Newspaper Room

ADMIN

2009. 07. 01.

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Á¦¸ñ: [Korea Herald] Will tax havens perish? 2009.06.30.

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The following is the 10th in a series of articles focusing on the ongoing campaign by G20 countries to reform the global financial regulatory framework and its impact on Korea and East Asia. - Ed.

By Kang Cheoljoon

In the April G20 London Summit leaders agreed to take action against tax havens and deploy sanctions to protect the public finances and financial systems. They declared in the final communique that the era of banking secrecy was over and called on all countries to adopt the international tax standard developed by the OECD. The standard aims to improve transparency and the exchange of tax information between jurisdictions.

On the same day the OECD published a list of countries assessed by the Global Forum of Taxation who were not complying with the international standard for exchange of tax information.

The list identifies (i) jurisdictions that have substantially implemented the standard (the white list), (ii) other jurisdictions and tax havens that have committed to but not yet implemented the standard (the grey list), and (iii) jurisdictions that have not committed to the standard (the black list).

The white list includes Argentina, Russia, the United Kingdom, the United States and most Western European countries, as well as the tax havens of Guernsey and Jersey.

At the other end, Costa Rica, Malaysia's Labuan, the Philippines and Uruguay are classified as the black list countries.

The grey list is made up of most well-known tax havens such as the Bahamas, Bermuda, the Cayman Islands, Monaco and Liechtenstein. It also includes Switzerland and, somewhat surprisingly, EU member states including Luxembourg, Austria and Belgium.

While tax havens and banking secrecy have often been attacked in the past, for the first time an international agreement has been reached on criteria to determine which countries are out of line.

Unhappy calls

Right after the publication of the list, all four black list countries made a commitment to the standard. Labuan Offshore Financial Services Authority (Lofsa) director-general Datuk Azizan Abdul Rahman showed regret that the Lofsa Act was already amended in 2008 to allow disclosure and exchange of information. The Bank Negara governor, who is also chairman of Lofsa, said: "It was highly unfortunate and unfounded to be singled out in such a manner." Malaysia was removed from the black list on April 7.

Since the black list countries are not well-known tax havens, controversies centered around the demarcation between the white list and the grey list. First of all, Switzerland, Austria, Belgium, and Luxembourg were infuriated at being placed on the grey list.

Jean-Claude Juncker, Luxembourg's prime minister and finance minister, reacting angrily to his country's inclusion, described the OECD's work as a "rush job" and insisted that if Luxembourg was to be placed on any international list of offshore financial centers, then "Delaware, Nevada and Wyoming should also be named and shamed as tax havens."

Belgian Finance Minister Didier Reynders also said that it was "not very pleasant to be on a list that also included tax havens."

Swiss Finance Minister Hans-Rudolf Merz reiterated that "Switzerland is not a tax haven."

"Switzerland always meets its obligations and is always ready to engage in dialogue," he said in a statement. He was disappointed that despite being a founding member of the OECD, Switzerland had never been included in the discussions on drawing up the lists, an omission which he found "particularly strange."

Criticism of the OECD work also came from the Cayman Islands, which ranks 5th in the international bank deposit market. The chairman of the Cayman Islands Financial Services Association said, "We're baffled by the OECD. What they're doing is nothing to do with the fundamentals of tax evasion. They're such a political animal." He said the OECD's guidelines on encouraging offshore centers to sign international tax standards illustrated the issue was not about tax evasion, but about tax competition and suspected that the EU countries are seeking to control the flow of mobile capital.

On the other hand, key civil groups like Oxfam International criticized that the OECD standards require bilateral agreements for information on request, not automatic multilateral tax information exchange and that they call for only 12 such agreements to be signed by each tax haven.

They also attacked the list for reflecting promises rather than actions from uncooperative jurisdictions who sign on to OECD standards, allowing tax havens like Jersey and the Isle of Man to appear on the white list. An Oxfam report disclosed that, "Jersey has had such an agreement with (the United States) since 2001, yet has only delivered just five pieces of data in all that time."

Jeffrey Owens, director of the OECD's Center for Tax Policy and Administration, responded at a conference in May that automatic information exchange would not work, because, "For developing countries, it would be very hard for them to manage an enormous flow of information."

The U.S. government is also strengthening its position against tax havens since the inauguration of President Barack Obama, acknowledging that the U.S. tax system is rife with opportunities to evade and avoid taxes through offshore tax havens. For example, a January 2009 GAO report found that, of the 100 largest U.S. corporations, 83 have subsidiaries in tax havens. In the Cayman Islands, one address alone houses 18,857 corporations, very few of which have a physical presence in the islands.

Background

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The biggest reason for the current initiative is that each government is uncertain as to whether the existing tax system can raise the revenues needed to plug the unprecedented deficit foreseen for the next four-five years. Due to the recession, company profits and tax receipts are falling while social welfare spending is rising.

Most of the G20 governments also poured astronomical amounts of money into the financial industry to bail out banks and companies. The room to finance the deficit is already full as the ratio of government debt to GDP is approaching 100 percent in most governments.

Therefore, all governments are now very focused on countering aggressive tax schemes, the use of tax havens and the ways that banks and high income individuals exploit the tax system to reduce their tax burden.

"In the current crisis, it is important to assure honest taxpayers that tax burdens are being fairly shared," OECD Secretary-General Angel Gurria said.

Second, as all the national economies have been globalized over the last three decades, the role of offshore financial centers in the international financial system has changed dramatically and even become a major issue for international politics.

Today, $5-7 trillion are believed to be held offshore. The Cayman Islands are the fifth-largest deposit banking center in the world. India reports that 90 percent of its inward investment flows are via Mauritius. A recent report by the U.S. Senate estimated that $100 billion in taxes could be evaded through offshore tax schemes.

Globalization has created new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between states, which could lead to the erosion of the national tax bases.

The international tax standard

The internationally agreed tax standard on exchange of information, developed by the OECD and endorsed by the United Nations and the G20, provides for the full exchange of information on request in all tax matters without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged.

Originally the OECD established four key criteria for identifying harmful tax practices in 1998:

1. No or nominal taxes, in the case of tax havens, and no or low taxation, in the case of member country preferential tax regimes

2. Lack of transparency

3. Lack of effective exchange of information, and

4. No substantial activities, in the case of tax havens, and ring-fencing, in the case of member country preferential regimes.

However, the OECD dropped criteria 1 and 4, facing the U.S. Treasury opposition in 2001. Now the OECD uses

criteria 2 and 3, stating it does not prescribe appropriate levels of taxation or dictate the design of any country's tax system.

Currently the standards for exchange of information are set out in Article 26 of the OECD Model Convention and the 2002 Model Agreement on Exchange of Information.

The Global Forum has also developed an availability and reliability standard for accounting records.

These standards now serve as a basis for most bilateral tax treaties as the internationally agreed standard for exchange of information. The OECD used 12 agreements as the threshold to determine the effective implementation this time.

Confusing typology

In the academic world "tax haven" and "offshore financial center" are used interchangeably. However, there is hardly an agreement on the definition of OFCs nor on tax havens. For example, once you try to define a tax haven as, simply put, a place people use for tax evasion, you may have to call major financial centers like New York and London tax havens since the clear majority of tax evasion cases arise through the companies located in these centers rather than on a remote island.

The growth of offshore centers can be traced back to the restrictive regulatory regimes in many advanced countries in the 1960s and 1970s. These regimes blocked the flow of capital to and from other countries, or imposed restrictions on the interest rates banks could offer, or raised banks' funding costs in domestic markets. These restrictions encouraged a shift in financial activities to less regulated jurisdictions. As large multinationals and financial institutions shifted financial activity offshore, Euromarkets were established and financial activities, begun in the financial centers of Europe (mostly London), spread to other offshore centers.

A number of countries have been fostering offshore business as a development strategy to diversify their economy, create high-paying jobs and raise fiscal revenue. The IMF started the OFC assessment program in 2000 and extended the technical assistance that contributed to these OFCs to upgrade supervisory capacity and transparency to meet international standards.

Future prospects

At the meeting with the German Federal Minister of Finance at Berlin on June 23 Gurria said that "Over these eight months, we have made more progress than in the last 10 years" in implementing the standard.

In particular, he announced that Austria, Belgium, Luxembourg and Switzerland promised to meet the OECD standard and now all 84 countries surveyed by the Global Forum have endorsed the standards and agreed to implement them.

Next steps will be to impose defensive measures on uncooperative jurisdictions. Over the next two months the OECD will focus on further developing its toolbox of countermeasures against noncooperative jurisdictions and continuing work on the design of voluntary compliance programs. It will prepare a report on all of these issues prior to the Pittsburgh G20 Summit.

Thus, jurisdictions with strong secrecy laws will come under greater pressure. These countries will have to change

 

the rules to guarantee cooperation with foreign tax authorities in cases where evidence of tax evasion can be provided.

However, the rule changes will not affect account holders who are not under suspicion, according to the Swiss Bankers Association. "An automatic exchange of information is excluded," the SBA said. Legal tax avoidance is not covered by the G20 communique or the OECD standard and legitimate use of tax havens will not be hampered.

In addition, despite the G20 consensus, we are in the early days since "the devil will be in the details," as the French finance minister mentioned. There has been the big picture statement and political sound bites, but the real test will be to put the consensus into actual regulation, laws and proscriptions.

Another factor to consider is that antagonism against the OECD initiative is gaining support among conservative economists in the United States. Dan Mitchell at the Cato Institute argues that privacy rights and international tax competition are beneficial constraints on the monopoly power of governments, but high-tax nations and organizations such as the OECD and the EU are pressing for international agreements to remove those limits on government power at the expense of global economic growth and personal freedom.

*http://www.malaysia.or.kr/*