



Tax Policy Bulletin

The OECD's work on tax havens and offshore financial centres – what are the latest developments?

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The OECD's work on tax havens and offshore financial centres has achieved high profile with significant political backing over the last eighteen months. Tax issues in general have become increasingly prominent on the political agenda, with tax transparency being discussed at G20 summits since 2008. Although commonly referred to in the context of offshore centres, the OECD's work in this area actually applies also to all the leading developed countries.

This bulletin examines the background to this work, its current status and possible future developments in this area.

Background – the harmful tax agenda

Over the last 15 years or so, international organisations – particularly the OECD – have focused their attention on preferential tax regimes (including certain nil or low tax zones). Their aim is to identify and seek to eradicate regimes that they perceive as harmful, ensuring that economic rather than tax factors influence the location of business.

The OECD began work in this area in 1996, focusing on mobile activities such as financial and other service activities. The landmark 1998 report on harmful tax competition sets out the OECD's primary criteria for identifying harmful preferential tax regimes. They include: 1) no or low effective tax rates; 2) ring-fencing from the domestic economy; 3) non-transparent operation of the tax regime; and 4) lack of effective exchange of information. Other secondary factors are also referred to in the report including artificial definition of the tax base; failure to adhere to transfer pricing principles; exemption of foreign source income; inappropriate use of rulings; and negotiable tax bases.

Historically, the OECD adopted a three track approach to its harmful tax competition agenda, directed at: 1) member countries; 2) non-member countries; and 3) tax havens. But, over time, much of this work has merged so that the latter two groups now fall under the work being carried out on international financial centres and tax havens that has achieved such high profile under the G20's sponsorship.

Since 1998, non-OECD members have been actively encouraged by the OECD to participate in the campaign against harmful tax competition. Originally, the OECD focused on targeting low tax regimes within these territories – especially those designed to apply to activities or special arrangements which were 'ring-fenced' from the domestic economy (either by excluding resident taxpayers from the regime or by excluding participants in the regime from operating in the domestic market). The OECD now takes the approach that the design of the tax system is a matter for the sovereignty of the state concerned. It focuses instead on whether or not these territories meet the OECD's required standards for the exchange of information and transparency.

The OECD's initial (and largely negative) approach to tax havens has also evolved as a large number of these territories have indicated a wish to cooperate with the OECD. This led to the OECD inviting tax havens to make a public commitment (and develop a plan) to eliminate harmful tax practices. Any tax havens which were not prepared to make commitments on transparency and exchange of information were put on a list of uncooperative tax havens. However, all territories have now been accepted as 'cooperative'.

The OECD's approach to non-OECD members and tax havens in relation to harmful tax is therefore now broadly consistent, with a focus on ensuring that the OECD's standards on transparency and the exchange of information are met. Member countries are also expected to meet these standards which are centred around three themes: 1) availability of information; 2) appropriate access to information; and 3) exchange of information mechanisms.

The principles of transparency and effective exchange of information have been articulated and refined by the OECD's Global Forum on Taxation (Global Forum). The Global Forum is a multilateral framework used by the OECD to work on tax matters with non-OECD economies. Since its creation in 2000, the Global Forum has been the primary owner of the work carried out in this area. The Global Forum currently has 95 member jurisdictions, including all G20 members, all OECD members and all major financial centres.

Further details on both the concepts of 'transparency' and 'exchange of information' are provided below.

1) Transparency

The OECD sees a lack of transparency potentially arising in two contexts: 1) the way in which a regime is designed and administered including favourable or negotiable application of the laws, regulations or administrative practices; and 2) the existence of provisions such as secrecy laws or inadequate ownership requirements that prevent effective exchange of information or access to information.

The transparency standards promoted by the OECD require the availability of and access to the following types of information:

- bank information – access by the tax authorities to bank and other financial information relating to customers and transactions held by financial intermediaries;
- ownership and identity information – access to information relating to the beneficial ownership of all types of entities such as companies, partnerships, other entities and of managers and beneficiaries of collective investment funds and of those setting up and benefitting from trusts; and
- accounting information – access to information relating to reliable accounting records, audited accounts, etc.

The OECD has a variety of measures to be used as sanctions for those states who do not comply with their transparency requirements in order to counter harmful tax competition and/or uncooperative tax havens. Key sanctions are likely to consist of sustained political pressure from countries that actively participate in this process.

2) Exchange of information

The OECD seeks to achieve a ‘level playing field’ in relation to the exchange of information. This means ensuring that high standards of information exchange are implemented, for both civil and criminal taxation matters, within an acceptable timeline and with the aim of achieving equity and fair competition. The OECD recognises that this principle will be implemented through a process of bilateral negotiations between states.

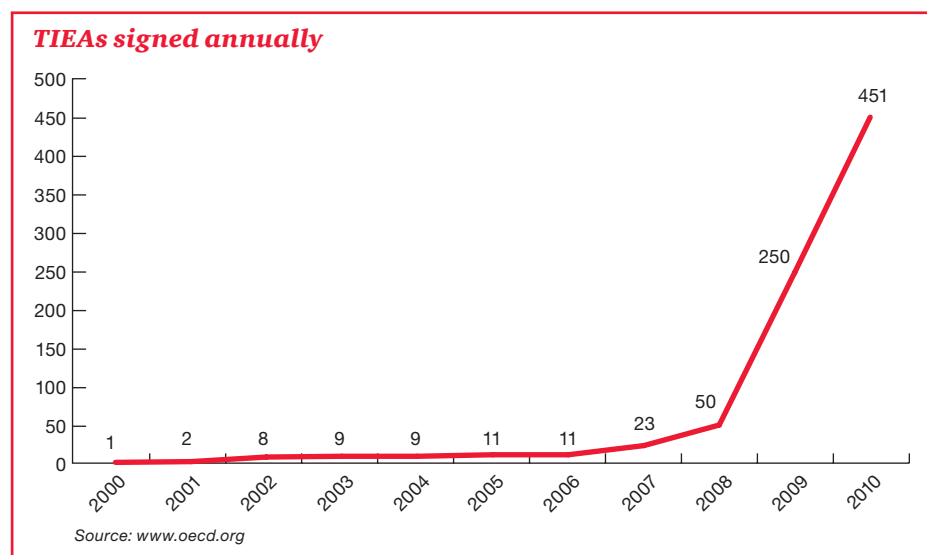
The OECD’s standards for the exchange of information require: 1) a legal

mechanism for providing information to another state for tax administration purposes when requested; and 2) administrative measures to ensure that the exchange of information functions effectively (e.g. adequate resources to deal with information requests and adherence to proper procedures to ensure prompt responses, etc.)

Current status of work on transparency and exchange of information

The progress made in implementing the internationally agreed standard of transparency and exchange of information over recent months has been considerable. In April 2009, at the time of the G20 announcement, four countries were identified as not having committed to the standard. Eight financial centres and 35 tax havens had committed to the standard, but hadn’t implemented it. Only 40 countries were identified as having substantially implemented the standard. By December 2010, all countries had committed to the standard with only three financial centres and six tax havens not having substantially implemented it. The number of countries who have implemented the standard has risen from 40 to 80 since April 2009.

Commitment to the standard is measured in terms of the number of double tax conventions (DTCs) and Tax Information Exchange Agreements (TIEAs) entered into. It’s therefore no surprise that the number of such agreements signed has risen sharply in the last few months. Only 65 agreements had been completed as at April 2009 compared to an expected 620 by December 2010. The dramatic rise in the number of TIEAs signed each year can be seen in the graph below:



Once all jurisdictions have implemented the international standard, the OECD progress report, first released in April 2009, will be superseded by the outcomes of the more granular 'peer review' process outlined below.

In order to monitor and review the implementation of the standards of transparency and exchange of information, a Peer Review Group (PRG) has been set up, consisting of 30 Global Forum members. A programme of peer reviews is now in progress for all members of the Global Forum as well as other relevant jurisdictions. In order to establish whether a territory complies with the standards of transparency and exchange of information, ten essential elements of the standards have been identified against which each jurisdiction is reviewed. These elements are grouped under the categories of availability of information; access to information; and exchange of information. The peer review involves an assessment of the jurisdiction's legal and regulatory framework (phase 1) as well as an assessment of the standards in practice (phase 2) against the ten elements. Forty reviews are planned to take place every year until 2014. Most jurisdictions will begin with a phase 1 review, followed by a phase 2 review 18-24 months later. In a limited number of cases, these phases will be combined.

Possible future developments

Due to the heavy schedule of peer reviews planned into 2014, any major changes to the Global Forum's current agenda on this topic are unlikely.

However, there are some questions around the future direction of this work. For example, the application of the existing exchange of information standard is based on an agreed approach of information exchange on request. Although this is seen as a major step forward, there have been repeated calls for the standard to be based on an automatic exchange of information. Given the more stringent and detailed OECD requirements in this area, it's

possible that this change could be made in future. But, for many jurisdictions – whether as providers or receivers of information – a material increase in exchanges of information may prove impractical.

There is also the bigger question of whether – and how – the OECD will return to the original harmful tax agenda and resume a more directive approach in relation to tax measures that are perceived as harmful. This seems unlikely since the harmful tax project has now evolved into the work on transparency and exchange of information. Also, given the increasing prominence of tax competition among states, it's uncertain whether the OECD could command a consensus view to support strong measures directed at removing such harmful tax competition.

Whatever the future developments at the OECD are, it does seem clear that increased coordination and cooperation between states will be applied in the fight against tax evasion. The recent IMF paper, 'Long-Term Trends in Public Finances in the G-7 Economies' makes a call for such cooperation. The OECD's Forum on Tax Administration (FTA) also has various initiatives underway (such as recently releasing guidance for joint tax audits) to support a move in this direction.

In addition to these initiatives taken by transnational organisations, individual countries are also likely to continue to introduce measures targeted at tax havens and offshore financial centres, whether by way of disclosure (as in Belgium), increased tax cost (as in France) or all encompassing rule-change (as in the US with FATCA).

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