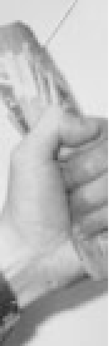

Towards a Global Tax Cartel?

David R. Burton

The true agenda of many advocates of greater financial information exchange has more to do with tax competition than criminal law enforcement or national security.

Since the September 11 terrorist attacks on the United States, there has been a renewed focus on obtaining information about the global financial activities of terrorists and criminals. The needs of law enforcement officials to combat serious crimes, prevent terrorism and protect national security are of the highest concern, but many OECD governments appear to be exploiting the political climate post-September 11 to promote information exchange policies that have more to do with limiting tax competition than enhancing international efforts to apprehend terrorists and criminals.

Well before the September 11 attacks, the OECD and the UN had launched major initiatives designed to abolish financial privacy and limit tax competition by blacklisting low-tax jurisdictions or so-called tax havens (the OECD Harmful Tax Competition project) and enabling the UN to share financial information among UN members through the proposed United Nations International Tax Organisation (UNITO).

Both initiatives are not only anti-competitive, but also constitute a gross violation of individuals' privacy. Moreover, they foreshadow a process of centralisation similar to that of the European Union, exacting a steep price in terms of reduced economic freedom and limits on national sovereignty.

The campaign against tax competition

The OECD is worried that low tax countries attract too much capital from high tax countries, primarily the welfare states of the European Union. In a 1998 report entitled 'Harmful Tax Competition: An Emerging Global Issue', the OECD stated that 'Globalization has . . . had the negative effects of opening up new ways by which companies and individuals can minimize and avoid taxes and in which countries can exploit these new opportunities by developing tax policies aimed primarily at diverting financial and other geographically mobile capital'.[1]

The OECD considers a country a 'harmful' tax regime if the country (i) has low or zero income taxes, (ii) allows foreigners investing in the country to do so at favourable rates, and (iii) affords financial privacy to its investors or citizens. The OECD identified 41 countries (mostly developing countries) as 'harmful tax regimes'.

Under an OECD Memorandum of Understanding (MOU), a jurisdiction must have made a 'commitment' by 28 February 2002 to eliminate 'harmful tax practices' to avoid being blacklisted as a 'non-cooperating jurisdiction'. By broadening what constitutes a 'commitment', the OECD has persuaded over 30 jurisdictions to become 'committed jurisdictions'. Seven jurisdictions have been blacklisted.[2] As a result of the fluidity of the process and the lack of any governing rule or principle, it is now far from clear what being a 'committed jurisdiction' actually means. The target date for the elimination of 'harmful tax practices' is April 2003. It is quite possible, if not probable, that the OECD and the 'committed jurisdictions' will

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have a falling out in Autumn as the OECD starts to demand binding agreements that would effectively abolish financial privacy. Alternatively, the OECD could compromise its aims.

Sanctions proposed by the OECD for imposition on the targeted low tax countries include the termination of tax treaties, denying income tax deductions for purchases made from targeted countries' businesses (thereby dramatically raising the cost of buying goods from that country), imposing withholding taxes on payments to residents of targeted countries, and denying the foreign tax credit for taxes paid to the targeted government. The OECD also proposes to explore measures designed to disrupt normal banking and business operation. These proposed sanctions are more draconian than those imposed on states that engage in the most egregious human rights violations.

OECD member countries like the United States, the United Kingdom and Switzerland are currently exempted from this initiative, but they can in time expect the high-tax European Union to bring pressure to bear through the OECD, the World Trade Organisation (WTO), and the UN. The US engages in classic tax haven behaviour by imposing no tax on most foreigners that earn interest or capital gains in the US while imposing substantial taxes on US persons that earn US source interest or capital gains. These provisions, originally enacted into law in the 1980s, have attracted over US $1 trillion to US capital markets. Furthermore, by targeting certain countries while exempting the United States and others, the OECD initiative is inconsistent with national treatment and most favoured nation treaty commitments as a member of the WTO.

The OECD initiative provides for the abolition of financial privacy in the 41 targeted countries as it relates to the 30 OECD member countries. The targeted countries would be under an obligation to routinely share banking, tax and other financial information with OECD member countries. There would be no requirement for the recipient country to show probable cause to believe that a crime had been committed in either country. There would not even be a requirement to show that some civil wrong had been committed or was even suspected. The information would simply be sent to any OECD country that asked for it. Nor are there any restrictions on the use to which the information may be put. For instance, nothing in the OECD proposal prevents OECD countries' intelligence services from sharing this kind of information with their own private companies.

Once this step has been taken, there will be no principled reason for the exchange of information not to be generalised so that any government in the world will be entitled to the information. The logic of the OECD proposal is the total abolition of financial privacy and a world where all governments can access the financial information of any individual living anywhere on the planet.

United Nations International Tax Organisation

The United Nations has adopted the logic of the OECD proposal and seeks to generalise its provisions to all UN member states. In recommending the creation of a United Nations International Tax Organisation (UNITO), the 2001 report of the UN High Level Panel on Financing for Development to the General Assembly stated:

> The taxes that one country can impose are often constrained by the tax rates of others: this is true of sales taxes on easily transportable goods, of income

WHY THE OECD INITIATIVE IS BAD TAX POLICY

As every Economics 101 student understands, competition is good. Imagine, for example, that a town has only one gas station. The owner of the gas station can charge high prices and offer poor service. But what happens if a couple of new gas stations open up? All of a sudden, the consumer is in charge. The gas stations must compete to attract business. Prices fall and services improve. The same thing happens with governments. If politicians know that taxpayers have no escape, they are much more likely to impose excessive tax burdens.

Now imagine if new gas stations could enter a market, but customers still had to pay the monopoly prices of the gas station that used to control the market. Needless to say, there is no competition in this system. The original monopoly station would have no incentive to lower prices, and the new stations would have scant incentive to enter the market since they would have no ability to offer a more attractive pricing structure to customers. To make the analogy exact, they technically could charge lower prices, but they would be compelled to report customer purchases to the old monopoly station and that station would have a right to charge those customers the difference between the two prices. This sounds absurd, but this is what the OECD and EU are trying to impose on the world economy.

From Daniel J. Mitchell, 'Ending the Tax Harmonization Threat', *The Insider* No. 299 (Washington D.C.: The Heritage Foundation, September 2002).

> taxes on mobile factors (in practice, capital and highly qualified personnel) and corporate taxes on activities where the company has a choice of location. Countries are increasingly competing not by tariff policy or devaluing their currencies but by offering low tax rates and other tax incentives, in a process sometimes called 'tax degradation'.[3]

The proposed ITO would engage in negotiations with tax havens to persuade them to desist from 'harmful tax competition'. It contemplates taking a lead role in restraining the tax competition designed to attract investment by multinationals in developing countries. Another task that might fall to an ITO would be the development, negotiation and operation of international arrangements for the taxation of emigrants. At present emigrants pay taxes only to their new country once they have changed nationality. This exposes high tax countries to the risk of economic loss when many of their most able citizens emigrate.

The idea that a government should be able to impose taxes on the future income of those who have emigrated from its jurisdiction is repugnant and a violation of fundamental human rights. It rests on the premise that the state retains a right to the fruits of its former nationals' future labour and investment income even after they have emigrated. It should be viewed as a violation of Article 13 of the Universal Declaration of Human Rights, adopted by the UN General Assembly in 1948, which states in relevant part that '[e]veryone has the right to leave any country'.

Providing the United Nations itself with the ability to tax directly the nationals of its several states, as is proposed, would effectively create the first global government. Indeed, the report endorses steps to create a global council to promote global governance because 'modern globalisation calls for global governance'.

Moreover, the proposed UNITO would result in governments using the information they receive not only for tax purposes but for intelligence purposes and to oppress minorities and political opposition. Corrupt officials in governments could provide the information to criminal elements. It is extraordinarily naïve to believe that governments, particularly those known to be corrupt or to systematically violate human rights, will not use sensitive information provided to them by the UN to achieve political objectives within their own countries. If the UN enables them to track the financial activities of their political opponents, then it will make it much easier for repressive governments to identify and oppress their opposition.

A better way

In the United States, a Task Force on Information Exchange and Financial Privacy was convened in 2001 to examine the needs of law enforcement in the light of September 11. Composed of leading former law enforcement officials, tax attorneys and economists, it developed a programme that would enhance the ability of Western governments to fight terrorism and organised crime while enhancing the financial privacy of ordinary law abiding citizens.

The Task Force recommended the formation of an international Convention on Privacy and Information Exchange composed of democratic governments that respect the rule of law. The proposed Convention would streamline and improve the exchange of information for law enforcement, national security and anti-terrorism purposes and establish under international law enforceable restrictions on the use to which collected information could be put. Moreover, the Convention would establish a private right of action to enforce individual legal rights under the Convention.

The Task Force also proposed that money laundering laws be better targeted. Rather than bury investigators in a mountain of millions of currency transactions reports or suspicious activity reports with respect to law-abiding citizens, a more effective system should be developed where the activities of persons on a government watchlist are provided by financial institutions to the appropriate national authorities. Persons could be placed on the watchlist if the government had a reasonable and significant suspicion of unlawful activities.

Conclusion

Information is power. Given the propensity for harm that the modern state has demonstrated time and again during the last century, is it prudent to trust governments with the power to identify, defund and cripple their political opponents, to suppress religious freedom and to control the lives of their citizens? The UN and OECD initiatives should give pause to anyone who attaches even the slightest value to financial privacy and the benefits of tax competition.

Endnotes

1. OECD, 'Harmful Tax Competition: An Emerging Global Issue', (Paris: OECD, 1998), p. 14, section 23.
2. They are Andorra, Liechtenstein, Liberia, Monaco, the Marshall Islands, Nauru and Vanuatu.
3. Report of the UN High Level Panel on Financing for Development to the General Assembly, p.65. Available at http://www.un.org/esa/ffd/a55-1000.pdf