

# **PROMOTING TAX COMPETITION**

**By**

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To work effectively, a global economy needs some acceptable ground-rules to guide governments and business. Such a framework can help business to move capital to locations where it can optimise its return without impeding the aim of national governments to meet the legitimate expectations of their citizens for a fair share in the benefits and costs of globalisation. The existence guidance for international taxation is a key feature of any global system. Over a 30 year period, the OECD's Committee on Fiscal Affairs (CFA), has worked in close cooperation with the Taxation Committee of BIAC<sup>2</sup>, to produce such globally accepted standards. Its pioneering work on encouraging the development of tax treaties (today there are more than 1500 treaties around the world all based on the OECD model); its guidelines on Transfer Pricing; its emerging work on e-commerce and taxation; and, more generally, its efforts to reduce conflict between tax authorities, have all contributed to a fiscal climate which is more conducive to cross border business while promoting a fair sharing of the tax base between countries.

It is against this background that the OECD's efforts to address harmful tax practices and promote fair tax competition must be viewed. Both OECD and non OECD governments are concerned at the proliferation of certain tax regimes which, together with the new opportunities opened up by globalisation, increase the potential for distorting economic behaviour and widen the avenues for non-compliance with the tax laws of a taxpayer's home country. Similarly, law-abiding businesses are concerned that such opportunities can skew the competitive environment unfairly in favour of the tax abuser and against the company that plays by the rules.

The CFA began this work in 1998 BIAC. BIAC was initially highly critical of the Report, as during the pre-publication phase, it had not been provided with an opportunity to engage in a

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<sup>1</sup> The views expressed are those of the authors and may not be taken as reflecting or committing their respective organisations.

<sup>2</sup> The Business and Industry Advisory Committee to the OECD (BIAC) was created in 1962 to officially represent and communicate the views of the business community to the OECD. Its members include the principal industry and employers organisations from all OECD countries. The BIAC Committee on Taxation and Fiscal Policy comprises senior tax experts from the private sector within the BIAC membership.

dialogue on what were the goals of the project. However, since that time, the CFA and BIAC have developed an increasingly co-operative relationship to address the challenging issues, both technical and political, that have been raised by the project. This article reflects the results of this co-operation and describes the common understanding we have reached concerning the aims of the project and how the business community will continue to contribute to this work.

### **What the project is about**

OECD member governments and the business community, represented by BIAC, agree that in today's global environment we must try to eliminate non-compliance with tax laws. This should be done without limiting the ability of taxpayers to engage in legitimate tax planning. There is no requirement under the taxation laws of any country that taxpayers must pay the highest tax possible. Multinational enterprises should be permitted access to certain corporate organisational and structural vehicles, such as co-ordination centres and holding companies. At the same time, care must be exercised by governments to ensure that such corporate vehicles are not misused. It is essential that anti-abuse measures taken by governments do not place excessive compliance cost burdens on companies domiciled and/or operating in their jurisdictions so as to place such companies at a competitive disadvantage in comparison to companies from other countries.

We believe that the business community and the OECD now have a shared perspective in the aims of the project:

- The project is intended as part of the broader OECD objective of providing a level playing field in the tax area for cross border activities.
- The project is intended to facilitate competition that is fair and transparent. Such competition is not harmful but healthy and indeed to be encouraged.
- The project is intended to ensure that all taxpayers meet their tax obligations, as was stated in the recently issued Guidelines on Multinational Enterprises<sup>3</sup>, a goal that is as important to business as to governments.

We agree that the project, as limited to geographically mobile activities in the service area, does not attempt to:

- harmonise tax structures or tax rates.
- set minimum levels of taxation.
- adversely impact commercially motivated cross border investment flows.
- eliminate commercially useful structures, such as holding companies.
- curtail legitimate tax planning.
- curtail privacy rights through the promotion of exchange of information (contrary to assertions that have been made by some).
- deny any government the right to determine its own tax policies and structures.

We believe that on the basis of this common understanding, this work can continue in a co-operative spirit for the benefit of governments and business alike.

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<sup>3</sup> see "OECD Guidelines for Multinational Enterprises" 2000, Paris

We also agree on the need to avoid raising new tax obstacles to cross border trade and investment. Indeed, it has been asserted that, if the project can be successfully concluded, governments will be subject to legitimate market constraints and that fair tax competition may produce a strong downward pressure on tax rates.

### **The current status of the project.**

Over the last year, the project has evolved into a more co-operative effort, with a particular emphasis on the elimination of tax practices and regimes that facilitate non-compliance with tax law. Jurisdictions outside the OECD area have been consulted both in bilateral and multilateral fora. Business involvement by means of BIAC has encouraged the move towards a more co-operative approach. An important element of the project is to seek out and terminate where possible non-compliance in the tax area.

### *Tax Havens*

In June 2000 six jurisdictions, (Bermuda, Cayman Islands, Cyprus, Malta, Mauritius, and San Marino), made a commitment to eliminate their harmful tax practices by the end of 2005. Of the other 35 jurisdictions identified as meeting the tax haven criteria, 32 have already contacted the OECD seeking further co-operative dialogue. Some of these jurisdictions have already made commitments (the Isle of Man, the Netherlands Antilles and the Seychelles) and others are expected to do so shortly.

To assist this process the OECD has agreed that a jurisdiction may either make a bilateral commitment or base its commitment on the recently issued Collective Memorandum of Understanding (see <http://www.oecd.org/media/release/nw00-123a.htm>). In either case a commitment can be made by means of a press release reflecting government action rather than a formal letter being sent from a Minister to the Secretary-General of the OECD. And to achieve greater transparency, all commitments will be made public.

Early in January 2001 a meeting, hosted by the Government of Barbados in association with the Commonwealth and the OECD, was convened to improve the dialogue between the OECD countries and jurisdictions primarily of the Caribbean region. The intention was to identify the common principles and shared concerns to guide this work. On 1<sup>st</sup> February 2001, a third meeting took place in Paris primarily for European jurisdictions and on 15-16 February a similar regional meeting took place in Tokyo for the Asian Pacific countries. These regional meetings have achieved a better understanding of the project and have encouraged jurisdictions to intensify their bilateral dialogue with the OECD Member Countries working towards the objective of having a minimum number of jurisdictions on the List of Uncooperative Tax Havens due for publication in July 2001.

### *Work within the OECD Member Countries*

The work on eliminating harmful tax practices within OECD Member countries is also expected to meet the deadline of April 2003, as set out in the OECD Ministerial Council decision. To assist countries, a series of application notes is being prepared. These notes will provide further

guidelines to countries on how to apply the criteria developed over the past two years. The OECD Forum on Harmful Tax Practices will continue its review of the 47 OECD tax regimes identified in June as being potentially harmful.

### Work with non-OECD Countries

The CFA is actively following up a meeting held in Paris last June which brought together 29 OECD countries and an identical number of economies outside the OECD<sup>4</sup>. The aim of this meeting, hosted by the French Ministry of Finance, was to see how far non-member jurisdictions shared the concerns of the OECD Member states, and to explore how they could be more closely involved with this work. It was clear from the discussion that countries as diverse as South Africa, India, Argentina and Russia were concerned at the spread of tax havens and other harmful tax practices. The OECD is exploring how these and other interested countries can be more closely involved in the development of the application notes referred to above and more generally in increasing transparency and information exchange in the tax area. A number of additional bilateral and multilateral contacts will take place over the next 12 months to encourage others to work with OECD countries to counter the spread of harmful tax practices.

### **The involvement of the Business Community**

The BIAC Taxation Committee has created a liaison group to work with the Forum on Harmful Tax Practices to ensure that the views of the business community are heard. That group has provided and will continue to provide input in the following areas:

- Development of the application notes referred to above.
- Analysis and possible resolution of compliance issues.
- Advice on how to structure any defensive measures.

At the same time Member governments and the OECD Secretariat and BIAC representatives have and will continue to participate in the business conferences organised to discuss this initiative.

Looking back since the start of the project, many issues have been confronted and on the basis of this reflection we have reached the following conclusions. First, there is a need for better communication between business and government, and, in particular, a more inclusive attitude on the part of governments toward the views of the business community. Dialogue between business and government on the major tax issues of the day is constructive in the search for practical solutions to complex problems, as can be seen from our experience with the Technical Advisory Groups on e-commerce tax issues. The vast array of sophisticated tax systems around the globe and their interaction on cross border transactions creates complexities for taxpayers and tax officials alike. Accordingly, there will be a multitude of challenges to address co-operatively.

Second, there is a need to ensure that the elimination of non-compliant tax practices is not carried out in a way that hurts legitimate business activities and transactions.

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<sup>4</sup> Argentina, Azerbaijan, Brazil, Chile, China, Columbia, Estonia, Hong Kong China, Egypt, India, Indonesia, Israel, Lebanon, Malaysia, Morocco, Pakistan, Philippines, Russia, Singapore, Slovenia, South Africa, Chinese Taipei, Thailand, Tunisia, Ukraine, Venezuela, Vietnam.

Third, the business community has clearly expressed its desire that this project should not jeopardise the core work in taxation carried on by the OECD, particularly in the areas of tax treaties and transfer pricing. It has been noted that the important work of the OECD in monitoring the Transfer Pricing Guidelines has been rescheduled, if not curtailed, since the start of this project. Business regrets this, as it is clear that the monitoring program, as carried out jointly by business and the CFA, is the cornerstone of the Guidelines, going a long way to ensure their continuing effectiveness in setting clear rules for business and generating a fair share of the tax revenue on cross-border inter-company transactions for the governments involved.

Ultimately, business will benefit as fair tax competition is promoted and non-compliance is eliminated or substantially reduced. This, in turn, will enable -- and even actively encourage -- governments to continue with tax reforms which reduce the rates of tax and widen tax bases. If the project is successful in removing many of the special non-transparent arrangements that currently impinge on fair and healthy tax competition, we believe that it will be easier and not harder for governments to cut their tax rates.

The work of the OECD's Committee on Fiscal Affairs on tax competition and other vital tax issues such as transfer pricing, and taxation of electronic commerce will benefit greatly from continued co-operation with the business community as well as other countries. It is in this spirit of consultation that the CFA will continue to move forward in the development of sound and appropriate fiscal policy.