), 21 - 44. Owens notes that 8 of the OECD member states did not tax non-resident portfolio investments or bank deposits.}
\footnote{623 J Owens 'Curbing harmful tax practices' (1999) OECD Observer 215; Eastmond (n 569).}
\footnote{624 OECD (n 394), 9. Owens (n 623). Owens identifies the non-taxation by OECD member states of non-resident bank deposits.}
developing countries which the Report identifies as ‘tax havens’, there is no basis for permitting the ‘tax haven’ countries to continue to compete with the developed countries:

Tax havens generally rely on the existing global financial infrastructure and have traditionally facilitated capital flows and improved financial market liquidity. Now that the non-haven countries have liberalized and de-regulated their financial markets, any potential benefits brought about by tax havens in this connection are more than offset by their adverse tax effects.\(^{625}\)

Objective evidence of the adverse effects produced by ‘tax havens’ was not provided. Subsequent analysis has not only questioned its existence, but also shown positive regional effects.\(^{626}\)

5.10 STANDARD SETTING AND INTER-NATION EQUITY IN PHASE 1 OF THE HTC INITIATIVE

There is no evidence that broad considerations of inter-nation equity, in the sense this phrase is used by Kaufman,\(^ {627}\) were entertained by the author’s of the 1998 HTC Report. While it is possible that it was assumed by the authors that what was good for the OECD member states was necessarily good for all nations, there is no

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\(^{625}\)OECD (n 394), 21.
explicit evidence of even this. The exclusive process and refusal to hear some non-members' perspectives on the complex issues involved, the targeting of small and developing countries as 'tax havens', and the pejorative manner in which this term was used to refer to such countries in the 1998 Report is consistent with indifference to broad considerations of inter-nation equity at the least.

In Paragraph 26 of that Report it is indicated that:

The fact that a country has modernised its fiscal infrastructure earlier than other countries, for example by lowering the rates and broadening the base to promote greater neutrality, is principally a matter of domestic policy. Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so. This study is designed, in part, to assist in that regard. 628

There is no evidence presented that any 'internationally accepted standards' existed apart from those that the OECD was attempting to establish within its proposed HTC regime. 629 The claim is therefore best understood as part of the policy narrative rather than as a statement of fact. Similarly, the 1998 Report's suggestion that controlling competition for more mobile resources will help create a 'level playing field' arguably is also best understood as policy narrative. 630

Objective analysis of inter-nation equity in relation to tax competition arguably would have taken into consideration that the only realistic options for

628 OECD (n 394), 15.
629 Littlewood (n 555).
630 OECD (n 394), 9.
development for many small and developing countries may require the diversification of their economies into services sectors, and of these, the financial services sector may be particularly attractive. Small and developing countries face competitive disadvantages in relation to the attraction of foreign direct investment as a result of the biased taxation regimes of many developed countries, including OECD member states. Therefore efforts by the OECD to restrict competition in the financial services sector, while at the same time not restricting competition for foreign direct investment which for reasons of existing tax related distortions and other factors favours the member states of the OECD, arguably makes any development ‘playing field’ less level rather than more level.

5.11 FAIRNESS, EXCHANGE OF INFORMATION AND REGIME FORMATION IN PHASE 1 OF THE HTC INITIATIVE

As noted in Chapter 1, exchange of information has been suggested as the last best hope for the residence-based taxation systems currently applied by OECD member states. The HTC Report sets out no discussion of when restricted exchange of tax information would be justified, focussing instead on repeated assertions that lack of exchange of information may produce ‘harm’. However, as none of the

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631 Biswas (n 452).
632 Liebfritz (n 431); Arnold (n 426), 18.
exchange of information practices of OECD member state were identified as harmful, even though some member states may restrict tax information exchange with other countries, the impression given is that the inability or unwillingness to exchange information is only harmful if it is practiced by a country outside of the OECD club.

The HTC Report also proposed that countries could be categorised according to whether they provided ‘effective exchange of information’ to other countries without any objective statement of what was meant by ‘effective’

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635 OECD (n 394), 29. “The ability or willingness of a country to provide information to other countries is a key factor in deciding upon whether the effect of a regime operated by that country has the potential to cause harmful effects.” Page 24 “Lack of effective exchange of information. Tax havens typically have in place laws or administrative practices under which businesses and individuals can benefit from strict secrecy rules and other protections against scrutiny by tax authorities thereby preventing the effective exchange of information on taxpayers benefiting from the low tax jurisdiction.” Page 25 “Thus, the lack of effective exchange of information is one of the key factors in identifying a tax haven since it limits the access by tax authorities to the information required for the correct and timely application of tax laws.”
exchange of information.\textsuperscript{636} ‘Harmful’, in the context of what the authors of the HTC Report identified as a lack of ‘effective’ exchange of tax information within the narrow scope of the OECD’s HTC Initiative, was in effect left to be defined subjectively. Essentially, the OECD could be seen to be asserting that other countries should do as the OECD said, not what at least some of the OECD members did. Even with this, not all of the member countries of the OECD agreed with the linkage which the HTC Report sought to create between ‘harmful tax practices’ and the exchange of tax information. This disagreement arguably contributed to the abstention of two OECD member countries from the Report.

Luxembourg, in its note of abstention within the Report, indicated that;

“It [Luxembourg] cannot accept that an exchange of information that is circumscribed by the respect of international laws and respective national laws be considered a criterion to identify a harmful preferential tax regime and a tax haven.”\textsuperscript{637} Switzerland also abstained from the Report, noting in relation to the focus on exchange of information,

The Report ignores the reality of the structural diversity of existing tax regimes. For instance, the only solution adopted is administrative assistance by means of exchange of information, even though this presents certain limits, and the existence of withholding systems is not taken into


\textsuperscript{637} OECD (n 394), 74.
account, even though such systems are viable alternatives which entail lower administrative costs.\textsuperscript{638}

The immediate effect of the abstentions by Switzerland and Luxembourg was to remove any direct effect of the HTC Report or its recommendations on these countries.\textsuperscript{639}

There arguably was a lack of procedural fairness in the purely subjective manner in which ‘lack of effective information’ was to be assessed, particularly when the sanctions, or as the HTC Report euphemistically called them, ‘collective defensive measures’,\textsuperscript{640} which the OECD proposed to impose on non-OECD countries which failed to meet such subjective standards, are considered.\textsuperscript{641} The use of purely subjective and unarticulated standards also potentially undermines substantive fairness in the sense this term is used by Franck,\textsuperscript{642} and inter-nation equity in the sense this term is used by Kaufman.\textsuperscript{643} The labelling or stigmatisation of a country as a ‘tax haven’ or as conducting ‘harmful tax practices’ based on entirely subjective, unarticulated and potentially variable criteria, together with the

\textsuperscript{638} OECD (n 394), 77.
\textsuperscript{639} OECD, ‘Convention on the Organisation for Economic Co-operation and Development’ (1960) OECD <http://www.oecd.org/document/7/0,2340,en_2649_201185_1915847_1_1_1_l_1,00.html> Article 6(2) accessed 17 January 2005.
\textsuperscript{640} OECD (n 394), 40.
\textsuperscript{642} Franck (n 497), 7-8.
threat of sanctions against stigmatised countries tends to create commercial
uncertainty which has the effect of distorting the distribution of economic activity
away from stigmatised countries. In the same manner, it also undermines the
neutrality of any location decisions in regard to international economic activity.

The approach utilised in developing the HTC Report, and the context of
that document, would therefore appear to be most consistent with a top-down neo-
realist interpretation of international relations, at least in terms of the determining
the parameters for rule setting. An overlay of a ‘suasion game’ approach to regime
formation is also evident in the reference to ‘collective defensive measures’ which
at least in theory, could be applied to both members and non-members. 644
Arguably, the OECD did not fully consider during Phase 1 the effects of the
perception, which was particularly prevalent outside of the OECD countries, that
such an approach lacked legitimacy. This analysis is supported by the fact that the
OECD itself later acknowledged that perhaps the process initially used in the HTC
Initiative might have been flawed, 645 or that it was not entirely satisfactory to all
concerned. 646 It is therefore understandable that reaction to the HTC Report led to
a change in the approach to international regime formation within the OECD.

643 NH Kaufman, ‘Fairness and the Taxation of International Income’ (1998) 29 Law & Policy in International
Business 2 145 - 204.
644 Undoubtedly Switzerland and Luxembourg were ‘persuaded’ not to veto the HTC Initiative prior to the release of
the HTC Report.
The Commonwealth Journal of International Affairs 365, 16.
646 G Makhlouf, ‘Opening Statement By Gabriel Makhlouf Chair of the Committee on Fiscal Affairs

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CHAPTER 6 - TAX INFORMATION EXCHANGE, NEUTRALITY AND INTER-NATION EQUITY IN THE CONTEXT OF THE OECD'S HARMFUL TAX COMPETITION INITIATIVE

1996 – 2006

PART 2

6.0 INTRODUCTION

Part 2 of the case study of the HTC Initiative examines phases 2 through 4 of the Initiative. Phase 2 refers to the period commencing immediately after the publication of the HTC Report in 1998, and extending to the publication in June 2000 of the OECD’s list of ‘tax havens’. Phase 3 refers to the period

immediately following the publication of the 2000 Report to the publication in April 2002 of the OECD’s Model Agreement for Information Exchange.\textsuperscript{649} Phase 4 of the HTC Initiative refers to the period immediately following publication of the 2002 Model to the present, and marks the period in which the often referred to ‘level playing field’ in relation to tax competition is being defined.

\section*{6.1 Phase 2 of the OECD Harmful Tax Competition Initiative}

Phase 2 may be said to be characterised in part by the marketing of the harmful tax competition policy narrative of the Harmful Tax Competition Report (HTC Report) outside of the membership of the OECD. It is also characterised in part by efforts to repackage what by late 1999 was a somewhat tarnished HTC Initiative.\textsuperscript{650}

The interactions among the principal state actors which occurred during Phase 2 will be divided into four sets for purposes of the present analysis. Interactions among the member states of the OECD constitute the first set of interactions. Interactions involving the OECD, its member states and geopolitically influential non-member states constitute the second set of interactions, while interactions between the OECD and its member states and the small and


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developing countries which they targeted as ‘tax havens’ constitute the third set. The initial stages of response coordination among the small and developing countries targeted by the OECD and other countries and international organisations which supported their position, constitute the fourth set of interactions.651

The interactions between the OECD member states and the targeted small and developing countries arguably were shaped in part by history. The social contexts and histories experienced by the small and developing countries were diverse, but contained a number of common elements apart from small size and relative level of develop. All of the countries targeted in the HTC Initiative were small democratic countries.652 None had any significant geo-political influence on their own. All of the countries targeted were in competition or potentially in competition with OECD member countries in the provision of financial services to both residents and non-residents, but lacked the right of veto or exemption within the HTC Initiative which financial services centres such as Switzerland, Luxembourg, London and New York enjoyed.653 The majority of the countries targeted were current or former colonies of states within the OECD and had experienced privations including slavery and other social ills associated with their

650 The labelling of tax competition as ‘harmful’ was replaced by references to harmful tax practices in the 2000 report. OECD (n 648).
651 J Owens, 'The OECD work on Tax Havens' (2002) OECD, 6 http://www.law.wayne.edu/mcintyre/text/Treaty_Class/oecd_work_on_tax_havens.pdf. accessed 10 July 2007. The term “targeted” to describe the OECD’s process in relations to the countries focused upon rather than any particular practice was used by officials within the OECD. C Stoll-Davey, Assessing the Playing Field (Economic Papers Commonwealth Secretariat Library, London 2007). Stoll-Davey notes that all of the countries targeted by the OECD in the HTC Initiative have very small populations, and the majority were relatively poor developing countries. 652 Stoll-Davey (n 651).
colonial status. Many were trying to diversify their economies away from a
dependence on subsistence agricultural and serving drinks to tourists from OECD
countries. Many had been encouraged by OECD countries during the 1980’s and
1990’s to diversify their economies into the services sector in order to limit aid
dependence.654

6.1.1 Reactions to the HTC Report

The HTC Report and the OECD’s activities throughout Phase 1 of the
Initiative produced mixed feedback. Naturally the governments of the OECD
countries and their academic advisors were supportive.655 Some academic writers
in OECD countries also supported the Initiative,656 seeing it as justified in the
context of concerns over capital taxation and the need for the OECD member
countries to prop up their potentially faltering residence-based taxation regimes.657

653 Discussed further later in section 5.7 of this work.
654 Commonwealth, 'Commonwealth Secretariat Press Release Statement by Commonwealth Secretary-General on
Document Related to Tax Talks 28 Feb 2001' Commonwealth
(September), 601-8.
also critical of aspects of the HTC Initiative including unsupported, and vague statements as well as limitations.
Other academic writers found the HTC Initiative less than well-considered.\(^{658}\) Governments of countries targeted by the OECD questioned the legitimacy of the HTC Initiative.\(^{659}\) Some even examined the potential for proceedings against OECD member states in the context of the World Trade Organisation.\(^{660}\) Some representatives of countries targeted by the OECD, being former or current colonies of the European OECD member states, saw the exercise as a form of economic neo-colonialism.\(^{661}\) Others, aware of the role that economic and even fiscal competition had served and continued to serve, in the development of the now dominant economies of the OECD member states, ascribed the actions of the OECD countries to be yet another example of what Chang has described as

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the wealthy countries 'Kicking Away the Ladder', which they themselves had climbed to achieve economic success.

On one analysis, the threats perceived by the member states of the OECD arising from uncontrolled globalisation, the political response of OECD member states in the form of threats of coordinated 'defensive measures' made to small and developing countries which were beginning to compete with the OECD, and the resistance of small and developing countries to the unilateral nature of the OECD's exercise, created the potential for confrontation. It also created a set of circumstances, which according to Franck's theory of fairness discourse, made possible a rapprochement, and a foundation for a regime not based exclusively on power differentials.

6.1.2 Procedural Fairness and Substantive Fairness in Phase 2

As noted in Chapter 4, Franck postulated that fairness, in the context of the actions of international institutions, has two components which he described as 'procedural fairness' and 'substantive fairness'. Perhaps inevitably, the issues of procedural fairness most likely to be highlighted in discourse between countries

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663 OECD (n 647), 40.
are those seen as having the potential to affect substantive fairness. Phase 2 of the HTC Initiative is no exception in this regard.

The early stage of Phase 2 saw the activation within the HTC Initiative of four committees, styled as 'Study Groups', each chaired by representatives of one of the more geo-politically powerful OECD member states. Each of the targeted non-OECD countries was allocated to a Study Group chaired by an OECD member which viewed the particular targeted country as being within the geographic or economic limits of its 'garde-chasse'. The procedures of the 'Study Groups' were less than fully transparent and according to at least one commentator, inquisitorial. Each Study Group's task was ostensibly to gather 'evidence' based on the criteria in the HTC Report, but their initial filter for choosing countries as potential targets arguably involved purely subjective tests.

The Study Groups were charged with writing country specific reports setting out whether each intended target country could be categorised as a 'tax haven' according to the 1998 Report criteria. As was discussed in Chapter 5, the evidence suggests that the Study Groups also assessed whether it would be prudent to do so taking into consideration the geopolitical strengths and weaknesses of the

665 OECD (648), 10.
666 R Saunders, 'The OECD'S 'Harmful Tax Competition' Scheme: The Implications For Antigua and Barbuda' presented at the Luncheon Meeting of the Antigua and Barbuda Chamber of Commerce and Industry on Tuesday, 27th March 2001.
667 OECD (n 647), paragraph 51.
intended target. On the basis of these criteria, the 'Study Groups' were required to provide an opinion on whether each of the potential targets ought to subjected to the public threat of sanctions in the context of the OECD's 2000 Towards Global Tax Cooperation Report.\footnote{OECD (n 648). R Woodward, 'Offshore Strategies in Global Political Economy: Small Islands and the Case of the EU and OECD Harmful Tax Competition Initiatives' (2006) 19 Cambridge Review of International Affairs 4 685 - 699, 689. Woodward describes the process in the following terms: 'Between July 1999 and April 2000 representatives from 41 jurisdictions, including 33 small island jurisdictions, were arraigned before the Global Forum for perpetuating harmful fiscal regimes.'}

In what may be viewed as part of a classic 'suasion game', the Study Groups put the targeted countries on trial, initially in absentia and without publicity. The Study Groups did later afford targeted countries the opportunity to complete OECD prepared questionnaires and to make a submission to the Study Group charged with determining the fate of the relevant targeted country. Targeted countries were eventually given the opportunity to appear before the OECD's Forum on Harmful Tax Practices to show why the OECD should not label them as 'tax havens' and at least potentially, subject them to sanctions. This process was described by one observer as follows:
In an inquisition-type setting, representatives of these small jurisdictions were arrayed before senior Treasury officials of the OECD countries and presented with an OECD researched report describing their territory as 'tax havens'. Dwarves before giants - and unsympathetic giants at that - the arguments of these small jurisdictions fell on deaf ears.669

The dynamic created by political representatives from the small and developing countries being summoned to defend their countries before a group of un-elected bureaucrats from more powerful states gathered in their Paris 'club house' arguably was not conducive to any perception of procedural fairness.670

Forty-seven small and developing countries were initially selected for interrogation by the OECD Study Groups,671 six of these countries were identified during the Study Group process as unsuitable for the targeting process whether by virtue of holding important positions in various international and regional organisations, or otherwise. The OECD Forum on Harmful Tax Practices was instructed to obtain from the remaining forty-one targeted countries, unconditional 'political level commitments' to the removal of specified competitive features of their financial services and taxation regimes which were viewed as potentially challenging to the interests of the OECD member states.672 Sufficient justification

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for OECD activities was attributed to endorsement of the process provided by the OECD Council of Ministers and the G7. Their principal tool in the suasion game was the threat of collective defensive measures, that is, sanctions.  

Six of the 41 countries ultimately selected by the Study Groups, all of which had relatively advanced financial services sectors which were relatively well integrated into the global financial infrastructure, agreed to work with the OECD prior to the June 2000 deadline. Two of these countries, Cyprus and Malta, were on-track to become Member States of the European Union. Arguably, all six countries did not see the restrictions on their competitive positions demanded by the OECD as critical to the development of their financial services sectors, particularly given that the United Kingdom had signalled several months earlier that OECD countries would also be expected to implement the same proposed restrictions that were being required of the targeted countries.  

As a result, these six countries avoided the ‘stick’ of being included in the list of ‘tax havens’ published by the OECD in 2000. Instead, they were offered the ‘carrot’ of being invited to participate in the development of standards for the exchange of tax

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673 OECD (648).
674 The six were: Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino.
information between OECD member states and the targeted jurisdictions. This 'benefit' for cooperation is also consistent with a power based suasion game.

6.2 THE FOUNDATIONS OF FAIRNESS DISCOURSE

Franck postulated that fairness discourse is most likely to develop and be productive when, "the allocation of rights and duties of nations occurs in circumstances which make allocation both necessary and possible." It is arguable that the reactions of non-OECD countries during Phase 2 of the HTC Initiative, gave rise to such conditions.

Conditions of moderate scarcity and a sense of community are also identified in Franck's construct as conducive to productive fairness discourse. Globalisation, arguably supplied these pre-requisites to both the OECD member states and the countries targeted by the OECD. The apprehension of moderate scarcity in relation to the potential erosion or loss of future tax bases on the part of the OECD member countries, arguably fulfilled this criterion for one side of the dialogue. The reality of existing moderate scarcity of economic resources in the small and developing countries targeted by the OECD, aggravated by the OECD's

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676 OECD (648), 29.
677 Franck (n 664), 9.
678 OECD (648), 16.
threats of sanctions which could have worsened their positions, perversely may have fulfilled the criterion for the other side.

A shared realisation that globalisation was in one sense creating a global community which offered both opportunities and risks for all countries, arguably supplied another of Franck's criteria, a sense of community, albeit one with competing interests. On one analysis therefore, the perceptions and facts surrounding the HTC Initiative satisfied each of the pre-conditions for productive fairness dialogue identified by Franck.

The satisfaction of Franck's necessary preconditions arguably was not sufficient in and of itself to bring about the spontaneous development of fairness dialogue in the context of the HTC Initiative however. The OECD member states had interposed the institution of the OECD between themselves and the countries which they were targeting, arguably for the purpose of limiting political risks, but possibly only for purposes of administrative convenience.

During the early phases of the Initiative, the institution of the OECD sought to isolate individual countries which were targeted, rather than conducting any multi-lateral dialogue. The form of submission sought by the OECD typically took the form of a signed 'Letter of Commitment' executed by the governments of
Attempts by the small and developing countries targeted by the OECD to initiate dialogue with individual OECD member states concerning the assumptions and biases of the HTC Initiative were deflected and referred to the institution of the OECD. Officials in the OECD in turn refused to discuss anything to do with the premises or fairness of the HTC Initiative by indicating that they were not authorised to speak on behalf of the member states, but were merely instructed to obtain the submission of the small and developing countries targeted. These obstacles arguably inhibited any opportunity for meaningful dialogue. An additional factor, one outside of Franck’s construct was therefore necessary if dialogue was to occur in anything like a timely manner. That additional factor was a catalyst.

6.5.1 The Commonwealth as Catalyst

The catalyst identified by the targeted small and developing countries was the Commonwealth, an international organisation with a long tradition of mediation and the provision of assistance to its smaller and less developed

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679 Cayman Islands (n 672); Isle of Man (n 672); Jersey (n 672). The commitments sought were initially not looked on favourably because of what was perceived as their one sided nature and the absence of a 'level playing field' L Mitchell, 'Reviewing the OECD Harmful Tax Initiative: The St. Vincent and the Grenadines Perspective' (2005) Government of St. Vincent and the Grenadines

members. As an organisation representing more than 50 countries, and representing approximately one third of the world’s population, including both OECD member states and many of the small and developing countries targeted, the Commonwealth was ideally placed to facilitate dialogue between these two groups of countries.

In terms of regime theory, the Commonwealth arguably was both a shield in terms of the pressures applied by the OECD, and a ‘suasion’ instrument in itself, in that the interposition of the Commonwealth potentially deflected the ‘top-down’ meta-regime for the imposition of tax competition rules sought by the OECD. The invocation of the Commonwealth as an international institution with long standing norms for inter-governmental relationships, and arguably with its own more democratic protocols for regime formation, arguably influenced the OECD’s approach to regime formation over time.

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In terms of fairness discourse, the catalytic potential of the Commonwealth arguably arose from the fact that the Commonwealth constituted a third and overlapping community with its own ongoing communications in a number of areas of international relations. In response to calls from targeted Commonwealth countries; 'The 1999 Commonwealth Heads of Government meeting affirmed the right of member countries to compete in the international financial markets, through the provision of both onshore and offshore financial services.' 683 Saunders notes that in February 2000 at a Commonwealth organized conference devoted to the Development Agenda for Small States;

[T]he targeted jurisdictions confronted the OECD for the first time in a multilateral forum. In the course of the meeting, Frances Horner the Head of the harmful tax practices unit in the Organisation, admitted that the conference’s focus on the problems of small states “had been a learning experience”. She said that the OECD recognised that its approach to implementing the HTCI may have been flawed and expressed an interest in a more consultative approach. 684

In May 2000, a ‘[M]eeting of Law Ministers and Attorney Generals of Small Commonwealth Jurisdictions critically discussed the ongoing work of the OECD Forum on Harmful Tax Competition.’ 685 According to an observer at the Law Ministers meeting:

The Law Ministers and Attorney-Generals requested the Commonwealth Secretariat to facilitate the expression of their concerns. A meeting is to be convened to enable small interested jurisdictions to discuss these issues further with a view to

683 Commonwealth (n 680), Paragraph 43.
684 Saunders (n 669), 16.
ensuring their concerns be recorded in the Secretariat's report to Commonwealth Finance Ministers in September 2000. A statement was also issued in order to bring concerns to the attention of the Commonwealth Finance Ministers and Heads of Government.686

It may be seen from the extract above that behind the scenes, the targeted small and developing countries were beginning to organise themselves to challenge the legitimacy of the HTC Initiative.

6.3 FAIRNESS AND THE HTC INITIATIVE'S METRIC OF LEGITIMACY

Buchanan and Keohane have noted that:

Legitimacy has both a normative and a sociological meaning. To say that an institution is legitimate in the normative sense is to assert that it has the right to rule—where ruling includes promulgating rules and attempting to secure compliance with them by attaching costs to noncompliance and/or benefits to compliance. An institution is legitimate in the sociological sense when it is widely believed to have the right to rule. 687

As noted in the preceding sections, the legitimacy of the HTC Initiative in the sense of the right of the OECD to promulgate what were widely perceived as self-serving rules with inherent double standards, was widely challenged, at least

outside of the OECD membership. The OECD’s 2000 follow-up report sought to address some of these challenges.\(^688\)

In response to criticism of the apparent double standards employed in identifying only small and developing competitors of the OECD member states as ‘tax havens’ in the HTC Report,\(^689\) the 2000 Report contained a substantial amendment to the criteria published in the 1998 HTC Report. This additional element to be used in identifying whether a country would be targeted as a ‘tax haven’ appears to have been introduced in an effort to justify the exclusion of more geo-politically influential non-OECD financial services centres from the ‘tax haven’ list:

> Whether a jurisdiction meets the tax haven criteria is determined based upon all the facts and circumstances, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.\(^690\)

Rather than conveying legitimacy, this added criterion arguably gave credence to concerns of bias in the HTC Initiative. Essentially, small countries were to be targeted because they were small and engaged in the international financial services sector. Large countries, and most particularly the OECD member countries, tend to have well diversified economies. Further, even though the OECD

\(^{688}\) OECD (n 647).

\(^{689}\) Mitchell (n 679), 4. Mitchell notes that these concerns were being raised in communications between the OECD and targeted countries by October 1999.

\(^{690}\) OECD (n 648), 10.
member states accounted for some eighty percent of global financial services provided to non-residents, the financial services sectors of the OECD member countries made up a smaller portion of their overall economies than would have been the case with smaller and developing countries with less diversified economies. This was the case even though the number of financial services provided to non-residents far exceeded the number going through any of the listed 'tax havens'.

Biswas has noted International Monetary Fund figures which showed that just three OECD member states, the United States, the United Kingdom and Japan, provided as many 'offshore' financial services as all of the so-called 'tax havens' plus all other non-OECD countries combined. It was also the case that although the financial services sectors of the OECD member states may have been a relatively smaller proportion of their respective economies, these sectors constituted a correspondingly more important part of the economies of the targeted small and developing countries which uniformly have fewer development

692 E Balls, ' The City as the global finance centre: risks & opportunities' Speech by Economic Secretary to the Treasury, Ed Balls MP' (2006) HM Treasury <http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2006/press_42_06.cfm> accessed 10 October 2007; G Brown, 'The right way to help the City thrive ' Financial Times (London 18 October 2006). UK ministers are not averse to bragging about the large relative size of the UK's financial services sector, in comparison with both the UK economy as a whole and in relation to other countries.
options. Arguably, some of the success of the OECD states' ‘offshore’ financial services sectors may be attributed to elements which are not taxed or otherwise receive preferential treatment.

The ‘untaxed’ criterion arguably was also questionable as an objective metric. A large part of the global offshore financial services sector which is located in OECD member states does not involve the taxation of non-resident clients. OECD countries such as the United Kingdom see the relatively large size of their financial services sectors compared to other countries as a metric of their success rather than as evidence that the UK is a ‘tax haven’ as others assert. Further, the OECD’s ‘significant financial services sector’ criterion appeared to operate in a biased fashion in the sense that it could be used by the OECD to put small countries onto the targeted list, but not to take them off. The Kingdom of Tonga and the Republic of the Maldives, by way of examples, two tiny countries targeted by the OECD, had no operational offshore financial services sectors yet were listed as ‘tax havens’. In contrast, the OECD’s analysis somehow overlooked the fact that by way of example, an analysis of the financial services sector of its smallest

694 Biswas (n 676), 108-112.
695 Balls (n 677), Brown (n 677). Non-resident bank deposits are not taxed and other concessions such as the Investment Management Exemption are designed to give tax related inducements for the financial services sector in the UK (Section 126 of the Finance Act 1995).
698 OECD (n 648), 17. The OECD later accepted that neither of the countries were ‘tax havens’

278
member, which by agreement among OECD member states was not labelled as a ‘tax haven’, indicated the following:

The banking industry has been the largest contributor to this success. Luxembourg’s 197 banks now employ 12.6% of the domestic working population in Luxembourg (an increase over last year), compared with the 2001 EU bank employment of under 2%. The banking balance sheet in Luxembourg rose 8.9% in 2001. Luxembourg’s investment fund sector is now considered Europe’s largest, managing assets of over 940 billion euro as of June 2002.699

A neo-realist assessment of the criteria established by the OECD for identifying ‘tax havens’, including the criterion based on the relative size of the financial services sector relative to the size of the domestic economy, arguably would suggest that those countries in which the financial services sector made up a large proportion of the total economy were more sensitive to the OECD’s ‘suasion’ tactics than others which were not. As noted by Drezner:

Sensitivity refers to the immediate costs that occur with the disruption of established patterns of economic exchange. Vulnerability refers to the costs that remain after a state has tried to adjust to the disruption of trade. In an open global economy, both great powers and less powerful states build up significant levels of sensitivity. However, because of their internal markets and diversified set of endowments, great powers possess significantly lower levels of vulnerability than other states in a globalized world. They have “go-it-alone” power.700

Apart from issues of fairness, objectivity and geo-politics, it arguably would have been futile, given Drezner’s construct for the OECD to target the Chinese

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territories of Hong Kong and Macao as 'tax havens' in 1998, although these jurisdictions were politely asked to join the dialogue as 'invitees' of the OECD Global Forum rather than 'tax havens' in 2005. 701

While the analysis set out above may appear somewhat cynical, it is not unique. Even those who had leadership roles in the OECD's activities at the relevant time found the process somewhat questionable, at least in retrospect. Frances Horner, a senior OECD official with responsibility for the HTC Initiative from 1998 to 2000 has subsequently observed that:

The OECD has evolved to become, principally, a policy forum to discuss, agree on, and promote the interests of the rich countries....The OECD likes to claim that it develops the "rules of the game," but unfortunately not all the players are at the table. 702

6.4 FAIRNESS, SUASION GAMES AND THE THREAT OF SANCTIONS

Phase 2 of the HTC Initiative also involved the 'fleshing out' of the 'collective defensive measures' or sanctions, which the OECD member states threatened to

use against any small or developing country which did not agree to the terms specified by the OECD. These sanctions arguably sought to achieve two purposes. Firstly, they may be seen as elements within a ‘suasion game’ designed to intimidate the targeted countries into submission. Secondly, they may be seen as designed to send a message to the global financial services industry to the effect that doing business in or through the targeted countries was relatively unsafe, at least in comparison with doing business in OECD states. Further, such signals arguably provide a potential up front ‘pay-off’ for powerful countries seeking to distort trade by decreasing the commercial certainty of transactions involving the targeted countries. Potential sanctions by dominant players have this potential to distort from the moment they are announced. In that sense, and in the absence of any evidence of harm to OECD economies, the announcement of intended sanctions was highly pre-emptive and arguably inconsistent with existing international obligations.

A number of writers have questioned the legality of the threat of sanctions made in the context of the HTC Initiative, particularly as among members of the

703 OECD (n 648) , 25.
704 Ring (n 681) ,21.
706 D Simmons, 'Some Legal Issues Arising out of the OECD Reports on Harmful Tax Competition' in R Biswas (ed) International Tax Competition Globalisation and Fiscal Sovereignty (Commonwealth Secretariat London 2002) ; W Gilmore, 'Towards an Understanding of the International Legal Context' in R Biswas (ed) International Tax Competition: Globalisation and Fiscal Sovereignty (Commonwealth Secretariat London 2002), 317. Professor Gilmore suggests that through the UN General Assembly, an Advisory Opinion on the issue of the threat by the OECD of ‘coordinated defensive measures’ could have been obtained from the International Court of Justice.

281
World Trade Organisation. While it is outside the scope of the present work to delve into the obligations of WTO members per se, it is at least arguable that the use of such threats in the context of the OECD's attempts at regime formation in relation to tax competition, did not come up to the standard of procedural fairness in the sense that this term is used by Franck, or the highest standards which might be expected of WTO members.

6.5 EXCHANGE OF INFORMATION AND THE UN-LEVEL PLAYING FIELD

The OECD's requirement for exchange of tax information also became more defined during Phase 2 of the HTC Initiative. The OECD recognised that the exchange of information practices which were permitted among the member states of the OECD were exceedingly varied, ranging from a relatively free flow of tax information among some of the Nordic members of the OECD, to very limited information provision by others including Switzerland. Given that the OECD did not intend for the exchange of information practices which were then applied as

708 Franck (n 664), 7.
between OECD members to set a standard for the access of OECD member states to information held in the small and developing non-OECD countries targeted by the OECD, \(^{711}\) a new and more detailed set of standards was required.

The OECD’s then existing models for exchange of information were meant to be applied within the framework of comprehensive taxation agreements rather than in stand alone documents. In the absence of an intention to allow the targeted countries to be able to compete on treaty terms comparable to those offered to geo-politically significant countries, \(^{712}\) a modified form of tax treaty or a new stand alone model tax information exchange agreement arguably was required. From a regime theory perspective the existence of double standards in relation to cancelling tax treaties with targeted countries while not punishing OECD member states or other geo-politically powerful states irrespective of their compliance with the proposed regime for tax information exchange is consistent with a strong neo-realist element in the HTC Initiative. \(^{713}\)

The OECD offered the six small and developing countries which had provided advance commitments to cooperate with the HTC Initiative, \(^{714}\) the option

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711 None of the exchange of tax information practices of the OECD member states were identified in the HTC Report as ineffective despite the fact that some of these member states had significant restrictions in relation to exchange of tax information.

712 *OECD* (n 647) Paragraph 128.

713 *Keohane* (n 705). Keohane suggests that those states necessary to maintain a proposed regime should not be punished but should be rewarded.

714 Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino.
of participating with OECD member states and representatives of the OECD Secretariat in the drafting of a new tax information exchange model agreement which would establish standards for exchange of information.\textsuperscript{715} Targeted countries which agreed to cooperate with the OECD subsequent to the publication of the list of ‘tax havens’ in June 2000 and before the new model was completed, were also permitted to join the drafting process then in progress.\textsuperscript{716}

The carrot offered by the OECD to the targeted countries, might be seen as the opportunity to help shape one of the sticks which was intended to be used on them. An alternate view is that noted by Rawlings:

As one regulator from an OECD country remarked in an interview with the author in Paris in February 2004:

At least once a year governments of places where you’d normally think ‘where is that?’ basically get to sit down with the large economies and discuss issues that are relevant including tax legislation. At least they get the attention of people they normally wouldn’t get the attention of. This has two advantages for them. For one they are at the table with the largest, most developed countries. Second, they are inside the process and they can influence it.\textsuperscript{717}

From a regime theory perspective the approach adopted for the countries which agreed to commit is consistent with a change from a suasion game to a

\textsuperscript{715} OECD (n 648), 20.
\textsuperscript{716} OECD (n 649), 2.
coordination process. Coordination arguably introduced an element of a ‘prisoner’s dilemma’ game into the relationship between the powerful OECD member states and the less powerful targets, although there were very different defection options and consequences. OECD member states could defect and grant exemption with relative impunity.

6.5.1 Timing of Implementation and the Un-Level Playing Field

Thirty-five small and developing countries were ultimately listed in the June 2000 OECD Report as ‘tax havens’. These countries were given twelve months to provide an unconditional ‘commitment’ to follow the wishes and directions of the OECD Forum. Unsurprisingly, no OECD member states or geo-politically influential countries were listed despite substantial and readily available evidence that on any objective basis, nothing material distinguished the named countries from some member states of the OECD, other than geo-politics.

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718 Ring (n 681), 21.
719 The US changed its position in 2001 and in 2003 exemption from the agreed exchange of information standards was granted by EU members of the OECD to a number of states including Luxembourg, Switzerland and Austria.
720 OECD (n 648), 17.
721 ibid.
722 Discussed in Chapter 5 of this work.
The twelve month timetable for targeted non-OECD countries was significant, particularly given that OECD member states gave themselves 5 to 7 years to remove features of their own tax regimes that they ultimately agreed by consensus to change.\textsuperscript{723} As noted by Keohane, deferring costs to the cooperating members of international institutions relative to the timing of costs imposed on outsiders is consistent with maintaining cooperation among relatively powerful states.\textsuperscript{724} In one sense therefore, Keohane's analysis would suggest that unfairness to non-members in terms of the timing of costs may be an essential element in maintaining cohesion among OECD member states in contentious subject areas such as taxation. It is also consistent with a neo-realist view of regime formation in which the powerful seek to enhance their relative advantages.

The commitments of the targeted countries on their face required a significant cession of sovereignty in relation to tax policy to an unelected multilateral body staffed by employees with allegiances to foreign governments. The required commitments may be seen as not only containing an obligation to bow to the competition conditions specified in the HTC Report, but also to allow the ongoing oversight and veto of the OECD in relation to the terms of future competition in the financial services sector. However, the commitments obtained by the OECD from the targeted countries were interpreted by those countries as

\textsuperscript{723} OECD (n 647), 56. It is noted that as of September 2006 the status of most but not all of the measures identified within OECD member states had been agreed to the satisfaction of all member states. OECD 'The OECD'S Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries' (2006) OECD <http://www.oecd.org/dataoecd/1/17/37446434.pdf>, 3-6 accessed 17 March 2007.

\textsuperscript{724} Keohane (n 705).
being subject to ‘level-playing field’ conditions.\textsuperscript{725} Ultimately, the OECD confirmed its commitment to a level playing field which included non-OECD countries.\textsuperscript{726}

\section*{6.6 Phase 3 of the OECD Harmful Tax Competition Initiative – June 2000 to April 2002}

The third phase of the HTC Initiative commenced immediately following the publication in June 2000 of the follow-up to the HTC Report entitled ‘Towards Global Tax Cooperation’,\textsuperscript{727} and lasted until the spring of 2002 at which point the OECD Model Agreement on the Exchange of Information in Tax Matters was published.\textsuperscript{728} This phase saw the evolution of multi-lateral dialogue among OECD member states and the small and developing countries targeted in the Initiative. It stands in contrast to earlier phases which involved primarily bilateral interactions characterised by confrontations between representatives of the OECD bureaucracy and representatives of individual targeted countries over whether and how the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{725} While the ‘level playing field’ commitments were not explicit in the commitments published in 2000, the targeted countries asserted entitlement to the ‘level playing field’ references incorporated into the 1998 HTC Report. By the end of 2000, the ‘level playing field’ requirement had become explicit in commitments given by targeted countries.\textit{Isle of Man} (n 672).
\item \textsuperscript{726} \textit{Isle of Man} (n 672); OECD ‘Closing Statement by Co-Chairs’ (2003) OECD <http://www.oecd.org/document/0,2340,en_2649_33745_16643264_1_1_1_1,00.html> accessed 29 November 2006.
\item \textsuperscript{727} OECD (n 648).
\item \textsuperscript{728} OECD (n 649).
\end{itemize}
\end{footnotesize}
small and developing countries were going to comply with the demands of the OECD. 729

Throughout Phase 3, the prospect of controlling competition for financial services from outside the OECD, and of limiting the terms of competition to those favoured by, (and at least potentially favouring), the OECD member states remained a strong focus for the OECD. As was noted in the 2000 Report:

Some non-member economies feature strongly in the global financial marketplace, with possibly major distortions being caused by the harmful tax practices they have put in place. There is a significant risk that a failure to address these practices in parallel with the work in relation to Member countries will cause a shift of the targeted activities to economies outside the OECD area, giving them an unwarranted competitive advantage and limiting the effectiveness of the whole exercise. 730

The risk envisaged was a shift in activities to jurisdictions outside of the OECD, rather than a risk that distortions created by the OECD member states might result in global inefficiencies. There is no indication as to anything, other than self-interest, that made the competitive advantages of the OECD member states ‘warranted’ in comparison with the ‘unwarranted’ ones of non-members. It is also significant that the 2000 Report notes the need to address the activities in non-member economies ‘in parallel’ with the OECD’s work in relation to Member countries, however the 2000 Report provides no explicit justification for the fact

that the time allowed for member states to assess and correct ‘potentially harmful practices’ was far longer than allowed for the countries targeted as ‘tax havens’. 731

6.6.1 Fairness Discourse and the Role of the Commonwealth in Phase 3

It is arguable that the methods employed by the OECD in the HTC Initiative prior to 2001 were inconsistent with the high standards of Commonwealth community membership. In that sense, what may be viewed as the meta-regime for setting rules for tax competition which the OECD sought to establish, 732 came into conflict with an existing and arguably quite powerful international institution in the form of the working relationships and principles within the Commonwealth.

By the fall of 2000, there was also growing recognition outside of the OECD of the double standards and self-serving features within the HTC Initiative, features which arguably detracted from the OECD’s harmful tax competition policy narrative. The OECD, having limited prior experience of serious opposition to its pronouncements on international tax policy and smarting from accusations of

731 OECD (n 648) Paragraphs 4 and 15 for member states. The obligations of targeted countries are set out in relevant commitment letters. The commitment timetable for the Isle of Man commitments provides an example. *Isle of Man* (n 672).
bullying and unfairness, reacted with denial and protestation.\textsuperscript{733} In a sense, this arguably demonstrates a linkage between the perception of fairness and regime formation in relation to taxation. Perceived breaches of procedural fairness or substantive fairness create obstacles to broad regime formation. Similarly, it is arguable that even if power relationships force acceptance of a regime perceived as unfair, the regime is less likely to be stable over time.

In September 2000, Commonwealth Finance Ministers meeting in Malta, were called upon to consider the HTC Initiative and its effects on the targeted Commonwealth members which made up more than three quarters of the thirty-five countries targeted as ‘tax havens’ by the OECD.\textsuperscript{734} Politics being what they are, in a forum in which 49 Commonwealth members are not OECD member states, the four Commonwealth members of the OECD agreed that the Commonwealth Secretariat could intervene to initiate the multilateral dialogue sought by the targeted countries. According to a January 2001 Commonwealth press release:

\begin{quote}
At the Malta FMM, Ministers mandated the Commonwealth Secretariat to facilitate high-level multilateral dialogue on harmful tax competition....in
\end{quote}

\textsuperscript{732} The meta-regime referred to would be one in which OECD member states decided the rules and the penalties for breach of such rules in non-transparent processes and without consideration of inter-nation equity.
\textsuperscript{734} Saunders (n 669), 35.
order to establish a co-operative global framework for negotiations on these matters.\textsuperscript{735}

Owen Arthur, the Prime Minister of Barbados, playing a leadership role among the targeted Commonwealth countries,\textsuperscript{736} offered that Barbados would host the first meeting on the HTC Initiative to which all OECD and targeted countries would be invited.

Persaud notes that shortly after the release of the 2000 Report, and in parallel with the involvement of the Commonwealth or perhaps because of it, the French Minister of Finance, 'launched a global dialogue on harmful tax practices bringing together the 30 members of the OECD with 30 other countries to discuss how to develop a global response to harmful tax practices.'\textsuperscript{737} This may be seen as a 'one off' effort to develop political support for the OECD exercise among countries previously not involved as part of regime dissemination.

6.6.2 Fairness within the HTC Initiative and Shifts in US Policy

In November 2000 a new President with a different perspective on tax competition, was elected in the United States. In addition, the association of the U.S. with ‘unfair’ practices was also something that at least some within the US Congress found increasingly uncomfortable. 738

Woodward notes that the European member states of the OECD were informed shortly after the change in administration that the new US administration would require substantive changes to the HTCI. 739 Saunders has further noted that:

While there was pressure on the four large Commonwealth countries that were also OECD members from the Commonwealth targeted jurisdictions, the OECD hoped to secure agreement for the HTCI at the Barbados meeting. The OECD was keenly aware that representatives of the Republican Party had spoken out against the HTCI in US Presidential elections in November ....and [the election of President Bush] would mean the end of the strong Democratic administration support which the HTCI had enjoyed. 740

The change in US position associated with a change of government demonstrates that the factors shaping international regimes exist on both

740 Saunders (n 699), 17. Words within the square brackets are added to show the context.
international and national dimensions. In terms of international regime theory, both neo-realist and game theory perspectives arguably would suggest that such a change would require reassessment and possible reformulation of approaches to regime formation within the HTC Initiative.

6.7 THE BARBADOS DIALOGUE – FAIRNESS AND REGIME PROMOTION

In his opening address at the 8 January 2001 Barbados meeting of Commonwealth and OECD members, Jeffrey Owens, Head Fiscal Affairs of the OECD, re-formulated the OECD’s HTC policy narrative, arguably in an effort to take the focus away from the OECD’s competitive objectives:

The work of the OECD on harmful tax practices is concerned primarily with effective exchange of information and transparency for tax purposes on a global level so that tax administrations can prevent and detect violations of the civil and criminal tax laws. The project also seeks to ensure fairness by asking that countries do not “ring-fence” tax regimes since ring-fencing enables one country to benefit at the expense of other countries. The project is initially limited to geographically mobile activities, particularly in the area of financial services.

OECD countries welcome competition which is fair, i.e., competition which is transparent, non-discriminatory and by jurisdictions which are prepared to co-operate to counter abuse.

There may have been some justification in 1998 for this criticism [aimed at the lack of consultation] but I feel that since then we have made a major

effort to improve the process of consultation by having extensive bi-lateral and multi-lateral dialogues.\textsuperscript{744}

Owens arguably was not advocating any broad form of non-discrimination in the HTC Initiative, but rather only a very limited form of non-discrimination. Specifically, Owens’ reference to the OECD’s requirement for non-discrimination referred only to the presence of certain non-banking related ‘ring-fenced’ taxation regimes among non-OECD countries. It is also worthy of note that even this limited form of non-discrimination was subsequently dropped from the HTC Initiative in May 2001 as a result of the intervention of the incoming Republican administration in the United States.\textsuperscript{745}

The OECD’s exclusion of their own ‘ring-fenced’ regimes regarding such things as the taxation of bank deposits owned by non-residents,\textsuperscript{746} called into question the OECD’s claims that ‘ring-fencing’ by non-OECD countries was somehow harmful.\textsuperscript{747} Further, while Owens acknowledged that the HTC Initiative was limited in its scope, there was no acknowledgement that distortions in the international allocation of goods and services created by preferential regimes

\textsuperscript{743} Owens (n 742), 3.
\textsuperscript{744} ibid.
\textsuperscript{746} Owens (n 696).
\textsuperscript{747} OECD (n 647), paragraph 26.
operated by the OECD countries outside of the scope of the HTC Initiative, might undermine inter-nation equity on a global basis.

The Deputy Secretary General of the OECD Seiichi Kondo who also spoke at the Barbados meeting added his backing to the OECD’s revised harmful tax competition policy narrative:

Our task over the next two days is to engage in a genuinely constructive dialogue on what is, we know, a politically sensitive issue – that of how to ensure fair competition between different national tax regimes in a globalized economy.748

Until there is universal agreement on the vital importance of transparency and openness for effective and fair competition, world financial markets will be subject to tax-induced distortions, which are harmful to competition and result in an unfair distribution of tax burdens domestically.749

Deputy-Secretary General Kondo was explicit that it was not the fairness of the global or inter-nation distribution of tax resources and burdens that was the focus of OECD concerns regarding tax competition, but rather the fairness of the domestic distribution of tax burdens within countries with residence-based taxation systems. While the OECD complained about the potential effects of competition for capital on their tax bases, the non-OECD countries targeted by the OECD used essentially the same language in relation to the effects of OECD tax regimes on

748 S Kondo, 'Opening Remarks of Seiichi Kondo, Deputy Secretary General of the OECD at the High Level Consultations on the OECD’s Harmful Tax Competition Initiative, Barbados' (8 January 2001) OECD, 1.
749 ibid, 4.
their economies, and what they perceived as the unfair ongoing treatment which they were receiving at the hands of the OECD member countries. 750

The reference to effective exchange of tax information by Deputy Secretary-General Kondo may be understood in the context that what the OECD wanted in practice, was access to information without having to enter into tax treaties with the small and developing countries with which they were competing in the financial services sector. Many, if not all, of the small and developing countries targeted arguably would have been very willing to enter into what they viewed as fair tax treaties which contained exchange of information provisions with any and all OECD member states. 751 A number of the OECD member states had refused to enter into, or had terminated, tax treaties containing exchange of information with many of the targeted small and developing countries gathered in Barbados. 752 These factors apparently escaped the OECD’s concept of ‘unfairness’.

750 Simmons (n 691).
6.7.1 Shared Understanding in Relation to Fairness and Regime Formation

The exchanges which took place within the context of the 2001 Barbados meeting were illustrative of the challenges to taxation related regime formation in the absence of a shared perception of procedural and substantive fairness. The tendency of each country to view fairness narrowly in terms of actual or potential detriment to its current situation or its aspirations for a future situation, and the use of very similar phrasing in competing and contradictory claims of unfair behaviour on the part of other countries, also exemplify challenges noted by Franck in relation to fairness discourse.\textsuperscript{753}

In order for fairness discourse to have utility, there needs to be some level of common understanding of matters to be discussed and how fairness is to be assessed. That however does not imply that “fairness” is too vague to have any utility in setting standards. Indeed, the recognition and concession by the OECD of the error in relation to the lack of procedural fairness in the early phases of the HTC Initiative arguably shows that such a standard, or at least the lack of


\textsuperscript{753} Franck (n 664), 14-24.
application of a such a standard, can be identified and agreed, albeit grudgingly.\textsuperscript{754}

As noted by Franck:

Fairness it is not ‘out there’ waiting to be discovered....... It is, instead, a human, subjective, contingent quality which merely captures in one word a process of discourse, reasoning and negotiation leading, if successful, to an agreed formula located at a conceptual intersection between various plausible formulas for allocation. Fairness discourse requires the reasoned pursuit of what John Rawls has identified as ‘the idea of an overlapping consensus’.\textsuperscript{755}

The objections of small and developing countries to the HTC Initiative voiced in Barbados arguably were based on both issues of procedural fairness, (biased standards and biased application), the lack of prior consultation, and the potential breach of international law in the form of threats of ‘unfriendly’ economic acts),\textsuperscript{756} as well as substantive unfairness. By way of example, the then Attorney General of Barbados took exception to the ‘naming and shaming’ approach of the OECD among other matters:

\textsuperscript{754} Owens (n 742), 3. This acknowledgement was reiterated subsequently by another OECD representative. G Makhoul, ‘Opening Statement By Gabriel Makhoul Chair of the Committee on Fiscal Affairs’\textsuperscript{1} (2002) OECD <http://www.oecd.org/dataoecd/16/15/1835746.pdf> accessed 10 October 2007.

\textsuperscript{755} Franck (n 664), 14.

\textsuperscript{756} Simmons (n 706).
The Government of Barbados does not accept that the OECD has any lawful authority to seek to cause any sovereign government to so order its taxation regime as to amount to an attempt to fetter the supremacy of that government’s parliament. 757

and;

(a) Is it legitimate, as a matter of public international law, that States within the OECD, should by the propaganda and threatened sanctions contained in the 1998 and 2000 Reports, seek to violate the absolute sovereignty of blacklisted States over their domestic fiscal affairs?
(b) Do the threats of sanctions and propaganda breach the principle of non-intervention?
(c) Have any States of the OECD considered that in threatening sanctions and giving bad publicity to countries, they may well be about to act in breach of international law? 758

His views contrast with those of Sharman who, in an essentially utilitarian assessment of the OECD’s use of non-objective ‘naming and shaming’ language and threats, offers support for the OECD’s tactics, if only in the sense that they had some short-term efficacy. 759

The Cayman Islands focused the presentation of its concerns regarding fairness, neutrality and inter-nation equity through a series of rhetorical questions including:

757 ibid, 1.
758 ibid, 4.
What assumptions define certain forms of tax related economic competition as “harmful” and other forms acceptable? The perception of some on the outside of the current processes is that the focus and scope of recent initiatives indicates that these initiatives are merely a means for large rich countries to preserve and project forward the existing global economic order at the expense of smaller less developed countries.

What is “fair” in terms of allowing for economic diversification in smaller states? The perception of some on the outside of the process has been that no economic diversification is to be tolerated if it potentially competes with the interests of large developed states.\(^\text{760}\)

It is worthy of note that while Franck focuses on substantive fairness in the sense of the equity of the outcome of a process under consideration,\(^\text{761}\) the vision of ‘fairness’ articulated by the non-OECD countries in Barbados arguably was less definitively ‘substantive’ than that required in Franck’s proposition. Specifically, the small and developing countries targeted by the OECD are not seen as asking for any guarantees as to the substantive fairness of any outcome in the HTC Initiative. Rather, they were asking for the opportunity to achieve distributional fairness through their own industry rather than as a hand out. They wanted the opportunity to compete on a “level playing field” with the OECD countries as well as their geo-politically influential non-OECD competitors such as Singapore which were not targeted in the HTC Initiative. In essence, the claim of the small and developing countries for the opportunity to compete on a ‘level

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\(^{761}\) Franck (n 664), 8-9.
playing field' appears to have substantially the same content as a claim for the opportunity to compete on the basis of competition neutrality.\footnote{K Vogel, Taxation of Cross-Border Income, Harmonization, and Tax Neutrality under European Community Law: An Institutional Approach (Kluwer Law and Taxation Publishers, Deventer 1994), 38.}

6.7.2 The Barbados Outcomes

The Barbados meeting concluded with an agreement to establish a Joint Working Group comprised of selected OECD and non-OECD countries which would consider how to resolve the issues identified in the Barbados meeting. From one perspective, this outcome arguably threatened the operative OECD policy narrative and the nascent HTC Initiative as it created the possibility for the introduction of alternative perspectives in a non-exclusive and relatively transparent space. It is therefore perhaps not surprising that the OECD’s post-meeting interpretation of the mandate of the Joint Working Group process limited its scope, and its probability of success, as follows:

The Working Group.....will focus its discussions on the remit provided to it in Barbados and, in particular, will attempt to find a mutually acceptable political process by which these principles (of transparency, non-discrimination and effective exchange of information) could be turned into commitments.\footnote{OECD, ‘OECD Press Release 13 February 2001 OECD – Commonwealth Working Group Continues its discussion on Harmful Tax Practices’ (2001) OECD <http://www.oecd.org/document/50/0,2340,en_2649_34625_2347634_1_l_l_1,00.html> accessed 8 October 2004.}
The perspective of the non-OECD participants was somewhat different, the contemporaneous Commonwealth press release noting that neither the limited scope of tax competition which the OECD was willing to discuss with non-OECD countries nor the OECD's requirement for ongoing control of the process were viewed as sacrosanct. Further, rather than the OECD's 'will attempt', the Commonwealth press release set a higher 'find' and 'replace' objective:

The Group's tasks are:

- To take the broad principles of transparency, non-discrimination and effective exchange of information and to find a mutually acceptable political process by which these principles could be turned into commitments. If successful, this process would replace the OECD's process in the context of its Memorandum of Understanding; \(^{764}\)

There was one additional feature of the Barbados meeting which also may have contributed to the development of dialogue. That feature was the presence of participants from third countries, specifically large Commonwealth countries which were neither OECD member states, nor among the countries targeted in the HTC Initiative. Put simply, the presence of witnesses and the presence of multiple targeted countries in the Barbados meeting changed the nature of dialogue, making coercion and the adoption of extreme non-objective positions untenable. Franck did not discuss the specific concept of objectivity in the characterisation of the issues or motivations of the potential participants in dialogue as a necessary component in fairness discourse. However, he did note that such discourse does require a reasoned pursuit of a consensus which would certainly be facilitated by
objectivity. From a regime theory perspective, a multilateral environment such as that in Barbados, arguably changed the limits of the suasion game by narrowing the range of what would be geopolitically acceptable to all those participating. As history unfolded however, it was arguably the growing perception of unfairness and resistance to the power political approach of the OECD together with the intervention of the Commonwealth which ultimately brought a somewhat reluctant OECD to the multilateral ‘table’.

6.8 THE JOINT WORKING GROUP PROCESS JANUARY 2001 – MAY 2001

The Joint Working Group established at the 2001 Barbados meeting was comprised of seven jurisdictions selected by the non-OECD countries present at the Barbados meeting, including Malaysia a non-targeted Commonwealth country, plus six OECD member states selected by the OECD membership. Both the OECD Secretariat and the Commonwealth Secretariat also participated as observers. The

765 Franck (n 664), 14.
767 Owens (n 651), 6. Owens indicated that the ‘name and shame’ tactics of the OECD were intended to get the targeted countries to the ‘table’. However, arguably it took the intervention of a large multilateral organisation to get the OECD member states to the table.
768 Commonwealth Secretariat (n 764).
relative balance in the numbers of the OECD and non-OECD countries and the
presence of a non-OECD state which was not targeted, as well as the presence of
the Commonwealth Secretariat as observers, were all aimed at introducing
elements of procedural fairness. The Joint Working Group met only twice, the first
time at the end of January 2001 at the headquarters of the Commonwealth in
London, and the second time in early March 2001 at the headquarters of the OECD
in Paris.

The OECD acknowledged that the JWG process was intended to identify
an acceptable political process, however it appears that for them, this meant
political compromise outside the OECD rather than within its membership. The
OECD member states sent technical representatives from various member states to
Barbados rather than political representatives, sending a signal that the political
policy narrative set out in the HTC Report was not open to change. In contrast to
this approach, the targeted non-OECD countries were led by the Prime Minister of
Barbados and other political leaders from the targeted countries supported by
technical experts. This asymmetry in representation made it unlikely that any
meaningful political compromise could be achieved as only one side had any
political decision makers present. It is doubtful that this was an oversight.

on Harmful Tax Practices' (2001) OECD
The concern within the OECD as an institution over the existence of the JWG dialogue, and the OECD's behind the scene manoeuvrings, bubbled into public view between the date of the first JWG meeting in January 2001 and the date of the second meeting in March 2001 as evidenced by a leaked OECD document, the existence of which was made public by the Commonwealth Secretary General. The Secretary General's very strong and public comments arguably revealed something of the OECD's approach to regime formation in this area:

I have seen what I believe is a minute of a meeting of the Fiscal Affairs Committee (FAC) of the OECD on the ongoing dialogue between that organisation and the Commonwealth.

If this is a true and accurate record, I am extremely disappointed. The non-OECD countries have been holding discussions in good faith with the OECD on what the OECD calls "harmful tax competition".

This minute clearly confirms the suspicion of many that the FAC not only writes the rules, but wishes to be the prosecutor, judge, jury and jailor. They are setting themselves up as the world's financial policeman....

In two meetings involving the OECD and Commonwealth non-OECD members - in Barbados in early January and London in late January - the discussions had been frank and constructive. The outcomes of these discussions are important to the Commonwealth developing countries which the OECD has threatened to list as "unco-operative tax havens". For these countries, the fabric of their economies and their societies is at stake, which is why so much time and effort has been put into these talks to enable the OECD to understand their concerns. But it now appears that the OECD may have a different agenda.

I can assure the OECD that the Commonwealth will not be "reined in" on this issue.

Our members are all committed to adhering to the highest standards of fiscal probity. This was made clear at the 2000 Commonwealth Finance
Ministers Meeting which requested regional and multilateral dialogue on the implications of the OECD proposals and mandated the Commonwealth Secretariat to facilitate this process.

Several of our member countries' offshore financial centres (OFCs) were set up at the urging of OECD member countries and now they are being criticised. These OFCs would readily accept assistance or advice, where necessary, to help regularise practices which might be seen to be inappropriate.

I am also concerned at attempts to denigrate Prime Minister Owen Arthur of Barbados. Prime Minister Arthur, the current Chairman of the Caribbean Community (CARICOM), co-chairs the Joint Working Group set up at Barbados and has invested, along with others, considerable effort to find consensus and has offered positive political concessions. This process was endorsed by Commonwealth finance ministers, so Prime Minister Arthur can indeed speak for the Commonwealth in this area.

This minute suggests that the FAC is determined to obstruct genuine political dialogue. It clearly has the potential to derail the negotiations which lie ahead. 771

Having light of this intensity shone on its practices was arguably inconsistent with the credibility of the 'club' process chosen by the OECD member states. As noted by Keohane and Nye, a self-serving 'club' process requires non-transparency. 772

The second meeting of the Joint Working Group on 2 March 2001 did not produce any resolution of the differences between the OECD and the targeted institutions.


772 Keohane (n 766).
countries. The targeted jurisdictions put forward a request for clarification of seventeen points designed to elicit a basis for dialogue, together with a proposal for what they viewed as an equitable agreement which provided for exchange of information linked to guarantees of neutrality in the manner in which OECD tax regimes were applied to them. While arguably the proposal if accepted would have gone some way to achieving fair competition, it was rejected by the OECD representatives.

6.9 THE INTERVENTION OF THE UNITED STATES

On 10 May 2001, following a meeting of the G7, the Treasury Secretary of the United States intervened in a very public manner to ensure that the OECD HTC Initiative would be re-focused and re-directed, and that dialogue rather than crude coercion would be used in addressing the concerns of both the OECD and the small and developing countries targeted in the HTC Initiative:

...Although the OECD has accomplished many great things over the years, I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any

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775 Saunders (n 669).
other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. 776

The US was not the only OECD country which was uncomfortable with the direction the HTC Initiative had taken. Saunders notes that by the spring of 2001, Canada, had also become concerned by the HTC Initiative. 777 Ultimately, the new direction of the HTC Initiative was brokered by the United Kingdom. 778

Thomas notes that following the US announcement of the refinement of its policy in relation to the HTC Initiative, there followed re-negotiation of the proposed harmful tax competition regime within the OECD:

After intense negotiations over the next 6 weeks, the United States won assurances that the measures would not target low tax rates (indeed, the phrase “tax competition” has disappeared from the official OECD descriptions of the project in favor of “harmful tax practices”); that the identifying criterion of “no substantial activity” in a tax haven would be effectively dropped; and that sanctions against havens could not come into effect earlier than they could be used against harmful tax practices in the OECD itself, that is, April 2003. 779

The intervention of the United States and the corresponding changes in the HTC Initiative, created a great deal of goodwill among the countries targeted by the OECD. As a result, a number of the targeted countries were able to successfully

776 O'Neill (n 745).
777 Saunders (n 669).
778 ibid.
conclude tax information exchange agreements with the US in the months following the May 2001 intervention.\footnote{OECD, '33 Jurisdictions Committed to Improving Transparency and Establishing Effective Exchange of Information in Tax Matters' (2003) OECD \textlangle}{http://www.oecd.org/document/19/0,2340,en_2649_201185_1903251_1_1_1_1_1,00.html\textrangle\ accessed 30 November 2006.}

\subsection*{6.10 The 2001 Revision of the HTC Initiative}


\begin{quote}
The OECD project does not seek to dictate to any country what its tax rate should be, or how its tax system should be structured. It seeks to encourage an environment in which free and fair tax competition can take place.\footnote{OECD (n 781), 4. Belgium and Portugal abstained from the 2001 Report. Switzerland and Luxembourg abstained from the 1998 HTC Report.}
\end{quote}

The OECD also used this document to clarify the changes which had occurred in the HTC Initiative as a result of the interventions of the Commonwealth and the United States, and to note that since the June 2000 publication of the 'tax haven' list, five of the thirty-five countries listed had provided commitments consistent with the revised criteria and an explicit requirement for a level playing field.\footnote{OECD (n 781), 9.}
However, an additional two of the thirty OECD member states had decided to abstain from the 2001 Report and the direction of the HTC Initiative, bringing the total number of OECD member countries which disagreed with the HTC Initiative to four.  

The miscalculation of the OECD in classifying Barbados as a jurisdiction without significant geo-political influence and therefore a safe target, was also about to be corrected. Apart from the fact that Barbados had tax treaties which provided for exchange of information with a number of OECD countries long before it was listed by the OECD as a 'tax haven', Prime Minister Arthur's leadership role in relation to the targeted countries and the publication by the Commonwealth of the OECD's criticism of him, arguably created a political problem for the OECD member states and therefore a problem for those managing the HTC Initiative. As the OECD's credibility arguably was viewed as relatively less valuable than other assets of the member states, at the end of January 2002, the OECD announced that contrary to their earlier findings, Barbados (which also had considerable success in early 2001 bringing the Black Caucus in the US Congress out in opposition to the HTC Initiative),  was not in fact a potentially 'uncooperative tax haven' after all.  

784 OECD (n 781), 4.  
785 Caucus (n 738).
It was perhaps hoped by the OECD that by removing Barbados from the group of targeted countries, and thereby removing the leadership which Barbados had offered to the other small and developing countries targeted by the OECD, that it might be easier to obtain the desired commitments from the remaining targeted states. In terms of regime theory, an analysis based on power relationships would suggest a premise to the effect that by means of a 'de-capitation', that is, the removal of a leader or dominant player in the targeted group, the remainder of the group would be more submissive to the process for regime formation favoured by the OECD. That was not to be the case.

By late 2001, the OECD had also made one other significant change to the commitments which were required.\(^787\) They agreed to permit commitments to be made explicitly, rather than implicitly, conditional upon the implementation of the required standards by OECD member states themselves. The commitments were also to be conditional on the more geopolitically powerful states not targeted by the OECD meeting the same exchange of information and transparency standards required of the targeted non-OECD countries.\(^788\)

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787 Isle of Man (n 672).

788 Jersey (n 672).
In essence, the OECD had agreed that exchange of information could be linked to at least one element of competition neutrality.\(^{789}\) As a result of the removal of the prohibition on ‘ring-fencing’ in the HTC Initiative in May 2001 following the US intervention, and the agreement of the OECD that the commitments which the OECD sought from targeted countries could be conditional on a ‘level playing field’, the vast majority of the remaining targeted countries withdrew their objections and provided commitments to implement the relevant standards.\(^{790}\) The dynamics of the response to the HTC Initiative by targeted countries also changed with many of those countries agreeing to cooperate in forming a new organisational structure to advance their collective needs in international arenas.

### 6.11 The Formation of the International Trade and Investment Organisation

The Commonwealth mediated JWG arguably allowed the targeted non-OECD countries to see the advantages of formal cooperation. Following meetings in March 2001,\(^{791}\) the targeted countries determined that there was a need for an ‘issue specific’ organisational and coordinating structure capable of representing

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789 Discussed in Chapter 4 of this work.
790 OECD (n 790).

their interests. As a result, the International Trade and Investment Organisation ("ITIO"), was born. While this organisation certainly did not have the resources of the OECD, it did provide an institutional basis for cooperation, coordination and sharing of information among the targeted countries. Further, it acted as a focus for dialogue with academics and private sector bodies interested in taxation issues, that is, for the possible formation of a new epistemic community. It also presented a body which could begin to disseminate the 'fairness' message which the small and developing countries wished to convey internationally.

In terms of regime theory, the creation of the ITIO may be viewed as the formulation of a new 'prisoner's dilemma' game among targeted countries with the targeted countries attempting to respond to the power differentials between the OECD member states and the targeted small and developing countries. Arguably one of the tasks which the ITIO was intended to adopt was to work with other multilateral organisations such as the Commonwealth and the United Nations, to

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792 Keohane (n 766).
793 The organisation was initially designated as The International Tax and Investment Organisation. As at 1 January 2007 it had sixteen member countries.
795 The Commonwealth has been an observer within the ITIO since its inception. In 2006, the ITIO obtained observer status in the United Nations Committee of Experts in Taxation matters process.
develop a new ‘meta-regime’ which would require that fairness and competition neutrality were incorporated into any regime for limiting tax competition.\textsuperscript{796}

6.12 THE DEVELOPMENT OF THE 2002 MODEL TAX INFORMATION EXCHANGE AGREEMENT

Dialogue relating to the specification of standards for tax information exchange among the six countries which had given advance commitments to the OECD on the one hand, and the OECD member states on the other, commenced in November 2000.\textsuperscript{797} This dialogue was coordinated by the OECD Secretariat within a new OECD ‘Global Forum’ component established expressly for the purpose.\textsuperscript{798} Initial discussions, which revolved around a Memorandum of Understanding prepared by the OECD Secretariat, made little progress.\textsuperscript{799} It was only after firstly, the reformulation of the HTC Initiative as a result of Commonwealth and US

\textsuperscript{796} VK Aggarwal, ‘Building International Institutions in Asia-Pacific’ 33 (1993) Asian Survey 11 1029-1042. Aggarwal notes that; ‘Meta-regimes represent the principles and norms underlying international arrangements, whereas international regimes refer specifically to rules and procedures.’


\textsuperscript{798} ibid.

interventions, secondly the acknowledgement by the OECD of the need for a level
playing field in which the OECD member states would be required to meet the
same standards as the targeted countries,\textsuperscript{800} and thirdly, the interposition of the
ITIO as a body to coordinate the positions of the targeted countries, that
substantive progress became possible. The acceptance by the OECD of the concept
of a level playing field which would be available to non-OECD members, rather
than just for the OECD member states, arguably gave some reassurance that some
semblance of fairness might be possible within the revised HTC Initiative. That is
not to say that there was any consensus regarding what the 'level playing field'
was or how 'fair competition' could be achieved.

The OECD’s Global Forum on Tax Information Exchange arguably
offered greater potential for progress in broad regime formation than previous one-
sided discussions with the OECD ‘Study Groups’. Within the Global Forum
context, representatives of the targeted countries had the opportunity to discuss
issues directly with representatives of OECD governments. The OECD also
responded to previous complaints of bullying made in early stages of the HTC
Initiative by limiting the number of OECD country representatives present in
Global Forum meetings to roughly the number of non-OECD representatives
present. A co-chaired process was also adopted in which one of the co-chairs was
from an OECD country and the other from one of the targeted countries.\textsuperscript{801}

\textsuperscript{800} Isle of Man (n 672).
\textsuperscript{801} OECD, 'Closing Statement by Co-Chairs' (2003) OECD
\textless http://www.oecd.org/document/0/0,2340,en_2649_33745_16643264_1_1_1_1,00.html\textgreater accessed 29 November 2006.
Meetings were also alternated between OECD and non-OECD countries as a further gesture toward inclusion and procedural fairness. In terms of regime theory analysis, these changes may be seen to represent a shift in the approach of the OECD away from a crude suasion game towards a more cooperative process within a prisoner’s dilemma game in which each side had something to loose by defection.

6.12.1 Fairness in the 2002 Model Agreement

The OECD member countries adopted the position in the Global Forum process that ‘fair competition’ in relation to the implementation of any standards for tax information exchange needed to be dealt with in a subsequent phase of dialogue, rather than in the design of the Model itself. They arguably were concerned to ensure that discussion remained focussed on their concerns for access to information rather than looking more broadly at tax competition and inter-nation equity in general. The targeted countries acceded to the demands of the OECD to begin with discussion of exchange of information, while making clear in the Model document itself that the Model was non-binding, and that they did not consider themselves obligated to implement any text developed until all of the “level playing field” issues related to fair competition in the financial services sector were addressed:
It is not in the interest of participating economies that the implementation of the standard contained in the Agreement should lead to the migration of business to economies that do not cooperate in the exchange of information. The OECD members and committed jurisdictions have to engage in an ongoing dialogue to work towards implementation of the standard. An adequate framework will be jointly established by the OECD and the committed jurisdictions for this purpose particularly since such a framework would help to achieve a level playing field where no party is unfairly disadvantaged. 803

The phrase 'where no party is unfairly disadvantaged' may be understood to refer to the 'third country problem' and 'last man standing' concepts discussed in Chapter 2, as well as more general concerns relating to the fairness. What then remained, as indicated in paragraph 4 of the 2002 Model 804 was to identify a process for the implementation of the standards set out in the Model which would ensure the inclusion of elements of neutrality and inter-nation equity within the overarching concept of fair tax competition.

6.13 PHASE 4 OF THE OECD HARMFUL TAX COMPETITION INITIATIVE

The fourth phase of the HTC Initiative commenced immediately following the publication of the 2002 Model, and is ongoing. Arguably, the tasks which remained to be accomplished in Phase 4, included both procedural fairness elements and

802 OECD (n 649), Paragraph 4.
803 ibid.
804 ibid.
substantial fairness elements. For the OECD countries involved in the exercise, the objective of securing tax information arguably remained the highest priority. For the small and developing countries, arguably the highest priority remained the securing of a 'level playing field' for the global provision of financial services, in the context of which, the exchange of information process could operate. That is to say the non-OECD countries involved sought to ensure that no party, or at least that they, would not be unfairly disadvantaged.

6.13.1 The October 2002 Cayman Islands OECD Global Forum

The first meeting between OECD member states and the majority of the small and developing countries targeted by the OECD following the publication of the 2002 Model took place in October 2002. The targeted countries insisted that the 'level playing field' issues should be put on the agenda. However, as in previous meetings, the OECD countries were represented by technical personnel while the targeted countries were represented by a mixture of both political and technical representatives. At that meeting, the Chairman of the OECD's Committee on Fiscal Affairs, Mr. Gabs Maklouf, addressing the non-OECD countries present, expressed

the re-modelled and expanded objective to which the OECD had agreed in the following terms:

The Committee on Fiscal Affairs attaches particular importance to our continued dialogue with you. It is through dialogue, that we have managed to re-shape the project so that it now addresses many of the concerns previously expressed. And it is through dialogue that we will achieve our common goal of fair competition in the financial sector.\textsuperscript{808}

The statement that ‘fair competition’ in the financial sector was a shared objective arguably was intended to signal a shift in position from that expressed in the HTC Report. It did not necessarily mean however, that the OECD member states and the small and developing countries targeted in the HTC Initiative had a common understanding of what constituted ‘fair competition’. Similarly, the OECD and non-OECD countries which were in dialogue, did not necessarily have a common understanding of how ‘fair competition’ could exist side by side with the objective of ensuring that the targeted jurisdictions assisted the OECD countries in enforcing residence-based aspects of their tax regimes.

The October 2002 meeting also produced another signal of a change in the OECD’s approach to the HTC Initiative. The countries sitting at the table agreed that the appellation ‘tax haven’ would no longer be used by OECD states to refer to the non-OECD countries participating in the process, at least while they were seated at the same table. The new designation, intended to be applied to both the
OECD countries and the non-OECD countries was that of 'participating partner'. While this may seem to be a minor step, it is arguable that from an international relations theory perspective it was representative of a change in the process of regime formation, one which focused on finding a mutually satisfactory 'community' solution in order to minimise defection in a 'prisoner's dilemma' game, rather than a purely coercive 'suasion' game solution. Consistent with this interpretation, the final communiqué of the October 2002 meeting, contained a statement recognising the importance of 'level playing field' issues, and of a 'global financial system based on common standards'.

The participants in the October 2002 dialogue appear to have understood that there was no uniform interpretation of what a 'level playing field' implied, and sought to devise a system which could achieve a common understanding of what the implementation language of paragraph 4 of the 2002 Model required. However, in the period immediately following the 2002 Global Forum meeting, geopolitics and what may be viewed as the hierarchy of regime importance, came into play.

809 OECD (n 807).
810 ibid.
811 OECD (n 649).
6.13.2 The Competition between Commitments to Non-OECD Countries and Regime formation in Relation to the European Union

Less than six months after the assurances given in the 2002 Global Forum, the level of commitment among OECD member states to defining a system for implementing the ‘level playing field’ in the HTC Initiative came into question.\(^{812}\)

There was a shift, on the part of some OECD member states, away from a commitment that all OECD member states and the targeted non-OECD countries would adopt the same standards for exchange of information on the same time line. The issue arose from the efforts of the EU Member States within the OECD to come to an agreement in respect of the taxation of savings income.

In negotiations in the context of the European Union’s so-called ‘Savings Directive’,\(^{813}\) an agreement was tentatively reached in which four OECD member states, specifically Austria, Belgium, Luxembourg and Switzerland would not adopt the 2002 OECD standards on exchange of information by 2005 as was expected of the targeted non-OECD countries. The deal brokered between the EU member states and Switzerland allowed that these four OECD member states would not in fact adopt the agreed standards until some indeterminate point in time.

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of their own choosing, likely to be after 2011. Further, it provided that there would be no coordinated pressure brought on Switzerland to implement the 2002 standard until at least 2011. This created the potential for a very un-level playing field, called into further question the bone fides of the OECD as an organisation, and gave great concern to the targeted small and developing countries.

From a regime theory perspective, the defection of OECD member states from the 'level playing field' agreements arrived at only a few months earlier, may be understood in neo-realist terms as consistent with the relatively low cost of defection from cooperation for OECD member states. In a sense, countries most likely to resort to the use of power differentials in regime formation are also most likely to defect when it suits their purposes. The 'marginal cost' of the use of power for OECD countries, in the context of making and breaking agreements with the targeted countries, was low.

6.13.3 The October 2003 Ottawa OECD Global Forum

817 Keohane (p 766).
In October 2003 a further meeting of OECD and targeted countries occurred in Ottawa, Canada. The meeting involved not only representatives from the OECD member states and representatives of the targeted small and developing countries, but also senior representatives from the European Commission. The purpose of this meeting was to examine whether there was in fact any common understanding of what the 'level playing field' was, and thereby to determine whether there was any basis for further discussions.

The ITIO member countries presented a very detailed note at the October 2003 meeting which focussed on the level playing field concept both in terms of procedural fairness in defining the concept, and substantive fairness which might be affected by the implementation of any plan to achieve a level playing field. The note pointed out that at that point in time, there was no 'level playing field' in relation to the provision of cross-border financial services. It also raised issues of fairness, inter-nation equity, the neutrality of taxation systems and exchange of information within the HTC Initiative.

The focus of the ITIO members concerns was the agreement entered into by more than half the OECD's membership with Switzerland in early 2003 which effectively exempted Switzerland, and other OECD member states from any

818 OECD (n 801).
820 ITIO (n 804).
obligation to provide exchange of information on the basis of the standards expected of the targeted non-OECD countries, until an indeterminate point of time after 2011.\footnote{821} Switzerland arguably was a significant competitor of the targeted countries in the financial services sector, which in and of itself gave rise to concerns. These concerns were heightened when, arising out of the agreement with Switzerland, a number of other OECD and non-OECD countries including Luxembourg, Austria, Belgium, Liechtenstein and Monaco, all competitors of the targeted countries were each given what amounted to exemption from any requirement to apply the standards for exchange of information embedded in the 2002.\footnote{822} This was despite the fact that Liechtenstein and Monaco had been labelled by the OECD as uncooperative tax havens in April 2002.\footnote{823} The ITIO member countries also pointed out that the OECD member states themselves had not applied the exchange of tax information language set out in the 2002 Model in revisions of bilateral treaties which they had negotiated after the date of the publication of the 2002 Model, thus creating further unevenness in the ‘playing field’.\footnote{824}

In regime theory terms, an agreement with geo-politically less influential countries in relation to one regime in formation, arguably was breached in order to advance a separate regime with more geo-politically influential states in a separate

\footnote{821 \textit{Switzerland} (n 815).}
\footnote{822 \textit{Council} (n 813).}
\footnote{823 OECD, ‘The OECD Issues The List of Unco-operative Tax Havens’ (2002) http://www.oecd.org/document/19/0,2340,en_2649_33745_20823231_1_1_1_1,00.html accessed 7 March 2007.}
\footnote{824 \textit{ITIO} (n 814).}
taxation context. However, the upfront payoffs in the form of exemption from OECD specified standards given to a small group of OECD and non-OECD countries in order to secure agreement in the context of the EU Directive on the taxation of savings income, arguably put the non-OECD countries cooperating in the HTC Initiative at a further competitive disadvantage. This was the second major challenge to the OECD’s regime for limiting tax competition.

While the activities of OECD countries in relation to the EU Directive caused at least one non-OECD country to withdraw from the process,825 the majority agreed to carry on with the discussions aimed at identifying a ‘level playing field’. The Ottawa meeting concluded with a commitment to give priority to developing further concrete proposals for how a ‘level playing field’ might be created and the establishment of a working group made up of both OECD and non-OECD countries tasked with making a start on this project.826

From a regime theory perspective, the defection of the more powerful participants in the prisoner’s dilemma game brought the cooperative process to the brink of collapse, and in so doing arguably created an impetus for the OECD to participate in more concrete discussions of a ‘level playing field’, something

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which to that point in time, the targeted small and developing countries had insisted on without much success.

6.13.4 The June 2004 Berlin OECD Global Forum

Representatives of more than forty OECD and non-OECD countries met next in the OECD Global Forum on Taxation session held in Berlin in June 2004. The main purpose of this meeting was to consider the work product of the ‘level playing field’ working group, established at the 2003 Global Forum meeting. The work product consisted of detailed, if somewhat theoretical, statements regarding what the participant countries thought a ‘level playing field’ was, how it could be identified, and what was necessary in moving toward such a status.

The representatives of the governments represented in Berlin agreed, among other things that:
8. Central to the concept of a global level playing field is that it is fundamentally about fairness....The convergence of existing practices of information exchange towards these standards thus should be coupled with a process that ensures equity and fair competition which aims to ensure that financial centres that are engaged in meeting the standards of transparency and effective exchange of information are not disadvantaged by countries that are not part of the process and that the latter are not permitted to profit from the promotion of their position of being outside the process.827

The linkage set out in the Berlin text between the movement toward a ‘level playing field’ with a ‘process that ensures equity and fair competition’ which would ensure that those countries which participate in exchange of information are not disadvantaged by countries that do not, arguably is consistent with, but not sufficient for, achieving the objective of competition under equal conditions.828 Specifically, it did not indicate that countries which cooperate through tax information exchange should be afforded a degree of competition neutrality so as not to undermine inter-nation equity.

The Berlin text also recognised three ways in which countries could advance the process; individual action, bilateral processes including treaty negotiations, and collective actions.829 In that context it was agreed that:

14. Action at the individual country level can also play an important role in encouraging other countries that have not yet adopted the principles

829 OECD (n 827), Paragraph 29.
to do so. Countries should continue to explore what they can do in their individual capacities, consistent with fairness, equity and proportionality, to support the adoption of transparency and exchange of information standards by others.  

It is unclear from the text precisely what the committee of authors saw in relation to the concept of proportionality that was distinct from the concepts of fairness and equity, and unfortunately there is no further explanation in the text. On one analysis, proportionality to the small and developing countries arguably was consistent with treating like tax related measures alike irrespective of the geopolitics of any situation - a form of horizontal equity. In contrast, proportionality to the OECD countries was arguably limited to a proposition that OECD countries could not be expected to impose or threaten to impose sanctions on geo-politically powerful countries or significant trading partners over tax measures when to do so might provoke disproportionate economic damage to their own interests.

Another important feature in the Berlin text was the commitment to expand the HTC Initiative process to involve not just the OECD states and the

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830 OECD (n 827), paragraph 14.
831 Discussed in section 3.3 of this work.
small and developing countries targeted initially by the OECD, but also all other
countries with significant financial services sectors.\footnote{832 OECD, 'Outcome, conclusion of the meeting of the OECD Global Forum on Taxation in Berlin, 3-4 June 2004.' (2004) OECD <http://www.oecd.org/document/5/0,2340,en_2649_201185_31967429_1_1_1,00.html> accessed 31 May 2005.}

26. The practices of all OECD countries, all non-OECD Participating
Partners and all other significant financial centres outside of these two
groups influence the achievement of the global level playing field. Because of this, efforts to include all countries not already part of the
process are imperative. The inclusive approach is intended to
communicate that no country be permitted to profit from being neither a
party to the principles nor a part of the process. The Global Forum will
take steps to engage all relevant countries in this process.\footnote{833 OECD (n 827).}

This arguably represented an important change in the OECD’s approach to
regime formation in which the size of the financial services sector was contrasted
with the size of the overall economy so as to exclude many geo-politically
influential countries.\footnote{834} The more geo-politically important countries which the
OECD member states were unwilling to label as ‘tax havens’ in 2000, having
avoided the ‘naming and shaming’ which was inflicted on weaker countries, would
nonetheless be invited to participate in the process of implementing the standards
for transparency and exchange of tax information built into the 2002 OECD
Model.

The countries which adopted the June 2004 proposals on the level playing
field also used rather carefully crafted language in relation to the potential for the
economic consequences which might potentially flow to countries which did not adopt the set of standards which were developed in the context of the OECD’s Global Forum process:

28. The underlying objective of the global level playing field is to facilitate the creation of an environment in which all significant financial centres meet the high standards of transparency and effective exchange of information on both criminal and civil taxation matters. This is vital to ensuring that countries can obtain from other countries the information necessary to enforce their own tax laws, to ensuring that financial centres that meet such standards are not unduly disadvantaged by doing so, and to ensuring that financial centres that meet such high standards are and remain fully integrated into the international financial system and the global community. Any significant financial centre that decides not to adopt high standards of transparency and effective exchange of information must not be permitted to profit from that decision.835

The language used is quite vague. There is no objective frame of reference in relation to which countries are ‘significant financial centres’. It is also noted that while efforts would apparently be made to ensure that centres which meet the ‘high standards’ referred to remain fully integrated into the international financial system and the global community, there is no direct statement that countries which failed to do so would be excluded. Rather, there was a statement that financial centres which failed to meet such standards ‘would not be permitted to profit from that decision’. It would appear that meeting the high standards ensures inclusion but not profit, whereas not meeting the standard does not imply the lack of inclusion but does imply some restriction on profit arising from the

834 Discussed in section 6.3 of this work.
835 OECD (n 827).
decision not to meet the standards, but not otherwise. It is not at all clear therefore as to what precisely the language used would imply for a geo-politically influential country that chose to ignore the standards. From a regime theory perspective, the statements reflect a reversion to an expansion of the project constrained by geopolitics and is consistent with the initial decision taken by the OECD to initially target only the geo-politically weakest countries. In contrast, retaining the participation of the geo-politically weakest countries arguably justified the invitation to join the process diplomatically extended to the next tier up in geo-political influence among non-OECD countries engaged in the international financial services sector.

There is however, evidence of some attempt at balance regarding the concerns of the less geopolitically powerful countries in this regard, with recognition of the legitimacy of competition on 'equal terms' to refer once again to Brand's definition of neutrality. Indeed, an extract from the opening address of the Berlin meeting given by Germany's Finance Minister illustrates this observation:

For Germany, it is of paramount importance for progress to be made on international cooperation on taxation. This cooperation is an essential requisite for the application of our tax laws....

I am well aware that this can be achieved only on the basis of fair and transparent procedures. We must make allowance for the legitimate interests of all financial centres to participate in global competition on equal terms.836
Minister Eichel's statement is also instructive in that it reiterates the OECD's new commitment to what it viewed as 'fair' procedures. It is also of interest in that the 'allowance' would seem to be required for the 'legitimate interests of all financial centres to participate in global competition' is limited to 'equal' rather than 'fair' terms. It was no doubt hoped by the targeted countries that fair procedures would give rise to fair terms which could then be equally applied.

The other principal outcome of the Berlin meeting was the endorsement of continuing work by the Global Forum sub-committee seeking to establish an objective basis for the assessment of the 'level playing field'. The sub-committee was tasked with the creation of a database of tax information exchange laws and administrative practices of all of the OECD member states (including Switzerland and Luxembourg), the non-OECD countries targeted as 'tax havens' in the 1998 and 2000 OECD Reports), and a group of previously non-participating 'significant financial centres' identified by the sub-committee. This group of 'significant financial centres' included many of the geo-politically influential international financial centres omitted from the 'tax haven' lists prepared by the OECD in 1998 and 2000, including Hong Kong and Singapore.

837 OECD (n 832).
6.14 THE 2005 LEVEL PLAYING FIELD ASSESSMENT - BENCHMARKING

TRANSPARENCY AND FRAMEWORKS FOR EXCHANGE OF INFORMATION

The process and principal outcomes of the benchmarking exercise conducted in the context of the OECD Global Forum's 'level playing field' assessment exercise following the Berlin Global Forum meeting are discussed in section 2.6 of this work and will not be repeated here. 839 For present purposes, the fact that the benchmarking exercise was published more than seven years after the OECD's 1998 Harmful Tax Competition Report is however worthy of note.

It might be argued that such a benchmarking assessment of the legal and administrative frameworks for transparency and exchange of tax information, as well as an assessment of the actual exchange of information practices of countries involved in the international financial services sector, should have been published at the outset of the OECD's investigation of so-called 'harmful tax competition'. This is particularly so given the OECD's intention to threaten non-members with 'coordinated defensive measures'. 840 However, such an argument would seem to ignore the possibility of competitive objectives in the HTC Initiative and the limitations which such information would have placed on the selected 'harmful tax

840 OECD (n 647), 40. As noted above, the OECD later acknowledged that there was no evidence that some of the small and developed countries targeted, such as Tonga and the Maldives, even had offshore financial centres.
competition' policy narrative. Specifically, double standards inconsistent with the narrative would have become immediately apparent upon publication. From a neo-realist regime theory perspective, a comparison of actual tax information exchange practices and transparency of OECD member states and the targeted countries may have been seen as counter-productive from the OECD members' perspectives. As Stoll-Davey has shown, there were no significant differences between the legal and administrative systems of OECD member states and those of the targeted countries as at December 2005. The factors her study identifies as differentiating the OECD states from the target countries arguably relate to size, wealth, and geopolitics. Specifically, OECD states enter into conventional tax treaties with each other, but have not made such treaties available to many of the countries targeted in the HTC Initiative for decades.

6.15 MEASURING THE SUCCESS OF THE HTC INITIATIVE AND IDENTIFYING ITS REMAINING SHORTCOMINGS

There have been relatively few agreements providing for tax information exchange entered into between the targeted countries and OECD member states since the

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841 Pacific Forum Secretariat, 'Regional Position Statement - Pacific Islands Forum' (2001) Pacific Forum Secretariat <http://www.forumsec.org.fj/news/2001/Apr13.htm> accessed 7 October 2004. Illustrative of the size and wealth disparity is the following comparison; "The seven listed Pacific nations have a combined GDP of around US$1 billion, compared to Australia's annual GDP of around US$300 billion, and they have a total population barely one eighth that of Sydney. Niue, the smallest nation, has a population of only 1800 and an annual government budget of around NZ$20 million."
launch of the HTC Initiative. The principal success story in relation to non-OECD countries relates to Barbados which was named as a ‘tax haven’ in 2000, then reclassified as not a ‘tax haven’ for reasons set out above, and then allowed to negotiate tax treaties with a number of OECD member states.\(^{843}\) Cyprus, Malta, Mauritius and San Marino, although initially targeted and subsequently classified as ‘advance commitment’ countries, have similarly been able to negotiate tax treaties with OECD member states.\(^{844}\)

In contrast most of the other countries targeted in the HTC Initiative have not been offered tax treaties, but rather tax information exchange agreements which lack the benefits typically afforded by a conventional tax treaty.\(^{845}\) As a result, there were very few tax information exchange agreements signed as at December 2006. As an exception, the Isle of Man negotiated a package of arrangements with the Kingdom of the Netherlands which included a tax information exchange agreement with a provision for a subsequent tax treaty.\(^{846}\) Bermuda also negotiated a tax information exchange agreement with Australia

\(^{842}\) Stoll-Davey (n 651).


\(^{845}\) C Stoll-Davey (n 651).
associated with limited benefits which fell well short of the benefits contained in a conventional tax treaty.\(^{847}\)

The pronouncements generated in the context of the OECD’s Global Forum indicate the desirability of ‘mutual benefits’,\(^{848}\) but such pronouncements are not binding on OECD member states. The absence of access to treaty benefits for small and developing countries has been identified by the ITIO as an obstacle to tax information exchange.\(^{849}\) As noted by Stoll-Davey, a position which denies access to treaty networks to small and developing countries is not consistent with a ‘level playing field’ that all participants in the OECD’s Global Forum claim to support. Neither arguably, is it consistent with what the OECD’s 2006 policy narrative indicates as the current objective of the HTC Initiative:

The aim of this work is to create an environment in which all countries, large and small, OECD and non-OECD, those with an income tax system and those without, can compete freely and fairly thereby allowing economic growth and increased prosperity to be shared by all.\(^{850}\)

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\(^{846}\) Isle of Man (n 672).


\(^{848}\) OECD (n 838).

\(^{849}\) ITIO (n 751).

CHAPTER 7 - FURTHER CONSIDERATIONS AND CONCLUSIONS

7.0 INTRODUCTION

The present work seeks to provide answers to several narrowly defined questions, and to thereby contribute to the solution a much larger problem relating to how taxation system design shapes, and is in turn shaped by, systems for cooperation among taxation authorities. In this regard, the hypotheses identified in Chapter 1 may be restated in a series of questions. These include the following.

1. Might the provision of tax information to foreign tax authorities affect national or global economic efficiency and inter-nation equity? If so, how and under what conditions?

2. Are there theoretical justifications following on from 1 above which may be advanced for and against restricting the provision of taxpayer specific information to foreign governments?

3. What types of mechanisms might be used to restrict the provision of taxpayer specific information to foreign governments so as to minimise any tendency for such provision to adversely affect economic efficiency or inter-nation equity?

4. Have notions of fairness, inter-nation equity, and the neutrality of taxation systems shaped the development of an international regime for limiting tax
competition through tax information exchange in the context of the OECD's Harmful Tax Competition Initiative (HTC Initiative), and if so how?

5. Might an analysis of the HTC Initiative utilising the lens of international regime theory afford an understanding of the development of inter-nation cooperation in the limitation of tax competition through the use of tax information exchange?\(^\text{851}\)

In the following sections of this concluding chapter, the answers to these questions as derived from the present work are summarised and certain implications of these answers are considered.

### 7.1 Tax Information Exchange, Efficiency and Inter-Nation Equity

The analysis set out in Chapters 1 through 4 inclusive, indicates that both the provision of tax information to foreign tax authorities, and the refusal to provide such information to foreign tax authorities, may produce negative externalities under certain circumstances. Specifically, the provision of tax information as well as the refusal to provide such information may affect the global allocation of taxation resources and therefore both global economic efficiency and inter-nation equity.

\(^{851}\) A general description of regime theory as it relates to the context of this thesis is provided at Section 1.5.5 above in which relevant references are given.
equity. According to at least one source, such provision or refusal of tax information may also affect the 'fairness' of inter-nation competition for mobile financial services.852 Further, as noted in section 2.2.1, there is a corollary to the 'third country problem' which has been noted in the literature. This corollary, which is referred to in this work as the 'last man standing' problem, becomes apparent when the implementation of tax information exchange is considered in a dynamic rather than a static context. Specifically, in the context of a group of countries which do not exchange tax information but which are willing to do so at a point in time in the future, the deferral of tax information exchange relative to other countries in the group may provide advantages.

The answer to the first question posed above is therefore that the provision of tax information to foreign tax authorities under conditions in which such information is used to give effect to non-neutralities may, under certain conditions, adversely affect global economic efficiency and inter-nation equity. Similarly the relative timing of the implementation of tax information exchange may affect inter-nation equity. What then are the implications of these observations for the design of national taxation systems and the design of systems for cooperation among taxation authorities?

852 Global economic efficiency is most likely to be optimal when the relevant taxation systems are neutral, that is, they do not bias investment, consumption or location decisions. The metric of inter-nation equity established by Musgrave is national wealth. P Musgrave, 'Inter-Equity' in P Musgrave (ed) Tax Policy in the Global Economy Studies in Fiscal Federalism and State-Local Finance (Edward Elgar, Cheltenham UK 2002), 164. The OECD raised the issue of tax information exchange as an element in fair competition in its 1998 Report. OECD, Harmful Tax Competition - An Emerging Global Issue (Organisation for Economic Cooperation and Development, Paris 1998).
7.2 Restricting Tax Information Exchange – Theoretical Justifications and General Policy Considerations

The design of international regimes for cooperation in the administration of other states’ taxation systems arguably necessitates some level of agreement regarding design latitude for taxation systems in general, and design latitude for tax competition in particular. As noted in Chapter 4 and section 7.1, the use of non-neutral tax systems as part of the exercise of sovereign taxation rights may distort the global allocation of economic activity and therefore the tax bases of other countries.\(^853\) However, policy makers have certain choices over whether, and if so on what terms, assistance which will give effect to other states’ taxation systems is provided.

The architects of taxation systems arguably ought to take into consideration; firstly that tax information exchange may be required in some instances to give effect to taxation induced distortions, be they domestic or foreign, secondly that distortions to the global allocation of economic activity may also be produced by tax payers seeking to evade or avoid taxes, whether such taxes involve non-neutralities or not, and thirdly that tax information exchange may

create disincentives for tax evasion or avoidance. How then ought such considerations be weighed?

The traditional view is that states have a primary, if not sole, responsibility to advance the welfare of their own citizens. Arguably, the other side of this coin in a taxation context is represented by the notion that states do not have an obligation to enforce the taxation systems of other states, as presumably other states taxation systems may not necessarily be designed to advance the welfare of the same persons. By way of example, if State ‘A’ designs its taxation system in a manner biased in favour of the citizens of ‘A’ and contrary to the interests of the citizens of ‘B’, and State ‘B’ has a primary responsibility to advance the welfare of its own citizens, then ‘B’ would have no interest in assisting ‘A’ in enforcing its taxation system to the extent that to do so would be inconsistent with its obligations to its own citizens.

That is not to say that short sighted self-interest, and the fact that absent of any treaty obligation there is no obligation for countries to exchange tax information, ought to be the end of considerations. The effects of tax policy extend beyond borders and indifference to externalities produced by any aspect of tax policy, including decisions related to international cooperation, arguably ought not to be taken solely on the basis of notional or actual sovereign capacity. Rather, states ought to consider both the externalities their taxation systems may produce
and those externalities produced by the taxation systems of other states which the
exchange of tax information may give effect to.

It is noted in the present work that the theory underpinning unrestricted
tax information exchange, and specifically the proposition that full information
exchange is likely to be Pareto-superior to restricted tax information exchange, is
suspect. As noted in section 3.4.3 of this thesis, the observation that in certain
contexts tax information exchange may decrease inter-nation equity and global
economic efficiency suggests that any such superiority is circumscribed rather than
general. This also suggests that policy makers ought to take into consideration both
local and global effects when setting criteria for tax information exchange.

There is a continuum of options available in relation to such criteria,
ranging from unrestricted tax information exchange to no tax information
exchange, with a similar array of theoretical justifications for particular choices
based on specific policy preferences. By way of examples, states with a preference
for administrative cooperation in taxation matters intended to produce greater
global welfare and inter-nation equity might elect to exclude tax information
exchange only with respect to specific provisions in requesting countries’ taxation
systems which detract from inter-nation equity and global economic efficiency.
Other states might focus more on self-interest and therefore permit tax information
exchange only to the extent that there would be no adverse effect on national

854 Jeffery (n 854), 23.
welfare, irrespective of global welfare consequences. Yet other states might look to comparisons of the extent of tax neutrality which is offered to it by a given state requesting access to tax information, relative to the treatment afforded by that requesting state to some reference group of countries, permitting tax information exchange as long as to do so would not be contrary to the providing state's self-selected status of 'most favoured nation'. This 'most favoured nation' option would not inhibit states in maintaining domestic preferences, but would deter third country preferences, at least to the extent that the availability of tax information was a consideration in relation to the setting of preferences for foreign states. States might also elect to adopt an exchange of tax information policy which retains only a limited inter-nation equity requirement, for example, that set out in the OECD Model Convention which permits the refusal of tax information exchange with respect to provisions which discriminate against nationals of the information providing state in comparison with nationals of the requesting state in the same position. 855

There is a further context in which policy makers may wish to consider the restriction of tax information exchange as a mechanism for limiting tax competition or enhancing inter-nation equity. This was introduced in section 4.5 of this work and relates to the vulnerability of tax related information to data mining, the increasing potential for data mining given emerging computer technologies and

the competitive advantage which data mining may give to states which have the capacity to use it. 856

Concern over the disclosure of commercially sensitive information through tax information exchange, even when there are treaty provisions requiring that such information must be kept secret, is not new. By way of example, Article V of the 1946 League of Nations London Model Convention provided for the refusal of tax information exchange where the release of information might compromise, 'a professional, industrial or trade secret'. 857 Similarly, Paragraph 2(c) of Article 26 of the OECD Model Convention provides for the refusal of tax information exchange; 'which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy'. 858

The risks posed by the mining of information obtained through tax information exchange arguably present new challenges to tax authorities. The risks

856 The following definition of data mining is used in this thesis: 'Data mining is sorting through data to identify patterns and establish relationships. Data mining parameters include:

- Association - looking for patterns where one event is connected to another event
- Sequence or path analysis - looking for patterns where one event leads to another later event
- Classification - looking for new patterns (May result in a change in the way the data is organized but that's ok)
- Clustering - finding and visually documenting groups of facts not previously known
- Forecasting - discovering patterns in data that can lead to reasonable predictions about the future (This area of data mining is known as predictive analytics.)


857 Discussed in 2.5.2 of this work.

associated with data mining arguably are a function of the ease with which information may be acquired, the extent of information exchanged and the taxpayers involved. Thus, the volume and low cost to the recipient state of information provided in the context of automatic exchange of information would likely make data mining more attractive than would be the case for information flows resulting from limited exchange of information upon request. Similarly, the mining of data relating to corporations may offer opportunities for exploitation which differ from those offered by the mining of data relating to natural persons engaged in subsistence farming.

The risks associated with data mining also relate to both the potential that information will be passed to private sector entities, whether within an information receiving state or otherwise, and the risk that information will be used directly by the information receiving state to refine its tax system in order to gain advantage over information providing states in the context of tax competition.

It may be suggested that data mining will give rise to no such risks as states simply would not breach the secrecy requirements typically attached to information provided by foreign tax authorities.\(^859\) There are two responses to this. The first is that states compete with each other using the tools available to them, with history also suggesting that from time to time states do not honour their

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\(^{859}\) ibid, Article 26 at paragraph 1.
obligations in international law. Given the political pressures to secure competitive advantage which exist in all states, it would be naïve to assume that data mining of tax information will not be used by states, particularly when its use would likely be very difficult to detect.

The second response is that information obtained from data mining may have value even with the identity of the relevant taxpayers removed. Such information may be blended with information obtained from other sources such that the end product would be very difficult to link with the source. Thus, aggregate non-public information relating to the sales, cost of sales, purchasing patterns or even depreciation practices of all mining companies in Zambia may have significant commercial value. Further, data obtained through tax information exchange and subject to secrecy requirements could also be used to identify contextually defined relevant data buried in a vast amount of irrelevant data available from sources other than tax information exchange. In that context it may be asked, 'would the commercial or state exploitation of such relevant data, which in one sense would be the product of data mining, but which did not include any information in the form made available through tax information exchange, violate the secrecy requirements of Article 26 of the OECD Model Convention'? The likely answer is, probably not.

860 According to a 1999 report prepared for the European Parliament, a US intelligence agency was used to intercept electronic data traffic relating to France's Airbus Industries and that this information was used to secure the interests of Boeing, a US company. Cyberrights.org, 'Interception Capabilities 2000' http://www.cyber-rights.org/interception/stoa/interception_capabilities_2000.htm accessed 10 October 2007. The US position in this matter is that it was seeking to ensure that bribery was not being used by entities competing with US interests.
There is a further consideration. The works of Dagan, Easson and Horner suggests that developed countries have used the combination of their residence-based taxation systems and treaties based on the OECD model convention to gain and maintain their advantage over developing countries.\(^{861}\) McIntyre suggests that some developed countries are happy to receive tax information from developing countries which they require, but are far less interested in providing tax information to developing countries which might have a better claim to such information as viewed from the perspective of inter-nation equity.\(^{862}\) Data mining arguably has the potential to compound these problems as it is likely to be of use only to developed countries, as poor countries are unlikely to have the resources to utilise it.

The concept of common but differentiated responsibility in international law arguably acknowledges that while states may share certain common responsibilities, their obligations in relation to those responsibilities differ as a result of their capacity to meet those obligations.\(^{863}\) While this concept has not

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been directly applied in the tax law literature to tax information exchange, it offers at least a useful analogy. To the extent that there is any obligation on states to exchange tax information, whether moral or otherwise, policy makers may wish to consider whether these obligations are capable of differentiation.

The risks of data mining and the observations of Dagan and McIntyre would suggest that equity might be best served by asymmetric information exchange. Thus, an argument might be made that developing countries with residence-based taxation systems should receive tax information from developed countries on an automatic basis in order to deter tax related capital flight, but that developing countries should only provide tax information to developed countries on an 'on-request' basis in order to minimize data mining risks. This suggestion is likely be highly controversial, not least because it runs counter to the premises underlying the reciprocity requirements for tax information exchange which are found in the domestic legislation of many developed states. Nevertheless, policy makers may wish to consider the basis for the suggestion and the possibility that asymmetric tax information exchange may be consistent with the logic of common but differentiated responsibility.

The answer to the second question posed in the present work is therefore also yes, there are theoretical justifications which may be advanced for and against

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restricting the provision of tax information to foreign governments in circumstances in which the provision of such information may undermine economic efficiency or inter-nation equity. This gives rise to a subsidiary question of how might states give effect to a selected policy preference?

7.3 MECHANISMS FOR RESTRICTING TAX INFORMATION EXCHANGE SO AS TO ENHANCE ECONOMIC EFFICIENCY AND INTER-NATION EQUITY

Constraints on the provision of taxpayer specific information could be achieved through a variety of means, ranging from those which require bilateral or multilateral action to those which may be accomplished unilaterally. These might include; the amendment of existing treaty arrangements, the limitation of future treaty arrangements, the adoption of asymmetric exchange provisions, the amendment of model conventions and commentaries in order to clarify the interpretation of existing or future treaty provisions, and the adoption of domestic interpretations of existing treaty requirements for the provision of taxpayer specific information which restrict the provision of information in instances in which inter-nation equity might be decreased.\textsuperscript{865}

\textsuperscript{865} There are theoretical and practical considerations outside of the scope of the present work surrounding any unilateral change in the interpretation of existing treaties. Pragmatists would likely argue that powerful states are able to do so with relative impunity.
While each of these options might go some way to enhancing the substantive fairness of taxation systems from a global perspective, it may be difficult given the self-interests of states, to achieve any broad agreement as to which option is best suited for any given situation. Undoubtedly there is at least the potential that in the real world, the more geopolitically powerful states would rather maintain a system of power based, rather than equitable rules-based, relationships.

That is not to say that equitable treatment for small and developing countries in the form of either substantive or procedural fairness cannot be achieved to any extent or under any circumstances. Carefully considered policies regarding tax information exchange may assist countries in minimising any potential damage resulting from tax information exchange while contributing to economic efficiency and potentially, global welfare. As between countries with relatively similar economies, stages of development and common economic interests, such as the member states of the European Union, arguably there would be less need for limiting tax information exchange. This is particularly so given that there are other available mechanisms for enforcing a limit on tax biases which may affect trade within the European Community.

866 Substantive and procedural fairness in this context refer to Franck’s usage of these terms as discussed more fully in Chapter 4. T Franck, Fairness in International Law and Institutions (Oxford University Press, Oxford 1995), 7 – 9.
867 The management of taxation related distortions in the European Union’s internal market is outside the scope of this thesis. However, it is noted that the European Commission, by way of example, seeks to discourage certain taxation biases which distort the European single market. A partial record of some of the Commission’s more formal activities in this regard is regularly updated at: http://ec.europa.eu/taxation_customs/taxation/index_en.htm . Disputes
between countries with dissimilar economies or stages of development. How then ought the tax information exchange decision making process be approached?

It is arguable that the selection of a tax information exchange policy should first of all be based on a clear understanding of the gamut of potential beneficial and adverse effects which may flow directly and indirectly from tax information exchange with particular foreign tax authorities. This in turn requires an understanding of a broad range of matters, including the economies and taxation systems of all countries to which tax information may be given and from which such information is to be received. It also requires that consideration should be given to the economic and treaty relationships which each such foreign country has with each of its other trading partners, and in particular those relationships involving competitors and potential competitors of the country considering the provision of tax information.

Also relevant to the policy maker is the fact that exchange of tax information with foreign tax authorities generally requires a legal basis and an administrative apparatus. The competence of a tax administration to send taxpayer specific information to a foreign tax authority may be found purely in domestic law, or by virtue of some combination of domestic law and international agreements with one or more other countries. It stands to reason that decisions

between the Commission and the Member States of the European Union may ultimately require resolution by the European Court of Justice.
regarding the conditions, if any, under which tax information may be provided to the tax administrations of other countries are likely to require consideration of, and have effects in, the context of one or more sets of foreign tax and other economic legislation, as well as foreign administrative practice, international agreements and arrangements.

Another consideration for policy makers pondering the dimensions of tax information exchange is that relating to the form of any relevant international instrument, assuming that such an instrument is to be used for that purpose. The OECD Model Convention,\textsuperscript{868} arguably is biased in favour of the interests of developed states.\textsuperscript{869} The UN model convention provisions on tax information exchange were similarly developed in a particular context, that is treaties intended to be entered into by one developed country and one developing country, rather than other contexts.\textsuperscript{870}

The 2002 OECD Model Agreement,\textsuperscript{871} may have limited utility particularly in that it does not expressly provide for the range of mutual benefits commonly found in more comprehensive taxation agreements. This consideration may be particularly relevant to small and developing countries which tend to be


\textsuperscript{869} Horner (n 861); Easson (n 861) 20-21.

\textsuperscript{870} UN, \textit{United Nations Model Double Taxation Convention between Developed and Developing Countries} (United Nations, New York 2001). This is expressly indicated in the title of the UN Model Convention.

excluded from treaty networks. \textsuperscript{872} If rich, developed, and geo-politically powerful countries give each other the benefits of conventional tax treaties but deny these to smaller and developing countries, then arguably, there is a risk that, all other things being equal, disadvantaged countries will stay that way. If such disadvantage is to be avoided, it may be necessary to either give small countries access to the treaty networks or to combine stand-alone TIEAs with contemporaneous side arrangements which obviate the potential for such disadvantage. \textsuperscript{873} How then would the incorporation of such restrictions affect the fulfilment of the objectives of tax information exchange?

\begin{quote}
It will be recalled that a number of objectives have been identified in relation to exchange of tax information. \textsuperscript{874} While in any given set of circumstances the applicable objectives may be multiple and overlapping, for present purposes such objectives may be divided into several general categories. These are competitive advantage, administrative efficiency, ‘narrow’ substantive fairness in the sense of inter-person equity in the application of residence-based taxation systems, and ‘broad’ substantive fairness in the sense of inter-nation equity, as well as the preservation of sovereign design latitude relating to taxation. \textsuperscript{875} As might be
\end{quote}

\begin{footnotes}


\textsuperscript{874} The range of objectives for exchange of information is discussed in section 2.2 of this thesis.


\end{footnotes}
expected, objectives for limiting tax information exchange may be divided into the same general categories.

7.3.1 Tax Information Exchange Restrictions and Relative Competitive Advantage

The neo-realist international relations literature suggests that states compete for relative advantage. There is no reason to expect that they would do otherwise in the design of taxation and tax information exchange systems. The competitive advantages which states may seek to create through the operation of their domestic taxation regimes and their tax treaty networks, may require access to taxpayer specific information held by other states. In such circumstances, it is foreseeable that states which require access to tax information in order to maximise their competitive advantage may seek means to secure such access. It is equally foreseeable that states which have control over the sought after taxpayer specific information may be hesitant to give competitive advantage to other states, particularly if such advantage is ceded at the cost of relative disadvantage to the state providing access to such information. How then might states restrict tax information exchange so as to prevent the erosion of relative advantage?

877 This will typically be the case for states with residence-based taxation systems as discussed in Chapter 2.
878 Ring (n 876), 17. Ring emphasises that from a neorealist perspective states compete for relative power. In the context of international taxation this would imply that states compete for shares of global taxation resources rather...
The absolute, as opposed to the relative, economic disadvantages associated with the provision of taxpayer specific information to other states, may occur primarily in the context of those particular aspects of the taxation system of a country requesting such information which produce negative externalities commonly associated with non-neutralities. If then the provision of taxpayer specific information is expressly limited to those aspects of the relevant taxation regime which do not produce non-neutralities then, all other things being equal, economic inefficiency with its associated economic disadvantages, should be avoided. Such an approach is consistent with enhancing global welfare to the extent that such welfare is a function of economic efficiency. However, it is arguable that this limitation may be disproportionate if only the national welfare of the state providing information is considered.

Given a preference for national welfare rather than global welfare, a state may adopt a more narrow limitation restricting the provision of taxpayer specific information so as to obviate the provision of tax information in contexts in which the particular taxation measure to which the requested information relates discriminates in some manner against the interests of the state requested to provide such information. Such a limitation of access to taxpayer specific information would permit a foreign state to secure an advantage through access to tax information, provided that such pursuit did not undermine the relative competitive position of the state from which taxpayer specific information is sought, than seeking to increase global wealth, that is, they seek the biggest piece of the pie rather than to make the pie.
irrespective of the consequences to global welfare. Such a restriction on tax information exchange would none the less potentially impose restrictions on taxation system design. How then might the latitude for taxation system design be reasonably constrained?

7.3.2 Determining the Reasonable Latitude for Taxation System Design and Restrictions on Tax Information Exchange

It would seem entirely rational in the current international environment of relative indifference to global welfare, that, apart from the neo-realist and game theory considerations identified by Ring,\textsuperscript{879} individual countries would be willing to cooperate by means of the provision of taxpayer specific information, even absent complete neutrality, provided that entities within their jurisdiction were not discriminated against. The rationality of this stance is enhanced with the further proviso that the public policy and other limitations on the provision of such tax information which are typically found in existing bilateral instruments providing for tax information provision, are in place.\textsuperscript{880} That does not necessarily imply that such cooperation would be reasonable as viewed from a global perspective.

\textsuperscript{879} ibid.
\textsuperscript{880} ibid.
It is beyond the scope of the present work to set out in any specific terms what a ‘reasonable’ latitude for tax system design would be under any given set of circumstances.\(^{881}\) However, it is suggested that if it is accepted that in certain circumstances tax competition may offer benefits,\(^{882}\) and that production efficiency theory has validity,\(^{883}\) then, as a general principle, the retention, by individual jurisdictions, of the maximal latitude in the design of national taxation systems consistent with enhanced long term or equilibrium global economic efficiency under conditions of inter-nation equity, arguably is a desirable long term equilibrium condition. Given a preference for tax competition rather than tax harmonisation, states may wish to cooperate in establishing and maintaining this constrained latitude. Absent the constraint suggested or specific incentives,\(^{884}\) and given a preference for inter-nation equity, it is difficult to see any reasonable basis for un-coerced ‘cooperation’ in maintaining another state’s taxation design latitude.\(^{885}\) That would include cooperation in the form of tax information exchange. How then would this conclusion fit with existing international instruments providing for tax information exchange?

\(^{880}\) By way of example, as set out in Section 2.6.2 there are a variety of circumstances in which states following the OECD Model Convention are not required to provide tax information.

\(^{881}\) The distinction between what is rational and what is reasonable is discussed in section 4.5 of this thesis. In summary what may be rational in the sense of the narrow pursuit of self-interest may not be reasonable from a more broad perspective which considers what the concepts of justice, fairness or equity in a multi-state context.

\(^{882}\) The potential benefits of tax competition are described in sections 3.5 and 3.6 of this thesis.

\(^{883}\) Production efficiency theory is discussed in section 2.2 of this thesis. In summary and in the context of taxation system design, production efficiency theory implies that given economic outputs will be maximised if the allocation of inputs is not distorted by taxation rules.

\(^{884}\) OECD (n 864). M Couch, ‘Cross-Border Tax Cooperation: Why Some Approaches Don’t Work’ (2007) 45 Tax Notes International 3 237 - 242. The OECD accepted a requirement for ‘mutual benefits’ in published documents, however Couch indicates that OECD member states have coordinated their negotiating positions in order to limit benefits to non-members.
7.3.3 Tax Information Exchange and Inter-Nation Equity in Bilateral Arrangements

There is little, if any, evidence that broad inter-nation equity has been other than a peripheral consideration in the design of the systems for cross-border taxation which are currently implemented by sovereign states.\(^{886}\) There are historical exceptions to this generalisation. Perhaps the clearest example of consideration of inter-nation equity in a two state context may be seen in the tax sparing treaty arrangements offered by a number of developed countries to certain developing countries.\(^{887}\) Undoubtedly these treaties were not entirely altruistic, but arguably they do represent a contrast to the biases in treaty terms modelled exclusively on the OECD Model Convention.\(^{888}\)

A second exception to the generalisation arguably exists in the context of the United Nations Model Convention,\(^{889}\) the creation of which was supported by a number of developed countries. Although this model convention arguably was not created in a context in which the designers were chosen in any democratic

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885 Coerced "cooperation" would imply that tax sovereignty would be the reserve of powerful states.
886 Various perspectives on inter-nation equity and tax policy design are discussed in section 3.3 of this work.
888 Ring, (n 876), 41 and following. Ring analyses the history of the development of the OECD model treaty and the biases which influenced it. Also Easson (n 861), 20; Horner (n 861); Dagan (n 861).
889 UN (n 863).
fashion, its design arguably did provide more opportunity for input from developing countries than did the OECD Model Convention.

The implementation of agreements providing for mutual benefits including exchange of tax information between countries participating in the OECD’s Global Forum on Taxation has the potential to provide a third exception, although the evidence suggests that there is still work to be done.\(^\text{891}\) There is only limited evidence in the form of new treaty arrangements providing for tax information exchange, that countries participating in the Global Forum process have a shared perspective of inter-nation equity and its role in relation to tax information exchange. OECD member states arguably were somewhat slow to acknowledge the adverse effects of exchange of tax information in the absence of ‘level playing field’ for competition in financial services.\(^\text{892}\) It is arguable that twenty-five years earlier the United States had recognised that exchange of tax information might adversely affect, or at least be unattractive to, developing countries in the absence of compensating benefits.\(^\text{893}\) However, an alternative view is that the US approach to the potential adverse effects of exchange of information in the absence of tax neutrality during the 1980’s was more concerned with the

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\(^{890}\) McIntryre (n 862).

\(^{891}\) Couch (n 884). Discussed in chapters 5 and 6 of this thesis.


relatively greater efficacy and lesser risk of a 'carrot plus a stick', as opposed to a 'stick only' approach to international relations during the Cold War era.

In advancing inter-nation equity through cooperation on tax information exchange, one unilateral approach would be to refuse to assist in giving effect to and thereby rewarding, biasing which undermines such equity. A refusal to assist in the application of such bias could obviate some of the efficacy of biasing, and might therefore remove at least part of the incentive for creating such biases, particularly with respect to tax measures which are heavily dependent on foreign source information for their enforcement. There are several variants within this approach, each with different efficiency implications for taxation system design latitude as well as inter-nation equity. These variants generally follow the various thresholds for declining tax information exchange set out in section 7.3.1 above. That is, they relate to refusal based firstly on various preferences for global equity or national welfare, and secondly they are referenced to agreed limits on tax competition rather than absolute neutrality.
7.3.4 Tax Information Exchange, Inter-Nation Equity and Limited Tax Competition

Tax information exchange systems may also be designed so as to limit tax competition, and to determine which states are allowed to compete according to any given set of rules.\(^{894}\) Similar to the situation described in section 7.3.3, there is a continuum of tax information strategies which may be used to shape tax competition. It encompasses everything from complete proscription of tax information exchange for any transgression of stipulated tax competition rules, to limitation of tax information exchange only if the breach of any given rule relating to tax competition causes actual harm to the state being requested to supply information, to no restriction at all. Each option has advantages and disadvantages. By way of example relating to a complete refusal to exchange tax information for any breach of any tax competition rule, such a refusal would remove a potentially significant enforcement tool from the state requiring the relevant tax information. Apart from issues of proportionality which, as an element of the reasonableness which Rawls indicates is required in systems of cooperation,\(^{895}\) one disadvantage would be that the enforcement of neutral aspects of the requesting country’s taxation regime unaffected by an isolated departure from any agreed tax competition rules might be adversely affected. This arguably would be disadvantageous not only in the context of intra-nation equity among taxpayers

\(^{894}\) This was the objective in the OECD’s Harmful Tax Competition Initiative. *OECD* (n 852).
within the requesting state, but also for the welfare of the entire universe of states to the extent that productivity is adversely affected in the particular state denied access to tax information.

The continuum of tax information exchange restrictions which may be employed to limit tax information exchange also includes those approaches which could be applied in relation to states adopting certain forms of residence-based taxation. By way of example, one approach would be to distinguish for purposes of tax information exchange, those entities within a country to which a double taxation agreement might apply from those which would be excluded from the benefits of a double taxation agreement. Thus, the exclusion of the availability of treaty benefits in relation to entities which are not subject to direct taxes may be found in the double taxation treaties of some countries, such as that between the United States of America and Barbados.896 This type of provision may be effected by means of the definition of ‘residents’ for treaty purposes which is conditioned by a ‘subject to taxation’ provision or otherwise. In the case of Barbados, entities to which its double taxation treaties do not apply may in some circumstances be excluded from the exchange of tax information provisions set out in those same

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treaties. Functionally, certain types of US entities which are not subject to US federal taxation may also be outside the scope of effective exchange of tax information in that there may be no information which would identify the location and controller of such information for purposes of exchange within a practical time period. An approach in which entities not afforded the benefits of an international agreement in relation to double taxation are also not subject to effective exchange of tax information may therefore be viewed as functionally similar to the situation which applies in relation to a significant minority of current double taxation treaties, in which exchange of tax information is limited to that which is necessary to give effect to other provisions within the relevant treaties.

A further example of a point on the continuum relates to the limited non-exchange of tax information which is only operative if a given foreign taxation measure has a direct adverse affect on a country requested to provide information or one of its nationals, such as might flow from discrimination against nationals of

899 OECD (n 897), 41.
the requested state.\textsuperscript{900} This point on the continuum as well as each of the others, may be juxtaposed against the present condition in which the most powerful states generally have favoured the least restrictions on the tax information which they require, but in some instances have not seen any need to remove restrictions affecting tax information which they may be called upon to provide.\textsuperscript{901}

The answer to the third question therefore, is that there are various mechanisms which may be used to safeguard or enhance economic efficiency and inter-nation equity and to shape tax competition in the context of tax information exchange. These relate to the selection of; firstly the countries with which exchange of information will occur, secondly the specific conditions under which particular types of tax information exchange will be permitted and whether such exchange will be symmetric or asymmetric, thirdly the tax provisions and types of tax payers in respect of which tax information exchange will occur, as well as fourthly, side payments or other benefits which will accompany such exchange. However, the utility of such mechanisms in the real world arguably is limited to the relative value which is given to considerations of economic efficiency and inter-nation equity, to say nothing of the constraints imposed by geo-politics.

\textsuperscript{900} \textit{OECD} (n 868), 41 and 39. Article 24 of the Model prohibits discrimination on the basis of nationality and Article 26 only provides for exchange of information which is not contrary to the Convention. Therefore states are not obliged to provide information if to do so would be to give effect to discrimination.

\textsuperscript{901} A lack of availability of tax information in respect of US corporate entities in which the US has no tax interest provides evidence of this type of approach. \textit{Nash} (n 898); \textit{El-Hindi} (n 898); \textit{USGA Office} (n 898); \textit{Financial Action Task Force} (n 898).
7.4 Fairness and Inter-nation Equity as Factors Influencing Regime Formation in the HTC Initiative

The fourth question identified in section 7.0 relates to whether notions of fairness and inter-nation equity and their relationship to neutrality, have shaped the development of an international regime for tax information exchange in the context of the OECD's Harmful Tax Competition Initiative. It will be recalled that Franck identified procedural fairness and substantive fairness as separate elements in what are commonly understood as fair practices in relation to international institutions. 902 The following analysis will follow this approach in examining the roles of considerations of procedural fairness and substantive fairness separately.

7.4.1 Procedural Fairness as a Factor Influencing Regime Formation in the HTC Initiative

The absence of procedural fairness in early phases of the HTC Initiative, at least as related to the non-OECD countries targeted, was ultimately acknowledged even by the Initiative’s proponents within the OECD. 903 Arguably, as a result of publicity

902 Franck (n 866), 7-9. Fairness is discussed in Chapters 3 and 4 of this work.
903 The OECD’s post-hoc analysis of the initial approach adopted in the HTC Initiative is discussed in Chapters 5 and 6 of this work.
and criticism regarding the lack of procedural fairness for non-member countries targeted in the HTC Initiative, the OECD took steps to ensure that the targeted countries could be seen to have been afforded greater procedural fairness in the OECD’s Global Forum process from mid-2001 onwards. This analysis suggests that broad procedural fairness was not a concern in the initial design of the HTC Initiative, but that publicity relating to the lack of procedural fairness was important in altering the evolution of the HTC Initiative.

The lack of procedural fairness in the initial phases of the HTC Initiative arguably may be understood from a neo-realist perspective of international relations as part of a pattern of dominant country dealings with less geopolitically influential countries. Procedural fairness, in the form of meaningful involvement in the development of international rules and standards by all countries most likely to be affected by such rules and standards, has generally been the exception rather than the norm. This is particularly so in relation to the ‘issue-specific’ intergovernmental organisations (IGOs) established by the G7 states in subject areas which affect the determinants, direction and flow of wealth. It is also of note that while standard setting in non-tax areas affecting trade may be conducted in part through organisations with more broad representation, such as the World

904 Discussed in Chapters 5 and 6 of this work
<http://www.essex.ac.uk/ECPR/events/jointsessions/paperarchive/edinburgh/ws11/Gstoehl.pdf> accessed 24 January
Trade Organisation, the OECD cannot be said to have either the same breadth in its membership or the same breadth of support for its objectives. The OECD is not unique however. Other self-selecting groups such as the Financial Stability Forum and the Basle Committee on Banking Supervision which are also dependent upon, or established by, the G7 also seek to set the rules in critical subject areas. As was recently noted in a World Bank report:

Neither the Financial Stability Forum nor the Basel Committee can legitimately represent the interests of developing countries. Various other standards, often developed by semi-private agencies (such as the International Accounting Standards Board), are based on practices in the United States and European Union. Greater participation and voice in rule-setting bodies would help ensure that outcomes are more favourable to developing countries. 906

Such observations may be understood to suggest that there is at least the risk of a variant of regulatory capture in which certain exclusive IGOs, acting as so-called ‘international standards setters’, function as instruments of developed countries, rather than as guardians of global welfare. 907 That is, capture may occur

2005. The G7’s preferred arbiters of standards in such areas include the Financial Stability Forum, the Financial Action Task Force, the Basel Group of Banking Supervisors and the OECD.


907 The concept of regulatory capture was originally used in a single state context to refer to regulators functioning to serve the private interests of regulatees rather than public interest. However, it may be extended to refer to a situation in which regulators function to serve some interest other than the public interest of the polity of the state from which they derive their legal authority. Thus, in the present context national regulators may be captured by the ‘international standard setters’ which act as proxies for the interests of governments who establish and maintain the so-called international standard setters. ME Levine and JL Forrence, ‘Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis’ (1990) Journal of Law, Economics, & Organization, Special Issue: [Papers from the Organization of Political Institutions Conference, April 1990], 167-198 <http://links.jstor.org/sici?sici=8756-6222%281990%29296%3C167%3ARCPIAT%3E2.0.CO%3B2-G> accessed 10 October 2007.
if exclusive supranational ‘standards setters’ do not specify standards that are based solely on competitively neutral prudential regulatory concerns, but rather specify standards that are biased towards the competitive interests of the countries which create, manage or fund them, and against the interests of other countries to which the biased standards are applied. In turn, the standards promulgated by captive IGO ‘standard setters’ and endorsed and enforced by developed countries, function as instruments to facilitate the conversion and ‘capture’ of the regulatory processes of developing countries, again to the benefit of the countries which sponsor the ‘standards setters’. As noted by Drezner:

When the great powers are in rough agreement on the regulatory issue at hand, but at odds with developing countries, the likely route to coordination is through club standards. Core states will create coalitions of the willing to generate a common set of rules and regulations. To formalize the coalition, core states will create or capture club IGOs with strong enforcement and sanctioning mechanisms. Stringent membership criteria permit great powers to act in concert while limiting participation in rule formation to like-minded countries.  

That is not to say that broad membership necessarily ensures that an organisation of sovereign states necessarily promotes broad equity. As has also recently been noted in a World Bank report in relation to the existing rule setting systems for economic cooperation:

[T]he rules may at times be unfair not because the formal processes are unfair but because of the underlying power imbalance between rich

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countries with strong commercial interests and poor countries with weak capacity.909

Arguments have been advanced by those representing the interests of the dominant states which tend to seek to control standard setting in taxation and other areas, to the effect that it would not be practical to have representatives of large numbers of countries involved in standard setting in such areas, or that broadly representative bodies would likely produce what may be described by the advocates and apologists for the dominant states as a set of ‘lowest common denominator’ standards.910 However, there is no evidence that there is a direct positive correlation between geo-political power and any unique capacity of states to identify and implement objectively superior standards in relation to taxation or other factors which affect the flow of capital.

It is worthy of note that many of the arguments against procedural fairness, including those set out above, tend to be efficiency based arguments rather than arguments about equity. That is, they play on the notional necessity of some type of ‘equity – efficiency tradeoff’ in which the equity which is lost is either immaterial to the entities which would deny procedural equity, or would have benefited ‘outsiders’, whereas the efficiency which is gained tends to

909 The World Bank (n 906), 212.
coincide with the substantive interests of those advocating efficiency over equity.

Efficiency based arguments against procedural fairness may be supplemented by other assertions offered as justifications for the denial of procedural fairness. It has been observed by some commentators that powerful states intending to bypass or restrict the procedural fairness which ought to be extended to the less powerful may find it expedient to assert, as a basis for the denial of procedural fairness, that some type of threat is posed by those countries which it intends to exclude or disadvantage, or that such countries are otherwise beyond the pale in terms of any claim to fair treatment.911 Looked at from the perspective of an alternative literature, such assertions may be understood as elements of policy narrative and as such requiring little if any objective validity.912

The OECD Global Forum on Taxation process, as it evolved from 2001 to 2006, arguably has demonstrated that improving procedural fairness through the use of both large inclusive ‘direction giving’ multilateral meetings together with small working groups comprised of representatives of both developing and

911 M Gaffney, 'Immobile Taxation in a World of Mobility' in DP Racheter, and Richard E. Wagner (ed) Federalist Government in Principle and Practice (Kluwer Boston 2000). Gaffney quotes the 19thC American statesman Henry Clay, "The arts of Power and its minions are the same in all countries and in all ages. It marks its victim; denounces it; and excites the public odium and the public hatred, to conceal its own abuses and encroachments."

developed countries,\textsuperscript{913} enables the production of standards that are generally accepted by a relatively large and diverse group of countries as non-binding 'high standards' in the area of tax information exchange.\textsuperscript{914} While the Global Forum process may not be entirely ideal from a procedural perspective in that it remains fundamentally an OECD process, and it may take more time than the 'gun boat diplomacy' which may be preferred by those least concerned with inter-nation equity or fairness, the product arguably has much greater legitimacy and enduring value in terms of compliance, than 'standards' developed in a setting with less procedural fairness.

7.4.2 Technical Capacity as a Determinant of Access to Procedural Fairness

Technical capacity arguments may also be used by those seeking to restrict procedural fairness. Such arguments revolve around the notion that it is only the dominant states which have the technical taxation and other resources required to set 'appropriate' standards,\textsuperscript{915} and therefore that it is only these states which have a

\textsuperscript{913} OECD, 'Outcome, conclusion of the meeting of the OECD Global Forum on Taxation in Berlin, 3-4 June 2004.' (2004) OECD \texttt{<http://www.oecd.org/document/5/0,2340,en_2649_201185_31967429_1_1_1_1,00.html>} accessed 31 May 2005; \textit{OECD} (n 864).

\textsuperscript{914} \textit{OECD} (n 871). The standards incorporated into the 2002 Model have subsequently been acknowledged by both OECD and non-OECD countries representing a majority of people on the planet as 'high standards' which all countries should aspire to.

\textsuperscript{915} Wechsler (n 910).
legitimate right to participate in standard setting. While it is undoubtedly true that developed countries spend more in absolute terms on developing technical capacity in taxation and related areas, that does not mean that developing countries ought to be excluded. Indeed, these types of 'qualification' tests arguably are in essence no different from now generally rejected arguments that have from time to time been used to prevent persons within individual states from participating in democratic processes on various bases including land ownership, skin colour, sex, and arbitrary standards of literacy. Such qualification tests have no legitimacy other than that conveyed by power, but rather tend to serve to ensure that the rules which are developed within exclusive processes, favour those entities which determine the nature of the qualification tests.

In the absence of the willingness of developed countries to increase spending on relatively more inclusive taxation related processes such as those operated by the UN, it is suggested that policy makers may wish to consider the following, admittedly imperfect proposition. Functionally any technical limitations of developing countries may be minimized if technical capacity were to be viewed as having two components which may have differing resource implications. The first component would comprise that technical capacity which is required to identify and reject flaws and biases which have the potential to adversely affect developing countries as set out in any proposals, analytical materials and other publications produced in exclusive fora, or indeed, by academics collaborating with such fora. The second would be that technical capacity which permits the
independent articulation of substantive standards which are not biased against the interests of developing countries. To the extent that rejection of biased proposals would interfere with regime formation around any biased products of exclusive fora, arguably far fewer resources may be required to ensure that developing countries can protect their interests through the rejection of both biases which operate against their interests, and cooperation mechanisms which operate to support such biases. By way of analogy, it takes more resources to manufacture a ruler than it does to publicly identify one that is bent. Similarly, it arguably took fewer resources to recognise that the process used in the initial phase of the HTC Initiative lacked procedural fairness than it took to operate the Initiative during that phase. A general recognition and application of this utility may go some way to ensuring that less biased products are produced in self-selecting exclusive fora.

It is important to note in this context that while there is evidence that some taxation protocols and instruments advanced by organisations such as the OECD may be inherently biased,\textsuperscript{916} it would be counter-productive for developing countries to simply reject all technical materials that are produced by organisations like the OECD without appropriate consideration. On the other hand, healthy skepticism may be warranted. In any context in which regulatory burdens are to be assigned, a combination of exclusive processes, the perspectives which representatives of developed countries naturally bring with them to any multilateral standard setting process, and a lack of awareness and accountability

\textsuperscript{916} Horner (n 861); Ring, (n 876). This is discussed in Chapter 5 of this work.
with respect to the legitimate objectives and concerns of developing countries, may bias proposals for ‘standards’ sponsored or authored by such organisations. 917

7.4.3 Inter-Nation Equity, Substantive Fairness and Multilateral Dialogue on Exchange of Tax Information Exchange

The notion of fairness as described by Franck, is rooted in shared perception. 918 This applies equally to procedural fairness and substantive fairness in relation to the allocation of taxation resources on a global basis. Franck has also observed that, ‘Fairness is the only basis for allocation on which ‘everyone’ is likely to agree. Only a fair formula can hope to succeed in limiting the (potentially ruinous) autonomous pursuit of goods.’ 919

It is undoubtedly correct that if the phrase ‘taxation resources’ is substituted for ‘goods’ in the quote from Franck above, that the statement remains correct. It is suggested that at the beginning of the 21st century, a shared perception of what constitutes fairness in relation to international taxation has not been fully

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917 Horner (n 861); Easson (n 861), 20.
918 Franck (n 866), 7-9.
919 Franck (n 866), 13. Franck’s text relates to the autonomous pursuit of goods however the same may be said to apply to taxation resources.
realized.\textsuperscript{920} Substantive fairness in taxation matters is subject to diverse interpretation. As discussed in Chapters 3 and 4 of this thesis, intra-nation fairness in the sense of horizontal equity and vertical equity among taxpayers within a single state, rather than inter-nation equity, has been a frequent focus in the academic tax literature as well as OECD and EU publications.\textsuperscript{921} Indeed such intra-nation fairness was arguably one of the principal ‘fairness’ issues set out in the OECD 1998 HTC Report.\textsuperscript{922}

In the absence of agreement on what substantive fairness is in relation to either processes for the allocation of taxation resources, or whether existing systems provide for such fairness, it is questionable whether it is possible to claim that fairness would necessarily be achieved by requiring countries to assist each other in enforcing national taxation systems by means of tax information exchange. It may be expedient for states to do so under certain circumstances as discussed in Chapters 3 and 4 of this work, but expediency does not necessarily enhance inter-nation substantive fairness, and neither does tax information exchange.


\textsuperscript{921} The ‘harmful’ tax practices featured in OECD publications and the ‘unfair’ taxes focused upon by the EU are discussed in Chapters 5 and 6 of this work.

\textsuperscript{922} OECD (n 852). In this analogy the patch may be said to have been required by the reduction or elimination of barriers to capital movement.
The focus on tax information exchange in the OECD’s Harmful Tax Competition Initiative arguably had most to do with an attempt to put what may be described as a ‘patch’ on the then existing residence-based taxation systems of the OECD’s Member States.923 While this strategic objective and the tool selected to achieve it may have been entirely rational in the sense of its potential ability to secure, or at least buy time for certain national interests, it is questionable whether it had much to do with fairness in an inter-nation sense.

An analysis of the ‘fairness’ or the lack of ‘fairness’ inherent in various versions of residence-based taxation is well outside the scope of the present work. However, a few observations may assist at this juncture. Undoubtedly the great majority of countries have implemented residence-based taxation regimes of one form or another,924 arguably as a result of the implementation of this system by the most powerful states over the past 100 years. It is also arguable that the broad adoption of residence-based taxation systems and the interactions which this has allowed has provided for a level of predictability in international commerce which in turn has enhanced the lives of at least some people in many countries. While these arguments may tend to support maintaining the status quo, they do not imply that residence-based taxation in its current forms should be considered sacrosanct.

924 OECD (n 897). The OECD study suggests that only a minority of countries, principally located in Latin America, the Caribbean and the Asia, maintain predominantly or exclusively territorial taxation regimes.
for all time, or that it is in any sense requisite for inter-nation substantive fairness. Arguably, the best that can be claimed is that residence-based taxation has contributed to the functionality of taxation systems and the delivery of public goods in many developed countries over time. That is, it has efficacy. The acknowledgement of efficacy need not be the end of the analysis.

The issue of ownership of, or entitlement to, particular taxation resources is not entirely a function of claims based on theories of residence-based taxation. This extends to the context of whether fairness requires countries to ‘prop up’ the taxation systems of other states by means of tax information exchange.

Arguments have been advanced that, by having relatively low or zero rates of capital taxation combined with an absence of tax information exchange, some countries in effect set the stage for the ‘poaching’ of taxation bases which ‘rightly belong’ to other states.925 This argument attempts to lump countries which have never had direct taxation together with those which have chosen to lower their rates of direct taxation in order to attract capital. One corollary to such arguments is that small and developing countries which have come into competition with OECD countries in the context of financial services, (what the OECD has chosen to label as ‘tax havens’), deserved whatever detriment they suffered at the hands of the OECD.

925 OECD (n 852), 16.
Such arguments appear to rely at least as much on emotive narrative rather than unbiased analysis. With the possible exception of the context of states bound to cooperate in taxation matters by treaty, as for example the Member States of the European Union, arguably the concept of agreed entitlement has limited application. Merely stating that a particular state is 'entitled' to a given tax base does not by itself make it so. Similarly, just because all, or the majority, or the most powerful, within a particular state agree that their particular state should have a particular tax system which has externalities does not morally 'entitle' them to enforce that tax system globally. The same could be said in relation to a limited group of states. This conclusion may be arrived at by different routes.

One route is by extension of the logic developed by Murphy and Nagel in a single state context.926 As noted by Murphy and Nagel, 'Justice and injustice in taxation can only mean justice and injustice in the system of property rights and entitlements that result from a particular taxation regime.'927 Thus, entitlement to any property which may form part of a tax base does not exist outside of a formal system of social cooperation, which in a single state context relates to the state itself as well as its residents or nationals. Transposing this argument out of Murphy and Nagel’s construct and into a multi-state context, it may be argued that no state

926 L Murphy and T Nagel, The Myth of Ownership (Oxford University Press, New York 2002). It is noted that Murphy and Nagel did not apply their construct in a multi-state context. The argument is therefore based on analogy only.
927 ibid, 8.
is entitled to any property right over any tax base, outside of global system of social cooperation which would necessarily include a currently non-existent global system of taxation. This absence of social cooperation argument is supported by the apparent disinclination of a number of the most powerful states to implement unbiased rules for tax competition, and also by their disinclination to be bound by the rules relating to tax information exchange that they seek to impose on others as was discussed more fully in Chapter 5 of this thesis.

A similar conclusion with respect to the weakness of claims of entitlement founded on residence-based principles and relating to at least certain tax bases, may be reached by examining this issue from the very different perspective of Nozick’s chain of entitlement.\textsuperscript{928} Nozick posited:

\begin{enumerate}
\item A person who acquires a holding in accordance with the principle of justice in acquisition is entitled to that holding.
\item A person who acquires a holding in accordance with the principle of justice in transfer, from someone else entitled to the holding, is entitled to the holding.
\item No one is entitled to a holding except by (repeated) applications of 1 and 2.\textsuperscript{929}
\end{enumerate}

Nozick’s proposition, transposed into a multi-state model, arguably would mean that there is no obligation to recognise any entitlement to a tax base in


\textsuperscript{929} ibid, 151.
instances in which the relevant tax base has been procured through processes of acquisition contaminated by injustice. Thus, there would be no obligation to recognise any claim to entitlement in instances in which the relevant tax base was procured or maintained by means of historic activities such as the slave trade. If correct, Nozick's proposition would cast doubts on claims to entitlement to at least some capital-related tax bases made by the majority G7 countries as well as many others. This theoretical underpinning for questioning of the OECD's claim relating to entitlement to what at least some of its members view as their tax bases, arguably is reflected in a 2001 speech given by the Cayman Islands Financial Secretary.\textsuperscript{930} It should also be noted that even the OECD in their 1998 Harmful Tax Competition Report were not so bold as to claim any absolute entitlements to particular tax bases, noting instead that unspecified others had characterized the attracting of elements of tax bases as 'poaching'.\textsuperscript{931} It is therefore perhaps the case that arguments which advance absolute claims to 'tax bases' based on the concepts of 'poaching' and 'entitlement' are also best understood as evocative policy narrative rather than the product of unbiased analysis.

For the sake of completeness, what may be described as the arguments deployed by certain advocacy groups which have joined the debate on entitlement


\textsuperscript{931} OECD (n 852), 16.
to taxation bases should also be considered, if only to cast doubt on their utility in the analysis of issues of entitlement to tax bases. Such arguments tend to be selective and derivative rather than novel. Some of these organisations and action groups have joined the attack on what they view as 'tax havens' and some have leapt to the defense of 'tax havens'. It should be noted however that few if any of these entities have views regarding which countries are 'tax havens' which correspond with those of the OECD or its member states. Those entities which choose to attack what they view as 'tax havens' tend to make assumptions that tax competition is 'bad' which appear to lead them inevitably to conclude that countries which may provide competitive environments for capital are engaged in something akin to 'poaching' and are therefore necessarily bad. Such assumptions and certain extrapolations from them have been criticized on economic grounds by their ideological opponents including Mitchell.

Those entities which see tax competition as 'good', tend to see the benefits derived by countries with low rates of capital taxation as proof that tax competition is 'good' and that the countries which benefit from such competition are entitled to those benefits as winners of the competition. This latter group

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932 A number of small well organized and increasingly influential organisations comprised of undoubtedly well intentioned and passionate individuals have sprung up in recent years. The Center for Freedom and Prosperity and the Tax Justice Network provide examples of such organisations. Both the Tax Justice Network and the Center for Freedom and Prosperity view the US and UK as operating tax havens while the OECD does not.

arguably has more support for their propositions in the academic tax economics literature, at least with respect to the welfare enhancing nature of tax competition.  

Arguments for entitlement to tax information exchange based on intra-nation social contract and intra-individual fairness within a single state, and counter-arguments based on the defense of social contracts in jurisdictions facing externalities produced by foreign states’ taxation regimes are set out in section 3.4.3 of this thesis and will not be repeated here. It suffices to note that increasing intra-nation fairness in a state which has a taxation system which does not produce negative externalities, arguably offers a rational and reasonable justification for tax information exchange. Indeed a state having such a tax system may possess a unique form of entitlement to tax information. This is not the context of the OECD’s HTC Initiative however.

Analysis of the evolution of the HTC Initiative, and in particular that aspect of the Initiative relating to tax information exchange, indicates that there has been a limited degree of willingness to consider issues of inter-nation equity in a relatively inclusive multilateral forum. By way of example within the HTC Initiative, it was only following the advent of substantive multilateral dialogue between OECD and the targeted non-OECD countries five years after the Initiative

was launched, that the OECD acknowledged that the timing of the implementation of the previously threatened punitive measures might not meet all of the objectives of the HTC Initiative, and did not appear to be fair either:

32. The Committee recognises that the potential application of a framework of co-ordinated defensive measures to tax havens prior to their potential application to OECD Member countries raises concerns regarding a level playing field between Member countries and tax havens. Therefore, the Committee agreed that a potential framework of co-ordinated defensive measures would not apply to uncooperative tax havens any earlier than it would apply to OECD Member countries with harmful preferential regimes. 935

By November 2005, a further acknowledgement of a substantive fairness requirement, in the form of an acknowledgement of the need for 'mutual benefits', appeared in the OECD’s Global Forum on Taxation process:

18. Ensuring that mutual benefits are derived by both parties will further the goal of helping financial centres that meet the high standards set for transparency and effective exchange of information in tax matters to be "fully integrated into the international financial system and the global community." Further, it is hoped that by providing mutual benefits, greater progress towards a level playing field will be made. 936

That is not to say that the countries participating in the November 2005 OECD Global Forum on Taxation had a common understanding of the nature or quantum of benefits that would create a 'level playing field' or compensate for a lack of 'levelness'. Rather, the available material suggests that there was at best, an acceptance that mutual benefits as an element in substantive fairness, was

relevant to the process, and at worst an acceptance that the inclusion of ‘carrot’ as well as ‘stick’ might be more efficacious in producing the access to tax information desired by OECD member states.\textsuperscript{937} What then may have been the catalysts for the emergence of considerations of substantial fairness in the HTC Initiative?

The available information suggests that within the OECD and its member states, limited considerations of substantive fairness and inter-nation equity in relation to the treatment of the countries targeted in the HTC Initiative emerged into the public domain only after the intercession of the Commonwealth in 1999 and 2000, and the 2001 change in administration in the United States. Such public recognition was reinforced in 2003 in the context of the near collapse of the HTC Initiative following the agreement of the EU members of the OECD to grant certain EU Member States and other countries a multi-year deferral in adopting the 2002 OECD exchange of information standards.\textsuperscript{938} The extent of substantive fairness offered to the targeted countries even after these events arguably provided only a very poor approximation of inter-nation equity, in that it was limited to deferral in the originally proposed dates for sanctions, together with somewhat vague references to ‘mutual benefits’.\textsuperscript{939}

\textsuperscript{936} OECD (2005) (n 913), 6.
\textsuperscript{937} Couch (n 884).
\textsuperscript{938} The relationships between the HTC Initiative and the EU Savings Tax Directive are discussed in Section 6.13.3.
\textsuperscript{939} OECD (2004) (n 913).
It therefore may be argued that considerations of substantive fairness for non-member states to date have played a relatively limited role in the evolution of the OECD’s proposed regime for tax information exchange. This is perhaps understandable given the advantage seeking objectives and exclusive nature of the process used for the setting of rules limiting tax competition. \(^{940}\) It may also in part reflect a notion that an outcome of international dialogue in relation to limiting tax competition, whether involving economic coercion or not, is ‘fair’ if the process used in arriving at the result has followed certain procedural norms which bestow ‘legitimacy’, irrespective of the equity in the final outcome. \(^{941}\) That is to say, meeting minimal procedural fairness criteria may be seen in some circles as a substitute for inter-nation equity, or at least as a significant shield with respect to criticism. Such an approach may be understandable in a context in which participants in the OECD process may see themselves as partisan seekers of their particular state’s maximal relative advantage.

The answer to the fourth question in relation to procedural fairness therefore is that issues of procedural fairness which go to the perceived legitimacy of any outcome of the HTC Initiative, have played a recognisable but limited role in shaping the Initiative’s proposed regime for limiting tax competition through the use of tax information exchange. Arguably, it was only a very public and emotionally resonant challenge to the procedural fairness of the HTC Initiative

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\(^{940}\) The nature of the competitive forces at play in the HTC Initiative are discussed in Chapters 5 and 6 of this work.

\(^{941}\) Nozick (n 928), 149 – 186. Nozick develops the concept of the need for legitimacy in the interactions leading up to the an result, specifically, entitlement is based on a chain of legitimate interactions.
which brought about this effect. That might suggest that a requirement not to be seen to be unjust or unfair may in some manner act as a meta-regime, at least in relation to the development of international regimes for cooperation in taxation matters, if not in relation to the operation of IGOs operated by the most developed countries more generally. 942

In contrast, the evidence suggests that issues of substantive fairness have played a very limited role in shaping the OECD’s HTC Initiative. This is perhaps an inevitable result of the fact that the ‘shape’ of what the Initiative’s political masters required was largely determined by geo-politically powerful states in an exclusive process in 1998 as described in sections 5.6 and 5.7 of this work, that is, long before discourse with their less geopolitically powerful targets had begun.

It may also be asked whether there was any substantively ‘unfair’ outcome caused to the countries targeted by the OECD in the HTC Initiative. It is certainly true that some of the targeted countries now have no significant presence in the international financial services sector. This would include the smallest, least integrated and most vulnerable countries on the list such as Tonga and Niue. 943 In the case of Tonga, it lost primarily opportunity for diversification. Niue has lost the small but significant income it had from the sector. Others among the initially targeted group have weathered the process relatively well, including the largest

and most integrated such as the Cayman Islands, the United Kingdom’s Crown Dependencies of Jersey, Guernsey and the Isle of Man and Barbados.\textsuperscript{944}

Another aspect related to the substantive fairness of the Initiative’s outcomes can be seen in the limits which are placed on access to treaty networks afforded to countries targeted in the HTC Initiative. In a 2006 paper the OECD noted:

A wide tax treaty network is helpful to countries seeking to raise and attract investment. They provide investors with increased certainty over their tax treatment, reduce the scope for double taxation of income, and they operate to improve profits and reduce risk. Tax treaties also provide a framework for the exchange of information among tax authorities to counter more aggressive forms of tax planning in relation to foreign and domestic source income.\textsuperscript{945}

On this basis, and consistent with the level playing field concept, it might be expected that all the non-OECD countries targeted in the HTC Initiative might be offered access to treaties so as not to give some countries an advantage that is denied to others. This has not happened. Only a few of the targeted sovereign states have been permitted to have conventional tax treaties.\textsuperscript{946} Further, in 2007 the OECD’s Jeffrey Owens indicated in relation to those targeted countries which are excluded from the treaty network; ‘What is clear, however, is that OECD countries

\textsuperscript{943} J Sharman, \textit{Havens in a Storm} (Cornell University Press, Ithaca and London 2007), 158.
\textsuperscript{944} ibid.
0/$FILE/JT03207558.DOC
are generally unwilling to enter into comprehensive tax treaties with tax havens. 947 This arguably reflects realism in action. Owens' statement ignores the fact that countries which provide tax information exchange on the basis of the provisions of comprehensive tax treaties based on the current OECD Model Convention are not 'tax havens' within the definition of the HTC Initiative. 948 Therefore, the issue of 'tax havens' being part of the treaty network would not apply. Arguably then, geo-politics and competitive interests rather than any notion of a level playing field, are likely to determine which countries are admitted to treaty networks.

The reluctance of OECD member states to enter into comprehensive tax treaties with the majority of the targeted countries may be understood as a composite of several considerations. Firstly, the policy narrative elements utilised in the early phases of the Initiative which suggested that countries with low rates of direct tax are either inherently bad or a pose a threat, may have made it politically difficult for jurisdictions to sign conventional tax treaties, particularly when no economic or political capital has been invested in the countervailing level playing field argument within domestic constituencies. The second relates to the entirely rational policy objective of maintaining the maximal latitude for taxation system design. While a general discourse on the rules of diverse countries relating

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946 OECD (n 897), 80 and following. Some of the initially targeted countries including Cyprus, Malta, San Marino and Barbados are permitted access to the treaty network. Most are not.

to the application of treaties is outside the scope of this work, it is sufficient to note for present purposes that tax treaties may constrain the latitude of taxation system design to the extent that they tend to override or constrain the interpretation of domestic tax legislation. At a simplistic level, states may feel obliged to ensure that all existing legislation as well as any new domestic legislation does not run counter to either the letter or spirit of any bilateral international obligations.

Further, the greater the divergence of the taxation systems of tax treaty partners is, then the greater the potential for constraint is likely to be. Seen in that context, OECD member states face a trade-off. Specifically, while securing access to tax information from countries with low rates of direct taxation in relation to capital may enhance the latitude for taxation system design, doing so within a conventional tax treaty framework potentially limits such latitude. From a neorealist perspective, states would prefer to secure advantage other than at the cost of constraint irrespective of any ‘level playing field’ considerations. This preference would appear to be evident in the Harmful Tax Competition Initiative.

It is also worth considering the effects experienced by countries that are neither OECD Member States, nor among the small and developing countries targeted by the OECD in the HTC Initiative in the period from 1998 to 2006. For the majority of them, it has been essentially business as usual. Singapore as an exception, has become a target for the OECD and EU given that it, rather than or at least in addition to, the OECD Member States, has been seen to have benefited

948 OECD (n 852)
from the movement of financial services activities out of at least some of the
countries targeted by the OECD.\textsuperscript{949} Other countries with relatively greater geo-
political influence than some of the countries which were forced out of the
financial services sector by the HTC Initiative, have seen an opportunity to
become financial services centres and have begun to take advantage of the space
created by the OECD. These include a number of the Gulf Emirates, Botswana,\textsuperscript{950}
and Jamaica.\textsuperscript{951} Given this array of outcomes, it would be difficult to contend that
broad and careful consideration of inter-nation equity has shaped the HTC
Initiative, or that substantive fairness in an inter-nation sense has either shaped or
been served by the HTC Initiative.

7.5 \textbf{INTERNATIONAL REGIME THEORY IN THE CONTEXT OF THE TAX}
\textbf{INFORMATION EXCHANGE COMPONENT OF THE HTC INITIATIVE}

The answer to the fifth and final question posed is that international regime theory
does provide a useful lens for understanding the development of international
cooperation in the context of tax information exchange, as was noted in Chapters 5

\textsuperscript{949} Jeffrey Owens, Written Testimony of Jeffrey Owens, Director, OECD Centre for Tax Policy and Administration
before the Senate Finance Committee on Offshore Tax Evasion May 3, 2007
notes that as of 2007 Singapore had become the third largest wealth management centre on the planet and, or perhaps
because, still refused to commit to the OECD process.

\textsuperscript{950} Sharman (n 943), 158.
and 6 of this work. That is not to say that any particular thread within international regime theory has evolved to the stage at which it has clear predictive value in matters of international taxation. Rather, it provides a framework and language which may be used to identify the connections which exist between the interactions of states in relation to tax information exchange and other interactions relating to diverse areas of economic competition among states which are described in other parts of the literature. It also offers the potential for greater understanding of how effective cooperative regimes may be created. What then does international regime theory suggest with respect to the ‘level playing field’ which participants in the OECD’s Global Forum process claim to be searching for?

An international regime arguably is in one sense, a tool which may be used to achieve certain objectives. In that sense, it is analogous to tax information exchange and shares with tax information exchange the attribute that neither is necessarily used for ‘good’ purposes. It therefore stands to reason that creating an international regime in relation to tax information exchange will not necessarily provide for greater substantive fairness or inter-nation equity in relation to the allocation of taxation resources. This is consistent with Keohane’s observation

951 K Barrett, ‘JLP Proposes Six-Point Plan’ (Cananews 19 April 2007)
that; '[A]lthough international regimes may be valuable to their creators, they do not necessarily improve world welfare. They are not ipso facto "good".'

International regime theory may also assist in other aspects of the analysis of processes relating to tax information exchange. By way of example, tax-related international instruments are unlikely to be the result of efforts to create a level playing field if neo-realist arguments concerning states pursuing their own relative advantage are accepted. If a level playing field is created as a by-product of such a tax-related instrument, it is likely to reflect a compromise in the pursuit of other objectives. Thus, the argument of Hurrell would suggest that the creation of a tax-related treaty arguably may be instigated by the pursuit of commercial interests by influential persons within the relevant states, or the pursuit of the domestic political or geopolitical interests of their rulers. A neo-realist perspective of international relations arguably would also suggest that a level playing field would most likely be achieved in the context of a series of bilateral treaties, if it provided sufficient net benefits for the relevant constituencies within the participating jurisdictions relative to non-participants, so as to overcome any tendency of the participants to seek competitive advantage in relation to each other. This scenario is difficult to envisage in the relationships among all of the various OECD and non-OECD countries affected by the HTC Initiative.


954 *Ring* (n 876), 17.
Keohane has recently articulated a series of proposals for mechanisms which may be used to enhance the probability of regime formation.\textsuperscript{955} Keohane's analysis would suggest that providing up-front benefits rather than burdens is more likely to contribute to regime formation. This approach appears to have been used successfully to create agreement among relevant 'insider' member states in both the HTC Initiative and also the EU Directive on the Taxation of Savings Income.\textsuperscript{956} Arguably, the relative lack of progress of the HTC Initiative in terms of producing large numbers of bilateral agreements providing for tax information exchange and involving the targeted non-OECD countries may be attributed to the fact that the OECD has sought to limit up-front benefits for non-members in order to preserve comparative advantage for its member states.\textsuperscript{957} Further, the potential upfront disadvantages faced by non-OECD countries targeted by the OECD in the HTC Initiative, and in particular those associated with the last man standing problem identified in section 2.2.1 of this thesis, arguably have also deterred progress in a manner consistent with Keohane's observations.\textsuperscript{958}


There is a possible corollary to Keohane’s observation which may be derived from an analysis of the HTCI Initiative. It is constructed as follows. It is arguable that all regulation imposes costs or burdens which must be borne by some entity or entities.\(^959\) If this is correct, and the neo-realist perspective of international relations is also accurate to the extent that states compete for relative advantage,\(^960\) then in keeping with Keohane’s observations of the value of rewarding insiders, it seems plausible that in formulating new international regulatory regimes in non-transparent and exclusive processes, the members of organisations like the OECD would be likely to allocate upfront benefits or defer burdens applicable to club members and to allocate relatively greater burdens to others. This certainly seems to have been the case in the HTC Initiative. To the extent this proposition has predictive value in relation to exclusive organisations, it would seem reasonable for policy makers excluded from standard setting organisations to carefully examine any relevant products of such organisations in order to exclude bias and disadvantage.

There is another context in which disadvantage might be anticipated by less powerful states in relation to the allocation of burdens within exclusive top-down processes. In the context of the HTC Initiative, that relates to whether there was or is any intention to create a fully fledged international regime which would

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\(^{957}\) Couch (n 884).

\(^{958}\) Keohane (n 951).


\(^{960}\) Ring (n 876), 17.
require OECD member states to provide tax information to other states, or rather a quasi-regime which would obligate only non-OECD countries to provide information to OECD member states which require it. In this regard it is noted that there has been no rush by OECD member states which operate taxation systems designed to attract foreign capital to enter into tax information exchange agreements with countries which might want tax information relating to non-OECD residents. Further, even within the OECD, the most powerful state has refused to enhance tax information exchange with other OECD member states when to do so might reduce the powerful state’s competitive advantage. These observations also support a neorealist interpretation of events within the HTC Initiative and suggest that policy makers should be sceptical of any claims relating to a fair allocation of burdens in relation to tax information exchange.


7.7 IF AT FIRST YOU DON’T SUCCEED - FALLOUT FROM THE OECD
GLOBAL FORUM’S SEARCH FOR A LEVEL PLAYING FIELD IN RELATION TO TAX INFORMATION EXCHANGE

Former British Prime Minister Tony Blair observed that; ‘Powerful nations want more effective multilateral institutions - when they think those institutions will do their will. What they fear is effective multilateral institutions that do their own will.’\textsuperscript{963} It is arguable that in the context of the HTC Initiative, that the OECD as one such multilateral institution has not delivered what its member states sought, or at least have not delivered within the desired time frame.

Recent evidence suggests that the relative paucity of new tax information exchange instruments produced by the OECD’s HTC Initiative to the end of 2006, has caused the political directorates of a number of OECD member states to contemplate new unilateral actions in order to circumvent issues of inter-nation equity which have caused the OECD to deviate from its original trajectory. Canada in particular has announced unilateral measures to encourage financial services centres outside of its treaty network, that is, those in small and developing countries, to provide it with access to tax information. It will use market access restrictions to penalise such countries if they do not provide tax information.\textsuperscript{964}

\textsuperscript{963} T Blair, ‘Speech to George Town University’ (2006) \texttt{<http://www.number10.gov.uk/output/Page9549.asp> accessed 26 May 2006.}

This comes at the same time as Canada’s announcement that it will join other OECD member states, including the US, the UK and Japan, which exempt from tax certain interest income belonging to non-residents.\textsuperscript{965} The proposed Canadian exemption will apply to income from capital, including capital belonging to residents of countries with which Canada does not exchange tax information, suggesting the pursuit of national interest rather than equity mediated through tax information exchange.

European Union Member States have moved to link the continuance of aid to small and developing non-European countries which they consider to be 'tax havens', to the implementation of OECD style tax information exchange agreements.\textsuperscript{966} In keeping with previous practices, the EU intends to impose these obligations on non-European aid dependent countries even though it does not require its own members and selected European non-EU states to do the same.\textsuperscript{967} This will be of particular policy relevance to those targeted small and developing states which are; firstly aid dependent, secondly in competition with the European financial centres which the EU has exempted from tax information exchange requirements, and thirdly attempting to diversify into the financial services sector so as to end, or at least minimise, aid dependence. The aggregate effect of the EU

stance, given the absence of diversification alternatives for these small states, would seem to be consistent with the objective of institutionalising aid dependence. An alternative interpretation would be that the EU is proposing to pay these aid dependent countries to remove themselves from competition in the financial services sector.

Perhaps of even greater potential interest in relation to both theory and policy, will be the playing out of recent United States legislative initiatives aimed at 'tax havens'. The rhetoric associated with these US initiatives appears to be aimed at geopolitically less powerful countries which are successful as financial services centres irrespective of whether they share tax information with the US or not. It is also noted that while these initiatives are not being led by the US Federal Government per se, and they are at present far from becoming law, a significant number of members of both Houses of Congress appear to have latched onto what Sharman identifies as the mirage that 'tax havens' hold vast amounts of wealth to which other states are entitled, or at least notional wealth which the United States can claim in order to balance its budget. One Democratic presidential contender has gone so far as to state in his campaign material that if elected, he

967 Courtois (n 952).
969 Sharman (n 936), 159. Sharman notes that, '[T]he idea that a more vigorous campaign against tax havens will yield major new government revenue is ....a mirage.'

398
will declare war on ‘tax havens’.\textsuperscript{970} This is occurring at a time when there is no evidence that the US has any interest in curbing its own ‘tax haven’ practices.

Sharman has observed that although OECD countries possess geopolitical power, they are none the less constrained by norms which limit the use of such power.\textsuperscript{971} This parallels the general neo-realist argument on the limits of state action made by Morgenthau and referred to in section 3.1 of this work. It may then be asked, are these constraints relevant in the current phase of the HTC Initiative as activity moves to unilateral measures?

The unilateral actions of OECD member states noted above arguably may highlight the practical limits of multilateral dialogue, and the operative limits of fairness norms as constraints in relation to tax information exchange. Specifically, OECD member states recognised in 1998 that unilateral actions were less likely to limit tax competition than multilateral action.\textsuperscript{972} They almost certainly realised that uncoordinated unilateral actions would leave a patchwork of tax information exchange which would be unlikely to control tax competition. On this basis they established a multilateral initiative designed to secure their collective interests. However, neo-realist theory would suggest that powerful states are likely to use multilateral fora only if, and only for so long as, such fora advance their interests.

As was noted in section 6.5 of this work, more powerful states face relatively low costs associated with defection from OECD processes. A neo-realist perspective would suggest that such states are likely to defect from a multilateral initiative and to seek a second best unilateral alternative if the unilateral alternative is seen to be more likely to serve their national interests. In the context of the OECD’s Global Forum, the poorly defined level playing field requirement accepted as reasonable in 2003 by both OECD and non-OECD countries, may now be unacceptable to OECD member states able to secure unilateral solutions. To the extent that this is the case, policy makers in small and developing states may be well advised to continue to pursue the setting of taxation-related standards in multilateral fora in which considerations of fairness are more likely to be considered, while simultaneously following the example of developed states in seeking advantage through unilateral means.

972 OECD (n 852), 8.


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