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February 2, 2009

Congressional Research Service

Report R40114

The OECD Initiative on Tax Havens

James K. Jackson, Specialist in International Trade and Finance

December 2, 2008

Abstract. Since the 1990s, the Organization for Economic Cooperation and Development (OECD) has pursued the issues of bribery and tax havens, resulting in changes to certain U.S. laws. In addition, the OECD, under the direction of its member countries, spearheaded an international agreement to outlaw crimes of bribery and it continues to coordinate efforts that are aimed at reducing the occurrence of money laundering and corruption. Also, the OECD is a pivotal player in promoting corporate codes of conduct that attempt to develop a set of standards for multinational firms that can be applied across national borders. In the 110th Congress, companion legislation was introduced in the House (H.R. 2136) and the Senate (S. 681) to restrict the use of tax havens. Similar legislation may be introduced in the 111th Congress. Some estimates indicate that tax havens cost the United States \$100 billion each year in lost tax revenues (The Christian Science Monitor, Tax Havens in U.S. Cross Hairs, by David R. Francis, June 9, 2008).

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Congressional Research Service

7-5700

www.crs.gov

R40114

Summary

Since the 1990s, the Organization for Economic Cooperation and Development (OECD) has pursued the issues of bribery and tax havens, resulting in changes to certain U.S. laws. In addition, the OECD, under the direction of its member countries, spearheaded an international agreement to outlaw crimes of bribery and it continues to coordinate efforts that are aimed at reducing the occurrence of money laundering and corruption. Also, the OECD is a pivotal player in promoting corporate codes of conduct that attempt to develop a set of standards for multinational firms that can be applied across national borders. In the 110th Congress, companion legislation was introduced in the House (H.R. 2136) and the Senate (S. 681) to restrict the use of tax havens. Similar legislation may be introduced in the 111th Congress. Some estimates indicate that tax havens cost the United States \$100 billion each year in lost tax revenues (*The Christian Science Monitor*; Tax Havens in U.S. Cross Hairs, by David R. Francis, June 9, 2008). This report will be updated as warranted by events.

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Background

The Organization for Economic Cooperation and Development is an intergovernmental economic organization in which the 30 member countries¹ discuss, develop and analyze economic and social policy.² The OECD is organized around three main bodies: the Council, the Committees, and the Secretariat. Committees are comprised of representatives of all the member countries. The overriding committee is the Council, which has decision-making power. It is composed of one representative for each member country, generally at the level of Ambassador, gives guidance to the OECD, and directs its work. Since the work agenda is set by unanimous consent by the Council, a veto by a Council member removes an item from the agenda. The OECD is a strong proponent of the view that increasing world economic growth and welfare is best supported by a free and open flow of goods, services, and capital. As a result, it views its own role in this process as that of a leading proponent of the benefits of globalization and as a force for developing institutions and regulatory structures that can make these benefits available to the OECD members and to developing countries.

International flows of capital and goods and services around the world, a phenomenon referred to as globalization, have grown dramatically over the last two decades and are producing significant challenges for the OECD members, including the United States. International flows in dollars, for instance, now total over \$1.9 trillion *per day*, or nearly as much as the total *annual* amount of U.S. exports and imports of goods and services. One part of these flows is foreign direct investment, or investment in businesses and real estate. The United States is the largest recipient of foreign direct investment and is the largest overseas investor in the world, owning over \$2.1 trillion in direct investment abroad, or almost twice as much abroad as British investors, the next most active overseas investors. This international expansion of business activity and overseas presence, however, often leads to a clash of cultures and values.

Tax Havens

During the last half of the 1990's, the OECD pursued an effort to curtail the use of what it termed "harmful tax competition,"³ which it defined as attempts by some countries to attract capital by offering tax-benefit inducements with the sole purpose of attracting foreign investment. These concerns arise from a judgement that certain kinds of competition for internationally mobile capital can threaten the tax bases of other OECD countries and can distort the worldwide allocation of capital. In one report on the issue, the OECD indicated that it was not focusing on any particular nation's tax structure. It stated:

¹ The member countries include Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

² For additional information, see CRS Report RS21128, *The Organization for Economic Cooperation and Development*, by James K. Jackson.

³ *Harmful Tax Competition: an Emerging Global Issue*. Organization for Economic Cooperation and Development, Paris, 1998.

Historically, tax policies have been developed primarily to address domestic economic and social concerns. The forms and levels of taxation were established on the basis of the desired level of publicly provided goods and transfers, with regard also taken to the allocative, stabilizing, and redistributive aims thought appropriate for a country.⁴

Instead, the OECD indicated that it was attempting to curtail tax practices by countries that have, “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 or residence...”⁵ As a result, the OECD indicated that it was not targeting merely differences in tax structures between countries that may be exploited by individuals or firms, but a practice that is meant specifically to reallocate investment:

Unlike the situation of mismatching...Here the effect is for one country to redirect capital and financial flows and the corresponding revenue from the other jurisdictions by bidding aggressively for the tax base of other countries. Some have described this effect as “poaching” as the tax base “rightly” belongs to the other country. Practices of this sort can appropriately be labeled harmful tax competition as they do not reflect different judgements about the appropriate level of taxes and public outlays or the appropriate mix of taxes in a particular country, but are, in effect, tailored to attract investment or savings originating elsewhere or to facilitate the avoidance of other countries’ taxes.⁶

The Clinton Administration played a leadership role in shaping the OECD’s tax competition initiative. When the initiative was publicly announced, for instance, the Clinton Administration, through Treasury Secretary Lawrence Summers, released a statement that read:

The identification of tax havens and potentially harmful tax regimes is a crucial step in preventing distortions that could undermine the benefits of enhanced capital mobility in today’s global economy...We encourage all countries to follow the example set by the OECD member countries...that have committed to eliminate harmful tax practices.⁷

The Bush Administration, however, led by Treasury Secretary Paul O’Neill, decided to pursue a different approach. In a statement before the Senate Committee on Governmental Affairs July 18, 2001, Secretary O’Neill voiced the Bush Administration’s opposition to portions of the OECD’s efforts to target tax havens. The Secretary said:

The 1998 OECD Report⁸, and a follow-up report issued in June 2000, contained rhetoric that implicated fundamental internal tax policy decisions of countries within and outside the OECD, including decisions regarding tax rates. The Reports enumerated the harms potentially caused by “tax havens or harmful preferential regimes that drive the effective tax rate levied on income from the mobile activities significantly below rates in other countries.” Tax systems that “redirect capital and financial flows and the corresponding revenue from” other countries were condemned as “poaching” the rightful tax base of the other countries,

⁴ *Harmful Tax Competition*, p. 13.

⁵ *Ibid.*, p. 21.

⁶ *Ibid.*, p. 16.

⁷ *Treasury Secretary Welcomes OECD Report on Harmful Tax Competition Havens*, U.S. Department of the Treasury, June 26, 2000.

⁸ *Harmful Tax Competition: An Emerging Global Issue*, the Organization for Economic Cooperation and Development, 1998.

even though such systems provide a more attractive investment climate without facilitating noncompliance with the tax laws of any other country.⁹

As a result of the Bush Administration's efforts, the OECD backed away from its efforts to target "harmful tax practices" and shifted the scope of its efforts to improving exchanges of tax information between member countries. In his statement, Secretary O'Neill stated that he was "troubled by the notion that any country, or group of countries, should interfere in any other country's decisions about how to structure its own tax system."¹⁰

Financial Action Task Force

Following the terrorist attacks of September 11, 2001, the Financial Action Task Force on Money Laundering (FATF),¹¹ the body within the OECD that had pursued the tax haven issue, redirected its efforts to focus on terrorist financing. In addition to its two main efforts on money laundering and terrorist financing, the FATF in 2007 revised its mandate to respond to such new and emerging threats as proliferation financing and vulnerabilities in new technologies which could destabilize the international financial system.¹²

The FATF is comprised of 31 member countries and territories and two international organizations¹³ and was organized to develop and promote policies to combat money laundering and terrorist financing.¹⁴ In 2008, China and South Korea were granted observer status, the first step in the process toward full membership in FATF. The FATF relies on a combination of annual self-assessments and periodic mutual evaluations that are completed by a team of FATF experts to provide information and to assess the compliance of its members to the FATF guidelines. FATF has no enforcement capability, but can suspend member countries that fail to comply on a timely basis with its guidelines. The FATF is housed at the headquarters of the Organization for Economic Cooperation and Development in Paris and occasionally uses some OECD staff, but

⁹ Statement of Paul H. O'Neill Before the Senate Committee on Governmental Affairs Permanent Subcommittee on Investigations: OECD Harmful Tax Practices Initiative, July 18, 2001.

¹⁰ Ibid., p. 4.

¹¹ For additional information, see CRS Report RS21904, *The Financial Action Task Force: An Overview*, by James K. Jackson.

¹² *FATF Annual Report: 2007-2008*, The Financial Action Task Force, June 20, 2008. P. 19.

¹³ The FATF members are: Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States; the two international organizations are: the European Commission, and the Gulf Cooperation Council. The following organizations have observer status: Asia/Pacific Group on Money Laundering; Caribbean Financial Action Task Force; Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures; Eastern and Southern Africa Anti-Money Laundering Group; Financial Action Task Force on Money Laundering in South America; other international organizations including the African Development Bank; Asia Development Bank; European Central Bank; International Monetary Fund; Organization of American States, Organization for Economic Cooperation and Development; United Nations Office on Drugs and Crime; and the World Bank.

¹⁴ To be admitted to the FATF, a country must: 1) be fully committed at the political level to implement the Forty Recommendations within a reasonable time frame (three years) and to undergo annual self-assessment exercises and two rounds of mutual evaluations; 2) be a full and active member of the relevant FATF-style regional body; 3) be a strategically important country; 4) have already made the laundering of the proceeds of drug trafficking and other serious crimes a criminal offense; and 5) have already made it mandatory for financial institutions to identify their customers and to report unusual or suspicious transactions.

the FATF is not part of the OECD. The Presidency of the FATF is a one-year appointed position, currently held by Mr. Antonio Gustavo Rodriguez of Brazil, who is to serve through June 30, 2009. The FATF has operated under a five-year mandate. At the Ministerial meeting on May 14, 2004, the member countries renewed the FATF's mandate for an unprecedented eight years.

When it was established in 1989, the FATF was charged with examining money laundering techniques and trends, reviewing the actions which had already been taken, and setting out the measures that still needed to be taken to combat money laundering. In 1990, the FATF issued a report containing a set of Forty Recommendations, which provided a comprehensive plan of action to fight against money laundering. In 2003, the FATF adopted the second revision to its original Forty Recommendations, which now apply to money laundering and terrorist financing.¹⁵

On October 31, 2001, the FATF issued a new set of guidelines and a set of eight Special Recommendations on terrorist financing.¹⁶ At that time, the FATF indicated that it had broadened its mission beyond money laundering to focus on combating terrorist financing and that it was encouraging all countries to abide by the new set of guidelines. A ninth Special Recommendation was added in 2005. In 2005, the United Nations Security Council adopted Resolution 1617 urging all U.N. Member States to implement the FATF Forty Recommendations on money laundering and the Nine Special Recommendations on terrorist financing.

The FATF completed a review of its mandate and proposed changes that were adopted at the May 2004 Ministerial meeting. The new mandate provides for the following five objectives: (1) continue to establish the international standards for combating money laundering and terrorist financing; (2) support global action to combat money laundering and terrorist financing, including stronger cooperation with the IMF and the World Bank; (3) increase membership in the FATF; (4) enhance relationships between FATF and regional bodies and non-member countries; and 5) intensify its study of the techniques and trends in money laundering and terrorist financing.¹⁷

Bilateral Exchange of Information Agreements

Another initiative the OECD has pursued since 2000 has been efforts with financial centers around the world to implement bilateral agreements on exchanges of information for tax purposes in order to bring greater transparency and accountability to cross-border transactions. On October 30, 2008, the OECD announced that 16 new exchange of information agreements had been signed, bringing to 44 the number of such arrangements that have been put in place since 2000. In addition, OECD Secretary General Angel Gurrja called for a new drive to raise standards and performance in the area of corporate governance. At the heart of this campaign are moves to strengthen implementation of the OECD Principles of Corporate Governance,¹⁸ first launched in

¹⁵ For the Forty Recommendations, see http://www1.oecd.org/fatf/pdf/40Recs-2003_en.pdf.

¹⁶ *FATF Cracks Down on Terrorist Financing*. Washington, FATF, October 31, 2001, p. 1.

¹⁷ http://www1.oecd.org/fatf/pdf/PR-20040514_en.pdf

¹⁸ The OECD Principles of Corporate Governance are a voluntary set of standards that were endorsed by OECD Ministers in 1999. They are a non-binding set of standards that are not intended to substitute for government, semi-government or private sector initiatives to develop more detailed "best practice" in corporate governance. The Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing (continued...)

1999 and adopted by the Financial Stability Forum¹⁹ as one of its 12 core standards for sound financial systems on March 26, 2000. According to Gurrja, the global financial crisis and tax evasion scandals have strengthened governments' determination to fight tax evasion and bring increased transparency to cross-border transactions.

Legislation

Congress has expressed a continuing interest in the issue of tax havens. In the 110th Congress, companion bills were introduced in the House (H.R. 2136) and the Senate (S. 681), titled the Stop Tax Haven Abuse Act, to restrict the use of offshore tax havens and abusive tax shelters to “inappropriately avoid Federal taxation, and for other purposes.” Similar measures may be introduced in the 111th Congress. Among other provisions, the measures would have amended Internal Revenue Code provisions relating to tax shelter activities to: (1) establish legal presumptions against the validity of transactions involving offshore secrecy jurisdictions (i.e., foreign tax havens identified in the act and by the Commissioner of the Internal Revenue Service); (2) impose restrictions on foreign jurisdictions, financial institutions, or international transactions that are of primary money laundering concern or that impede U.S. tax enforcement; (3) increase the period for Internal Revenue Service review of tax returns involving offshore secrecy jurisdictions; (4) require tax withholding agents and financial institutions to report certain information about beneficial owners of foreign-owned financial accounts and accounts established in offshore secrecy jurisdictions; and (5) disallow tax advisor opinions validating transactions in offshore secrecy jurisdictions.

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(...continued)

good corporate governance. Available at <http://www.oecd.org/DATAOECD/32/18/31557724.pdf>

¹⁹ The Financial Stability Forum is a group of about a dozen nations who participate through their central banks and financial ministries and departments, including Japan, Canada, Germany, France, Italy, the United States, the United Kingdom, and many other industrialized economies. It also includes several international economic organizations, consisting of major national financial authorities such as finance ministries, central bankers, and international financial bodies. The Forum was founded in 1999 to promote international financial stability. It facilitates discussion and cooperation in supervision and surveillance of financial institutions, transactions and events.