# Reviewing the OECD Harmful Tax Initiative:

# The St. Vincent and the Grenadines Perspective

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## The Changing Environment of the Initiative

The OECD Harmful Tax Initiative, which began as an unfair process that threatened tax competition and represented bad tax policy, and was also a violation of national sovereignty, is now giving way to a more meaningful dialogue between nations on the status of transparency and information exchange as well as a purposeful intellectual debate on tax policy. The OECD Harmful Tax initiative began as an attempt to ebb the flow of tax dollars from high tax nations to lower tax jurisdictions. To justify this attempt at reducing the outflow of tax revenue dollars to lower tax jurisdictions, the OECD spoke of such 'tax havens' as having distorting tax policies and found much similar language to black list the sovereign tax systems of countries.

Five years down the road, after a real battle of small island jurisdictions, like St. Vincent and the Grenadines, to bring fairness and transparency into the OECD process, with the support of key players in OECD member states, in particular the USA, the OECD language and direction is changing.

There is a new recognition in the OECD that it makes more sense to look at what is wrong in the tax systems of high tax states, i.e. to look at OECD members' tax policies, with a view to making them more efficient, rather than naming and shaming small lower tax states whose economies are much smaller and more vulnerable than theirs. The OECD initiative would perhaps have gone much father at achieving its misconstrued goals, if it had begun with an attempt by OECD members to first examine themselves, before pointing fingers at others. However, though late, it is certainly welcome to see that the OECD has finally woken up to what is happening amongst its own members and begun its own introspection into what is wrong with its own tax policies why its citizens would look to 'go offshore' to minimize taxes.

The recently published BackGround Paper of Jeffrey Owens, the Director of the OECD's Centre for Tax Policy and Administration, entitled "Fundamental Tax Reform: The Experience of OECD Countries," is a long overdue acceptance of a principle enunciated by Adam Smith long ago. The words of Smith were *"The proprietor of stock is properly a citizen of the world, and it not necessarily attached to a particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could … enjoy his fortune at more ease."* Owens' concession of this position is reflected in his conclusion that "*The tax base associated with capital income and high wealth individuals is becoming increasingly geographically mobile. Attitudes towards tax compliance are shifting, with more taxpayers being prepared to engage in aggressive tax planning, often involving the use of tax havens*." Owens goes on to say

that “Governments need to make their tax systems more competitive”. The Paper appears to be a shift away from the traditional OECD belief that it is wrong for taxes to influence decisions regarding where to work, save and invest; a belief which had pushed towards the harmonization of taxes. Now it appears, there is an acceptance of ‘tax planning’, that is the right of persons to seek economically more efficient tax structures, and a new look at how OECD members have been changing their own tax policies in order to become more economically efficient and tax competitive.

The paper tracks the recent downward trend in tax revenues and rates, which has come about mostly as a result of a reduction in personal and corporate income tax rates. It examines the introduction of a ‘flat tax’ in the Baltic states and the use of the mix of a flat and a progressive tax in the Nordic states. It usefully examines how ‘making work pay’ tax policies can serve to reduce some of the traditional disincentives to work caused by highly taxing labour or income. It examines how tax reform is being shaped by the principles of ‘fairness and simplicity.’

The paper is certainly a useful comparative study that is worth looking at by states that are restructuring their tax policies. But most importantly the paper represents for small states such as St. Vincent and the Grenadines an apparent acceptance of tax competition.

In order to appreciate the significance of this shift in attitude of the OECD, it is interesting to track the development of the ‘Harmful Tax’ Project, how it began, what were its flaws, and how it was forced to change along the way. This presentation reflects

the experience and the role of a non-OECD member that committed to the OECD process for the sharing of information and transparency, in making the OECD project a more fair and transparent one.

## Why St. Vincent and the Grenadines was Blacklisted by the OECD

Most countries would not know why exactly 41 countries were labeled as 'tax havens' by the OECD in the year 2000. Here is a look at how it all began and why St. Vincent and the Grenadines was so labeled.

In a letter to the then Offshore Finance Inspector of St. Vincent on October 8, 1999, the OECD writes:

"Some jurisdictions have asked for information about how the Forum distinguishes between jurisdictions that are potential tax haves an those that may have harmful preferential tax regimes. A jurisdiction would not be classified as a tax haven if it could be demonstrated that the jurisdiction has **a significant domestic tax base in geographically mobile financial and other service activities.** This issue is not amenable to a precise economic analysis but rather must be evaluated based on all the available facts and circumstances."

As such was the obfuscated language used by the OECD in the early days, not only in their 1998 'Harmful Tax Practices' but in related correspondence that attempted to explain aspects of the Report.

Soon after this letter was written the OECD issued a press release indicating their intent to publish a list in June 2000 distinguishing between uncooperative tax havens and jurisdictions that choose to commit themselves to work towards eliminating the harmful aspects of their regime. It was stated that the list would be used as bases for implementing defensive measures against such regimes by June 2001.

The St. Vincent Government wrote to the OECD asking what were the 'areas of concern' in relation to the Tax Regime and Tax Practice in St. Vincent and the Grenadines. Their response was the following:

- the law appears to prevent disclosure of international financial information where such disclosure would further a tax investigation or prosecution by a foreign government. Exchange would not be adequate if the exchange was prohibited in situations in which the activity under investigation would not constitute a crime under the laws of SVG
- the existence of bearer shares for non-bank IBCs
- no requirement for non financial entities to report beneficial information to the authorities
- non-financial entities need not file accounts or have their accounts audited

- regarding trusts, the trustee need not register or otherwise disclose the names of the settlor or the beneficiaries to the authorities and trust accounts need not be audited or filed and finally
- because Class II banks are restricted in the extent to which they can participate in the domestic SVG economy, it is possible for such companies to avail themselves of the SVG tax system without the need to have substantial activities there. [this 'reason' was not factually sound]

And so it was those were all of the reasons why St. Vincent and the Grenadines was placed on the OECD black list in 2000. It is interesting to reflect on how many other jurisdictions that you are familiar with would have had and in fact still have similar situations and how harmful are they and to whom.

## The Mistakes of the Past

The OECD's harmful tax project was based on the principle that countries could be forced into changing their tax policies based on the threat of sanctions or defensive measures. The project was flawed however, in the following ways. (1) It was not based on sound or tenable economic or moral principles, (2) it was riddled with obscure concepts that lacked real meaning; (2) its name and shame approach was not conducive to cooperation but rather to hostility and (3) its list discriminated against offshore financial centers in that it was not based on a level playing field approach.

What is more, the name and shame process had two responses. The first is that it did name and shame and harm listed jurisdictions. The second is that it provoked strong reactions within the United States and other powerful players who saw that the process was unfairly undermining the ability of developing nations to maintain financial services industries. In short, many viewed it as unfair.

The factor that really led to the hijacking of the Harmful Tax Project was the salient absence of the 'level playing field' concept in its process and the championing of this concept by small states.

**The role of non-OECD members in the OECD dialogue**

The OECD made its first retreat in pushing back the deadline from June 2001 to February 2002 for countries to commit to cooperating with the Harmful Tax Project. This list was eventually published on April 18, 2002. This delay came in the light of lots of international criticism of the unfairness of the Project. However, the tactics remained offensive. Countries were forced to sign 'Commitment Letters' to commit to transparency and the exchange of information in order to be removed from the OECD list and to avoid the application of defensive measures against them. In short, countries signed with a gun to their heads. Some 31 jurisdictions signed on and were removed from the list.

However, there was one key clause to the Commitment letters that fundamentally changed the OECD process, it read as follows:

**"St. Vincent and the Grenadines is determined to protect its economic interests and fiscal autonomy in any future negotiations with the OECD. The issue of level playing field is critical to those interests."**

The deadlines for the sharing of information set out in the Letter were as follows: information in criminal tax matters to be shared by January 2005 and in civil tax matter by January 2007.

Also part of the Commitment Letter was the undertaking by the OECD that SVG would be allowed to participate on an equal basis with all committed jurisdictions and OECD countries in any discussion in the Global Forum on standards of the Report and the implementation of them.

## The Global Forum Cayman October 26, 2002

The 31 committed jurisdictions sat together with the OECD members at the Cayman Islands Global Forum in October 2002. There were two key items that were on the agenda for the Cayman meeting (1) the Accounts and the Filing or Auditing Requirement and (2) the Level Playing Field. An Ad hoc Group on Accounts had been established because it was felt that before the issue of information exchange was addressed, it first had to be established what financial documents are and should be available in a jurisdiction that could be exchanged.

The Leader of Government business in Cayman Hon. Makeeva Bush began with a presentation outlining the issues of the level playing field and the hardships that had come to non-OECD members because of the Harmful Tax Report. The stage was set for a discussion of level playing field issues over the next two days.

The OECD conceded for the first time that the standards being developed are intended to apply both to OECD and non-OECD member states.

The OECD faced a barrage of questions on their own tax and accounting practices as well as their commitment to the level playing field. A communiqué was agreed upon whereby the OECD committed to examining the existing standards within their member states.

The second part of the meeting saw major concessions from the OECD on some of the ‘principles’ on which their 1998 Harmful Tax Report initiative was based and countries black listed.

The first concession was that neither the filing nor the auditing of accounts should be obligatory. And so one of the first ground for the blacklisting of SVG had been removed. The meeting determined that what was important was that quality of accounts be maintained and that the authorities have access to them.

There was no resolution on who should be responsible for the keeping of accounts, in particular as it related to trusts and partnerships. A special sub group was set up to look

into trusts and to 'nexus' principles, that is which jurisdiction would be primarily responsible for imposing the obligation to keep accounts and to access accounts for special entities like trusts. The work of the Sub-Group on Trusts, commencing after the Cayman meeting, has been a successful OECD project in that they have come up with clear and useful definitions.

**The Impact of the EU Savings Directive**

The level playing field issue was dealt its harshest blow by the famous EU compromise, in relation to the application of the EU Savings Directive. Given that the EU member states made up one half of the OECD's membership, the Directive was clearly relevant to the OECD project. The EU compromise, in allowing Austria, Belgium and Luxembourg to 'implement exchange of information upon request as defined by the OECD agreement no later than 2011', 7 years after the coming into force of the EU directive was clearly inconsistent with the January 1, 2006 OECD deadline for the sharing of information. The EU compromise also meant that Belgium, Luxembourg and Austria would only implement automatic exchange of information when there are tax information exchange agreements with Switzerland, Liechtenstein, San Marino, Monaco, Andorra and the USA. The fact that the USA did not support the Savings Directive dealt a huge blow to the OECD process.

The participating partners now began to write letters to the OECD asking them if they too would receive 5-year extensions and questioning what was the status of the OECD

project in the light of the EU compromise. Letters were written by the Cayman Islands, Antigua and Barbuda, Panama and St. Vincent and the Grenadines all stressing that OECD member countries should hold themselves to standards and timelines at least as rigorous as those to which they hold jurisdictions that are not part of the OECD. The letters demanded that the OECD recognize that the recent development with the EU raised questions regarding the position of certain OECD member countries. The OECD responded by recognizing this and reiterated their commitment to a level playing field, but asked for a constructive dialogue with non-OECD members to achieve it. The OECD acquiesced to the demand of non-OECD members to have a Global Forum that addressed singly the issue of the level playing field.

## The Ottawa Global Forum October 2003

The mood at the Ottawa Global Forum was very tense with certain admissions being made on the one hand by the OECD Secretariat that the Level Playing Field did not exist, while of the other certain OECD members attempted to distance the EU Compromise from the OECD process and show that it was not relevant. Antigua and Barbuda issued a statement to the Forum indicating that its Commitment Letter was Withdrawn, while St. Vincent and the Grenadines' indicated that its Commitment was in abeyance or 'on hold' until there could be real progress of the Level Playing Field issue.

The Forum press release attempted to hide all of the divisive discussions held during the Forum, and was filled with lots of positive language that did not reflect what had truly

transpired at the meeting. However, the salient point of the meeting was evident in the Communiqué – that is that the meeting agreed to establish a Sub-Group to examine the issue of a Level Playing Field and the Process of Achieving a Level Playing Field.

**Berlin Global Forum June 2004**

The Report on the Level Playing Field for discussion at the Forum contained certain points:

(1) that the level playing field is a 'continuing' goal and that it should not be that 'nobody moves until everybody moves' and that countries should undertake to achieve a global level playing field by 2006

(2) 'mutual benefits' are derived through bilateral implementation

(3) the Global Forum would be the appropriate forum for the discussion of developing a list of defensive measures against harmful tax practices

St. Vincent and the Grenadines made the following interventions in response to the Report:

(1) The issues of uniform defensive measures should be taken off the agenda.

(2) Defensive measures, if any, should be tied to failure to share tax information not to 'harmful tax practices.'

(3) The date of 2006 for achieving a level playing field should be removed.

The Forum accepted all of these positions of St. Vincent, resulting in a removal of the deadline for the implementation of tax information exchange. The language of the OECD had shifted away from harmful tax practices to 'information exchange'. A strong policy statement was made by the USA that 'the OECD cannot dictate 'tax policy' to sovereign states. It could merely encourage a flow of information and transparency.' The USA asserted that the OECD should not be asked to ask countries to remove 'country lists' as these as it was the sovereign right of states to do so. In short the USA took a strong pro sovereignty position on all tax and information exchange issues. The Forum also agreed that a benchmarking exercise would now be undertaken to determine the status of information exchange and transparency in jurisdictions. A study of the benchmarking exercise is to be presented at a Global Forum in Autumn 2005.

The meeting also agreed that the OECD will seek to engage significant financial centers currently excluded from the process, these are: Andorra, Barbados, Brunei, Costa Rica, Dubai, Guatemala, Hong-Kong-China, Liberia, Liechtenstein, Macao-China, Malaysia (Labuan), Marshall Islands, Monaco, Philippines, Singapore and Uruguay. The Forum has not reported back to the members of the status of this initiative.

**Where we are now?**

The deadlines for the sharing of tax information of the Harmful Tax Initiative have been pushed back indefinitely. The use of defensive measures has been taken off the agenda

for the time being. There is an acceptance by the OECD that the initial method of naming and jurisdiction was not only unjust and unfair but could not be supported in the face of the absence of a level playing field in terms of the commitments of its own member states. As a result the Initiative, while it is proceeding, it is doing so on a much more cautious basis and it has abandoned many of the original ill-conceived principles. Most importantly it appears that the thinking coming out of the OECD is that tax competition is not inherently evil or wrong and that it is best fought with even more competition, rather than attempts to stifle competition.

As OECD member states move to make their tax bases wider, simpler and more efficient and in short to be more competitive against lower tax jurisdictions, the success of lower tax jurisdictions will not suffer in any disproportionate way. Competition is good and it is healthy. It is the onus of states to continuously reform their tax structures to remain competitive.

What is left unknown to date is what will be the response of the significant tax centres that have been invited to join the OECD initiative. This response will be crucial to the progress of the Initiative going forward. It is highly unlikely that the OECD will get these centres to go along with the full OECD agenda. Without their support, the issue of the level playing field will remain continuously unresolved and the deadlines for the sharing of tax information will continue to be pushed back and back.

At the end of the day, the lack of success of the OECD Initiative, in my view is a reflection of the fact that taxation is indeed a matter of national interest and should be dealt with at a national level and where the economy requires on a bilateral level. As states protect their own states, they should be at liberty to engage in bilateral agreements that protect their national interests, in particular with their significant trading partners, for example a Tax Convention between the United States and Ireland. Tax policy should never be dealt with on a multilateral level. It is a matter for sovereign states.

In a recent speech by Owens he says that OECD's main functions are to encourage countries to share their experiences, develop best practices and set international standards. Such functions should indeed be encouraged. The paper on Fundamental Tax Reform that is a comparative analysis is a useful study, and is a step in the right direction away from the academically flawed and unfair 1998 Harmful Tax Report. May the new trend continue!

I am certain that Jeffrey Owens will be congratulated for his new apparent acceptance of tax competition at the next Global Forum. I trust that it will have a meaningful positive impact in further reforming the 'Harmful Tax Initiative' and making the initiative less harmful.

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