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TRUMAN KIRKLAND BUTLER
David vs. Goliath (2001) An Analysis of the Harmful Tax Competition Policy of the OECD
(Under the Direction of WALTER HELLERSTEIN)

The OECD or Organization for Economic Cooperation and Development has produced a report titled Harmful Tax Competition An Emerging Global Issue. The report is the single largest threat to the offshore finance industry. Further, the sweeping recommendations made by the report would at worst potentially discourage foreign investment in some of the more established offshore financial centers. This thesis represents an analytical view of the report and further gives some highlights to the anomalies found in the tax regimes of the major industrialized countries. It is clear that the actions of the OECD does create in effect a tax cartel. This thesis then discusses the smaller offshore financial centers appear helpless in the midst of the tremendous onslaught by the OECD and its member states. Finally, the thesis presents alternative measures that may be taken globally in order to combat harmful preferential tax regimes in all countries.

INDEX WORDS: OECD, Organisation for Economic Cooperation and Development, Harmful Tax Competition, Preferential Tax regime, International Tax, Offshore Centers

DAVID VS. GOLIATH (2001) AN ANALYSIS OF THE HARMFUL TAX COMPETITION POLICY OF THE OECD

by

TRUMAN KIRKLAND BUTLER

LL.B., University of Wolverhampton, England, 1995

A Thesis submitted to the Graduate Faculty of The University of Georgia in Partial fulfillment Requirements for the Degree

MASTER OF LAWS

ATHENS, GEORGIA

2001

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TRUMAN KIRKLAND BUTLER

Approved:

Major Professor: Walter Hellerstein

Committee: Frederick Huszagh
Gabriel Wilner

Approved:

Gordhan L. Patel
Dean of the Graduate School
The University of Georgia
December 2001

DEDICATION

"I CAN DO ALL THINGS THROUGH CHRIST WHICH STREGTHENETH ME"

Philippians ch.4: 13

Dedicated to the precious memories *of* Raphael, Ralph Sr., Nathalie and Leet

A very special thank you to my beloved parents Ralph Jr. and Mildred Butler and to my siblings Garfield and Sharmaine and many others for their unyielding support.

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CHAPTER I

INTRODUCTION

In recent times the offshore financial centers[1] of the world commonly referred to as "Tax Havens " have been under intense scrutiny by several international organizations and institutions. A substantive element of this attack on these centers is provided in the very comprehensive OECD[2] Report on 'Harmful Tax Competition An Emerging Global Issue[3].' The report is the culmination of a series of international tax initiatives by several states either individually or collectively. One notable example is the 1981 Report submitted to the Reagan Administration called the Gordon Report. The Gordon report cited several reasons why it would not be in the best interest of the United States to allow the proliferation of tax haven jurisdictions. Chief among them was the concern that tax

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1 Generally, the financial centers referred to as tax havens include: Cayman, The Bahamas, Luxembourg, Switzerland, British Virgin Islands, Bermuda, Monaco, Mauritius, Cyprus, Anguilla, Aruba, Belize, Cook Islands, Malta, San Marino, Grenada, Gibraltar, Jersey, Nauru, Panama, Turks and Caicos, Antigua, Dominica, Guernsey, Isle of Mann, Liechtenstein, Netherlands Antilles, St. Kitts and Nevis, Seychelles.

2 Organization for Economic Cooperation and Development based in Paris, France its membership of 29 nations include: United States, Great Britain, Ireland, Turkey, Switzerland, Luxembourg, Germany, France, Italy, Australia, Belgium, Canada, Denmark, Greece, Iceland, Austria, The Netherlands, Norway, Portugal, Spain, Sweden, Japan, Finland, New Zealand, Mexico, Czech Republic, Hungary, Poland and as of the (12th December 1996) Korea. On 28th July 2000 The Council of the OECD agreed to invite the Slovak Republic to accede to the convention.

3 The Report was approved by the OECD Council of Ministers on 9th April 1998 in accordance with Article 1 of the OECD Convention namely to achieve the highest sustainable economic growth, to contribute to sound economic expansion in Member as well as non-member countries and to contribute to the expansion of world trade.

havens caused the erosion of the United States tax base as more companies and individuals sought to take advantage of the opportunity and loopholes for flight capital.[4]

According to United Nations figures, which were recently published[5], about (8) eight trillion dollars is invested in offshore accounts worldwide. Oxfam, the British based interest group, says [6]that tax havens have attracted an estimated $6 trillion dollars in assets with approximately $4 trillion of it representing the wealth and savings of the worlds most affluent. In perspective, the total holdings of the worlds rich and well to do are believed to be in excess of $25 trillion.[7] However, several factors have contributed to the failure of earlier attempts to stifle the growth of such centers.

The 1998 OECD Report represents the most considerable challenge to the validity of offshore centers as viable, legal and internationally reputable centers of financial excellence. Despite this challenge it is highly questionable whether the report will be successful in limiting the effects of all of the major offshore financial centers. Switzerland in its condemnatory statement on the report exclaims: "financial and investment decisions depend on a multiplicity of economic, political and social factors."

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[4] The 250 page "Gordon Report" is out of print but a copy cane be found in Appendix A of Langer, Marshall J., Practical International Tax Planning (PLI, 3rd edition,1985-1999)
[5] Jack Blum "*Criminal Money Laundering and Illegal Flight Capital"* Brookings Press Briefing, Washington, D.C. Sept. 29, 1999.
[6] Oxfam, Tax Havens: *Releasing the Hidden Billions for Poverty Eradication."*
[7] William Hall, "*Worlds Wealthy Press for Service,"* Financial Times, July 7, 2000

Moreover, within developed nations there exist numerous tax incentives for which the entire purpose is, precisely as offshore centers, to attract capital investment[8]. It is generally accepted within the international society that sovereign states will adopt fiscal policies that do not impede or obstruct the entrepreneurial spirit. Hence, the assertion made by the report that countries with no or nominal taxation are a threat to the sustainable development of its members does not address the underlying issue which can be placed in the form of a question: Why are countries offering offshore investments attractive? It is this basic question, inter alia, that will be addressed. It is interesting that the OECD and its members have suggested that the purposes are solely to evade taxes and protect illicit profits through a web of bank secrecy and confidentiality.

However, in defense of the Offshore Centers numerous measures have been undertaken by several of the leading centers in order to avoid the dubious connotation that offshore denotes sham type of banking. Indeed, centers such as the Bahamas, Cayman and Bermuda arguably are better regulated and are much more sophisticated centers of financial excellence than some of the members of the OECD such as Turkey, Poland and Czech Republic.

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[8] *See generally the tax breaks afforded to Puerto Rico, U.S. Virgin Islands and Delaware*: with reference to the Puerto Rico the provisions of section 936 of the Internal Revenue Code allows substantive tax credits to domestic corporations.

Exchange of Information[9]

A central thrust of the Report is to launch an attack on the present exchange of information or lack thereof with the offshore sector. The OECD has made it a distinct requirement that in order for the offshore centers to maintain a level of cooperation from its members there must be a massive increase of exchange of information treaties or otherwise[10].

This particular recommendation has sent shivers throughout the offshore industry for several reasons. Several of the countries identified by the OECD have previously enacted legislation specifically detailing the circumstances under which the veil of confidentiality may be pierced[11]. Moreover; there is adequate case law[12] illustrating the use of such legal assistance treaties. The judiciary has also played a major role and within the offshore centers has overwhelmingly rejected breaching the confidentiality provisions of the law where the revenue collectors of the contracting state are at best only capable of proving a "fishing expedition[13]"against the alleged individual. In the case of Re Grand

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[9] See in particular The OECD Report on Harmful Tax Competition An Emerging Global Issue Paragraph 64 page 29…" The ability or willingness of a country to provide information to other countries is a key factor in deciding upon whether the effect of a regime operated by that country has the potential to cause harmful effects."

[10] Ibid page 46 "Recommendation concerning greater and more efficient use of exchanges of information that countries should undertake programs to intensify exchange of relevant information concerning transactions in tax havens…."

[11] See the laws between the Untied States and Bermuda, Bahamas, Cayman and British Virgin Islands all of whom have a Mutual Legal Assistance Treaty

[12] Hence, tax regulators have sought other means to have information released, In this regard see Mackinon v Donaldson Lufkin Jenrette, Judgement of Nov. 5, 1985, Chancery Division, London (court declined to exercise jurisdiction over Bahamian bank account in alleged fraud case and quashed subpoenas) Clinch v Inland Revenue Commissioners (1974) Q.B. 512

[13] Cayman Islands Financial Secretary George McCarthy has emphasized that the Caymanian government will work with the OECD in order to produce an administratively workable procedure for the release of

Jury Proceedings United States of America Plaintiff- Appellee v The Bank of Nova Scotia Defendant Appellant[14].

On the 4th March, 1983 Bank of Nova Scotia's Miami branch was served a subpoena duces tecum issued by the United States District Court for the Southern District of Florida. The subpoena called for production of financial documents related to two individuals and three companies who are clients of The Bahamas, Cayman Islands and Antigua. The Miami Office duly complied with the order and sent telexes to the branches requesting the information. Meanwhile, on 4th April, 1983 the bank filed a motion to have the order quashed as compliance with the order would constitute a violation of the laws of Cayman and The Bahamas as regards to client confidentiality. The court dismissed this motion. Further, throughout May 1983 the Bank requested the Assistant United States Attorney to show materiality and necessity for the subpoenaed documents. The U.S. Attorney stated his willingness to assist short of showing any materiality or necessity.

Following a period of impasse on both sides, on October 26th 1983 the district court imposed a fine of $25,000 per day until the bank complied with the initial order. Not until 14th November 1983, after the Attorney General of The Bahamas' intervention, was the information released to the United States District Court. The United States Eleventh Circuit Court of Appeals held that the District Court did not abuse its discretion in finding the Canadian bank in civil contempt and imposing a fine of $25,000 per day until

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information. The foreign government must show a credible case that there is good reason to believe tax evasion or avoidance has taken place
Wall Street Journal 28th July 2000.

the bank complied. This decision highlights the lack of comity of nations displayed by United States federal authorities when dealing with matters in relation to bank secrecy and confidentiality.

The circumvention by the United States Assistant Attorney of the local judicial system in The Bahamas, Cayman Islands and Antigua should have been emphatically rejected by the United States District Court. Indeed, in the United States federal investigators must comply with certain procedures before they are granted access to records protected under the United States' Right to Financial Privacy Act..[15] The Assistant United States Attorney D. Lowell Jensen exclaimed in reaction to the Scotia Bank case and other similar cases " it is a mistake to condemn bank secrecy…because it is being abused in some jurisdictions. Persons and companies transacting business with and through banks are entitled to a reasonable degree of privacy in connection with such business transactions. The United States itself, through the Right of Financial Privacy Act, recognizes this right. The critical question is…whether the country has built into its laws effective and efficient means of piercing bank secrecy where there is reasonable suspicion that a bank account has been used in connection with a crime or has been the depository of a crime."[16]

The point here is evidently there is arguably a need for jurisdictions that operate a level of confidentiality. The total revamping or elimination of such centers would leave a vacuum in several spheres of the international banking environment particularly with respect to

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[14] 740 F.2d 817
[15] See 12 U.S.C. 3413(i) (1983)

international trade matters and international financing. The threshold question that must be examined is whether the offshore financial centers possess the degree of legitimacy mentioned by D. Lowell Jensen. It is clear that the centers through their respective legislatures have more often than not shown the determination to dissuade money launderers and their associates in business from coming to their shores.

However, if such financial centers are to operate and provided there is a clean and transparent atmosphere in their operations it is necessary that the OECD, its membership and the developed nations generally respect those jurisdictions and their laws. Hence, those investigating possible infringements in their tax laws should consistently seek to obtain banking information through the manner prescribed in the law of the particular center and not through the back door.[17] This level of cooperation in the international tax arena would provide some ease of the strained relations which have existed between offshore financial centers and the developed nations with regard to bank secrecy and confidentiality matters. An identical case to United States v Bank of Nova Scotia[18] which was decided differently by the United States Court of Appeal Seventh Circuit is United States v First National Bank of Chicago.[19] The facts of case concerned an Internal Revenue Service investigation into two bank depositors maintaining accounts at the Athens, Greece branch.

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[16] Problems of Obtaining Evidence in Foreign States for Use in Federal Criminal Prosecutions 22 COLUM J. TRANSNAT'L L. 233, (1984) page 216

[17] See The Third Party Record Keeper's Act 19 U.S.C. 1509 (1982) allowing disclosure of financial records to the Internal Revenue Service, but only under limited circumstances and with sufficient procedural protection.

[18] Supra page 5

[19] 699 F. 2d at 1391

The First Chicago case revolved around the question whether an order by the district court of subpoena duces tecum which would have the effect of causing violation of Greek Bank Secrecy laws, which incurred criminal sanctions, was a valid order.

The Court of Appeal held that there was no question that the Internal Revenue Service had shown a prima facie case.[20] However, there should be other determining factors. Specifically, the court felt " where criminal sanctions for the production of information could be imposed abroad, a domestic court, although not automatically barred from compelling discovery, must weigh the competing interests of the parties before imposing domestic enforcement sanctions."[21]

Two further points highlighted by the Court of Appeal were that the employees of First National Chicago and Greece were "neutral sources and not adverse parties in litigation."[22] In addition, the interests of the two sovereign nations Greece and the United States should be equally viewed.[23] The application of the balancing test prescribed in the Restatement (Second) on Foreign Relations would result in the order to compel documents in this case as an abuse of discretion. [24] However, the OECD's report's recommendation now makes it abundantly clear that the threshold required before information should be released to Tax authorities of the individual country will be

[20] Id at 343
[21] Id at 345
[22] Id at 345-346
[23] Id at 346
[24] Id at 345-346

significantly lowered[25]. This provision will be the cause of disruption of the financial activities of the unscrupulous investors who may for instance be attempting to avoid the reach of potential creditors.

More importantly, the provision will affect the legitimate investor whose desire was to dispose of his assets upon his demise with a degree of certainty without the risk of normal estate taxes diminishing the final sum of assets available for his heirs. It is unfortunate that the OCED has not considered that a great deal of the offshore investors intend at some point to return their assets in a taxable manner in various forms such as in the purchase of real property or investing in a company or a financial instrument[26].

Other Legal Implications

The First National Bank of Chicago case represents a welcome departure from the limits established in the Bank of Nova Scotia case.[27] Moreover, undoubtedly, the response of the OECD with respect to the sovereign and independent nations labeled as Offshore centers has some repercussions in the context of international law. In the First National Bank of Chicago Case the Court of Appeal for the Seventh Circuit referred to the recommendation provided in the Restatement (Revised) of Foreign Relations Law

[25] Wall Street Journal Article by Staff Reporter Michael Allen 'Tax Havens Offer Collectors Concessions dated 28th July 2000 reports that the Cayman Islands has agreed to waive its bank secrecy protection for clients in civil investigations conducted by tax authorities

[26] Ibid "Cayman government minister Truman Bodden said 85% of clients are large firms doing institutional business"

[27] See Brief of the Government of Canada as Amicus Curiae on Appeal from the United States District Court of Florida at 16 In re Grand Jury Proceedings, The Bank of Nova Scotia v United States

Sections 419(1) and 420 (2)[28] as some guidance on this subject. The main benefit of the Second Restatement test is that it maintains that the interest of both states are of equal importance. [29] The five considerations that should be made according to the Restatement are:

1) Each states vital interest,

2) The extent and nature of the hardship that enforcement might impose,

3) The extent to which action is required in the foreign state,

4) The parties nationality, and

5) The extent enforcement will achieve compliance with the rule in each state. [30]

The above provisions of the Restatement (Revised) would be a more productive approach to dealing with such a delicate issue.[31] The Restatement considers the effect compliance will have on the individuals in the foreign state. Previous case law has tended to consider only the result without the effect of the courts order.[32] This authority of the Restatement is further supplemented by the rule established by the United States Supreme Court in Societe International pour Participations Industrielles et Comerciales, S.A. v Rogers. [33]

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[28] Id at 346

[29] See Paikin, Problems of Obtaining Evidence in Foreign States for Use in Federal Criminal Prosecutions 22 COLUM TRANSNAT'L L. 233 (1984)

[30] Davis 767 F. 2d at 1033-35 (balancing competing interests under the Second Restatement of Foreign Relations Law) The term balancing of interests may have originated with the governmental interest analysis proposed by Professor Brainerd Currie. See generally Currie Married Woman Contracts: A study in Conflict of Laws Method: 25 U. CHI. L. REV. 227 (1958) "Today, however, interest balancing test suggest a decision making process in which the court identifies the interest of the countries having contact with the situation to be adjudicated" 9 FORDHAM INT'L LAW JOURNAL 680, 733

[31] See e.g. United States v Vetco Inc. 691 F. 2d 1281 1288-1289 (9th Cir) Cert. Denied, Other factors the courts have considered include the absolute necessity of the documents, the availability of alternative means of compliance

[32] Supra see United States v Bank of Nova Scotia

[33] 357 U.S. 197, 205, 208-209 (1958)

The court stated that to address the conflicting requirements faced by individuals in cases where there are strict confidentiality laws, a good faith test should sometimes be employed. The essential elements are that the order was proper and not an abuse of process, the appropriateness of the subpoena, and, perhaps most important is whether the individual(s) use of the foreign jurisdiction was solely to defeat any requirement to produce information.[34]

Of note, however, the court was clear in stating "We do not say that this ruling would apply to every situation where a party is restricted by law from producing documents over which it is otherwise shown to have control[35]"

This approach by the Supreme Court would ameliorate an otherwise extremely difficult situation. The difficulty is evidenced in the view of the Grand Court of the Cayman Islands in the case of In Re An Application by ABC Ltd. Under the Confidential Relationships (Preservation) (Amendment) Law 1979.[36] In this case the Cayman bank official who was in possession of information that he perceived would be the subject of a compelled waiver asked the court for direction. The court opined, "consent given under compulsion is merely submission to force."[37] It has been suggested that the reason the

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[34] Good faith is only relevant to he determination of sanctions for noncompliance, which is a procedural issue. See Societe Internationale, 357 U.S. 208 (discussing the district court's power to impose sanctions under Rule 37(b) In order to have made the requisite good faith efforts at compliance, the party resisting production must have made efforts to the maximum of its ability to comply with the United States order. 357 at 205. Because the plaintiff in Societe Internationale had acted in good faith, he was entitled to a hearing on the merits of his claim. See 357 U.S. 211-212.

[35] Id at 205-206

[36] Judgment of July 24, 1984, Grand Court, Cayman Islands, July 24, 1984 (Cause No. 269)

[37] Id at 2. The court admitted that it is only concerned with the position in its jurisdiction of such a consent directive compelled by a foreign court. Both under United States law and British common law indicate that the Cayman Grand Court's definition of consent is neither the only, nor even the predominant, interpretation of consent. Under British common law, the term has no uniform definition. See e.g. Whittaker v Campbell (1983) 3 All E.R. 582 (consent of automobile owner to another use of his automobile not vitiated by fraudulent misrepresentation) Barton v Armstrong 1976 A.C. 104, 121 (P.C. 1973) absence

Cayman court refused to consider the United States interest is because of the established private international law rule that states do not enforce the revenue laws of other states.[38] In United States v Davis [39] which came after the decision in the ABC Ltd. case, the Second Circuit affirmed the district court order which had required Davis to request the Cayman bank to release the account information and thereby waive his bank secrecy rights.[40] The court in Davis, which concerned money laundering, was able to bypass the decision in ABC Ltd. because the case also involved breach of Cayman Law. [41]

Having regard to the above, it is clear that there are international ramifications when the use of the compelled waiver procedure is made by the Untied States. Moreover, this area of international law has as the case law authorities suggest too often been victimized by self-interests alone. In addition, as my analysis will show, leaving this important area of

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of choice regarding contract entered into by fraud does not negate consent in law (Lord Wilberforce and Lord Simon dissenting) Cumming v Ince 11Q.B. 112, 116 Eng. Rep. 418 K.B. 1847 (plaintiff's incompetency precluded her acting from free will and hence contract was voidable for duress.) The issue in these cases was not whether the consent was produced under compulsion but whether that compulsion is lawful under the circumstances. 9 FORDHAM INTERNATIONAL LAW JOURNAL 680 at page 27 note 97. See also Biffin v Bignell 7H. &N. 877, 879-880, 158 Eng. Rep. 418 K.B. 725,726 (Ex. 1862) Smith v Moneith, 13 M & W 427, 437, 153 Eng. Rep. 178, 182 (Ex. 1844) Under the United States common law of contracts, a party's consent to a contract is vitiated if the party consented to the agreement while under duress. J.CALAMARI & J. PERILLO, THE LAW OF CONTRACTS 9-2 AT 262. RESTATMENT (SECOND) OF CONTRACTS has defined duress as any wrongful act or threat which overcomes the free will of a party.

[38] See generally ABC Case Judgment supra note 32 "The Term Private International Law is the term used to describe the branch of law that addresses the questions of when and why the courts of one jurisdiction consider the prior determination of another state or of a foreign nation in a case pending before it" E. SCOLES & P. HAY, CONFLICT OF LAWS 1.1 AT 1(1982) The RESTATEMENT (SECOND) OF CONFLICT OF LAWS SAYS " that a true conflict exists when each country has a strong interest in having its own law or lack of a law applied to the transaction, and application of each law would produce a contrary result. "

[39] 767 F. 2d. 1025 (2d. Cir. 1985)

[40] Professor Maier advocates diplomatic resolution of conflicting claims of authority to forbid or require conduct within a nations borders, rather than judicial decisions in which a forum court balances its own interest against the competing interests of other states. FORDHAM INT'L L. J. 680 at page 29 note 105

[41] " In the diplomatic forum, the label balancing of interests merely characterizes the ordinary international law formation process of demand, response and eventual accommodation in the light of reciprocal national needs and tolerances. The rues of international law describe community expectations that result from this process" Maier, supra note 36

international law open for the courts to clear up will not achieve a desired result for any party. One day a court may decide to follow the harsh rules of the Bank of Nova Scotia Case which will lead to one result. Yet on another day a court may decide upon the principles in Societe Internationale which would lead to a different result. Yet a further court decision may be upon reliance solely on the Restatement on Foreign Relations which arguably will lead to a result different from the either the former or the latter case. Equally, important the pathway now set by the OECD and its membership cannot with its methods prove to be any more productive. Rather, a preferred approach based on equal respect for sovereign nations and upon the firm principles of customary international law would achieve a degree of success for both sides in this arena.

CHAPTER II

TAX HAVEN FEATURES IN OECD COUNTRIES

"It does not surprise anyone that the most important tax haven in the world is an island. They are surprised, however,… that the name of the island is Manhattan. Moreover, the second most important tax haven in the world is located on an island. It is called London in the United Kingdom**."[42]**

The Caribbean Community (CARICOM) as well as other regional Western Hemisphere organizations such as the Organization of American States have been virulent in their stance against the position taken by the OECD and Financial Action Task Force against their member countries economies. Their position has been that too many abuses of preferential tax policies can be found in the laws of the leading OECD states and that the organization needs to tackle the problems that lie within its own membership first. This chapter provides an accurate highlight as to why the above argument by CARICOM and others is indeed a legitimate one. As an added support to their arguments, several leading international tax experts have similarly concluded that the OECD initiatives despite its well intention motives are half-baked and ultimately unfair to the smaller economies.[43]

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[42] Text of Speech presented at a meeting of the International Tax Planning Association on November 20, 2000. In the report, Langer has argued that many of the members of the OECD are tax havens themselves and that the OECD should not attack non-members for harmful tax competition until its members clean up their own tax systems.

[43] See generally comments by Dr. Daniel Mitchell of the Heritage Foundation supra note 37 and Ibid note 46

Indeed, according to the OECD it has identified harmful preferential regimes that fly in the face of worldwide tax competition and gives an unequal edge in favor of the so called tax havens and encourages abuse by its citizens. This argument lacks any credibility. The United States admittedly has a preferential regime in the form of the Foreign Sales Corporation that the World Trade Organization has already successfully attacked. Switzerland has also admitted that the position with regard to its administrative and service companies can be justifiably labeled as preferential regimes. Ireland has gone as far as admitting that it has preferential regimes but according to its own statements only to the international Financial Services Center, which arguably does the very same level of offshore finance work as Cayman, Bermuda or The Bahamas, and the Shannon Airport Zone.[44]

A further point, which has been highlighted, is the approach of the United States in particular as regards to foreign earned income. A U.S citizen who has received income from a bank deposit must pay federal income tax up to 39.6 percent on the income earned. However, the position is different with non-resident aliens or foreign corporations who pays zero U.S. income tax on U.S. bank deposit interest. The only exception is for residents of Canada, with respect to other countries the amount of the interest that is earned is not even reported to the Internal Revenue Service. Hence, obviously, it is not being reported to other countries under United States tax treaties or tax information exchange accords.

[44] Ibid note 46..Langer also points out that the United Kingdom does not admit that it has any preferential regimes that may impugn the level of tax competition that it allows.

Hence, since 1986[45] the income earned has been treated as domestic source income but it still remains exempt from United States taxes when it is received by a foreign person if it is not effectively connected with the conduct of a US trade or business. Moreover, if the interest on the deposit is exempt from United States income tax the deposit itself is also exempt from estate tax.[46]

In 1975, the Joint Committee on Taxation estimated that more than $3.1 billion dollars annually is paid as interest to foreign persons and companies. This figure today can perhaps be estimated as being in the hundreds of billions of dollars per year. This is only heightened by the fact that because of the robust American economy and the tax benefits on foreign earned income those more foreign enterprises are lured to invest in the United States[47].

As evidence of this, one can point to a very recent report[48] by A.T. Kearney, the renowned global consulting firm, which has compiled an annual survey of executives of the 135 of the world's 1,000 biggest companies, who gave their grades as to which foreign countries they would be inclined to invest in. The United States handsomely won. Most executives were inclined on the overall benefits of investing in the United States given its share of the world market on consumption of goods and requirements of

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[45] See generally section 861 (a) (1) (A) and (c)
[46] See also Section 2105 (b) (1)
[47] See U.S. Taxation of Foreign Source Income of Individuals and Corporations and Domestic International Sales Corporation Provisions, Committee Print Prepared for the Use of the Committee on Ways and Means by the Staff of the Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., at p.23 (Sept. 29, 1975)
[48] February 17th, 2001 edition of *The Economist* News Magazine report on Foreign Investment page 104

services.[49] The tax benefits of investing in the United States, which result in a much lower tax burden than operating in some of the industrialized European economies with the exception of Great Britain made the country equally a good choice for future investments.

However, the OECD in its haste to categorize the less developed countries as offering preferential tax regimes has failed miserably to take note of the advantages offered by the United States as tax incentives. The United States has several key elements found in its laws which experts argue have been "conveniently ignored by the OECD[50]." The US has allowed portfolio interest of foreign persons since 1984 to be paid free of U.S. income tax[51]. Similarly, interest paid to alien persons on treasury bills, government bonds, and many other corporate bonds is generally free of US income tax whereas its is fully payable where those interests are accrued by an American citizen or resident.[52]

In addition, the long-term capital gains that are earned by a US resident or citizen are taxed at a reduced rate. On the other hand, short term capital gains such as that arriving from day trading is taxed under federal income tax rate of up to 39.6 per centum.
This is in contrast to the position with regard to foreign persons. All of the capital gains that are earned by foreign persons other than for the sale of US real property are tax-free.[53] The United States' estate and gift tax which can be as high as 55 percent on the

[49] According to The Economist article…Despite concerns about a slowdown in its economy, America remains the most attractive destination for foreign direct investment.
[50] Ibid note 46 at page 668
[51] Sections 871(h), 881(c)
[52] Supra
[53] Ibid note 46. Langer points out that he has personally advised of a case where a foreign individual earned in excess of $120M in day trading profits during 1999 that had been treated as tax-free capital gains.

transfer of property at death or lifetime gift technically applies to non-resident alien individuals. However, it is axiomatic such transfers by non-residents are exempt if the foreign individual holds the United States property in a foreign holding company.[54] Essentially, this and other benefits[55] offered by the US adds credence that the industrialized nations are similarly offering preferential regimes for taxation purposes.

Another highlight of the United States treatment of foreign investment preferentially can be found in the laws of Delaware and more recently Nevada. The companies' law of the United Kingdom traditionally has been used by foreign persons in a manipulative fashion to incorporate entities in the UK but which carried on no business there. This obviously resulted in substantial savings by US companies and individuals and gave the United Kingdom a competitive edge. As some experts point it out[56] many individuals including some tax authorities incorrectly surmised that because the company was registered in London it was subject to United Kingdom company taxes.

Once these amendments were made by the United Kingdom the most popular "successor" has been the Limited Liability Companies as established under Delaware and

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[54] See generally Marshall Langer arguments on this and other similar points.. Langer has argued that although the United States wants every country to give it tax information, U.S. law does not permit the IRS to give any tax information to a foreign country, unless either that country has either a tax treaty or a tax information exchange agreement (TIEA) with the United States.

[55] The OECD June 200 reports suggest several countries such as Canada, Norway, Italy and Germany all have preferential regimes with regard to international shipping. However, arguably the US could have been included on this list of countries. A huge number of cruise ships leave from Florida and Gulf Coast ports to the Caribbean and South America. If the cruise ship companies used US- registered ships owned by US companies, they would be subject to full US income tax. However, by using foreign flag vessels owned by foreign companies, the cruise ship companies reduce their tax burden to zero. The Internal Revenue Code exempts all income from international shipping operations if the company's country of residence grants an equivalent exemption to US persons. SEE S.883 (a)/ See generally Langer note 46

[56] Se generally Rhoades and Langer, US International Taxation and Treaties, Chapter 47 and 73 which gives an expanded view of their opinion on this issue.

Nevada laws. These company's laws have allowed foreign persons to carry on business outside of the United States free of income tax but with a United States registered address. Arguably, the entire incorporation is comparatively cheaper than some of the offshore financial centers under attack by the OECD. Even more importantly, the fact that the company is registered in the United States and the integrity of the United States legal system as an added benefit only serves as a greater incentive for potential investors in such companies. [57]

Indeed, the most cogent argument, theoretically, that the established offshore centers such as Cayman Islands, The Bahamas, British Virgin Islands, Cook Islands and Bermuda present to clients is that their jurisdictions have the respectability and integrity of the United States and Great Britain. Indeed, many of these centers have targeted potential clients under the premise that their systems are arguably as strong and stable as a developed country coupled with an added benefit of confidentiality and privacy. Hence, it is submitted that there is a very strong aroma of double talk as the developed countries have capitalized on the very same preferential benefits that are being challenged by the OECD.

Yet the preceding argument against the United States position can also be made against other well-respected OECD member states. Switzerland has openly provided for Swiss

[57] The United Kingdom repealed its position with regard to such companies in the very comprehensive The Companies Act 1992. Langer' The most popular successor to the non resident U.K. company seems to be the U.S. limited liability company (LLC), which offers essentially the same cosmetics. It a tax nothing for U.S. tax purposes. Its registered office is in Wilmington Delaware and it offers essentially the same cosmetics as the former non-resident UK Company. Delaware and Nevada LLC's are generally considered to be much more of a bargain in some cases than most of the other offshore companies and centers.'

banks to place fiduciary deposits in foreign branches of Swiss banks in order to avoid Swiss withholding tax of 35 percent. Canada similarly offers tax-free bank deposits to foreign persons in currencies other than the Canadian dollar.[58]

With respect to the Austrian position an even more preferential tax regime is present as regards to the well-established anonymous bank accounts allowed under Austrian law. Austria has very well entrenched strict bank secrecy laws. The tax authorities in Austria are only themselves allowed access to financial and bank records after an Austrian judge has made an order. Moreover, Austrian judges will not give this approval unless evidence can be provided that shows reasonable grounds to conclude that a criminal act has been committed. [59] It has been estimated that up to 24 million anonymous bank accounts are held in Austria with a net worth of about $100 billion dollars. [60]

Similar to the United States, the United kingdom has other features present within its own tax structure that has caused alarm within the countries designated by the OECD as having preferential regimes because the U.K. rules with regard to domiciliary leads to an uneven and unfair tax assessment. For instance, the United Kingdom has never taxed foreign income of its residents if they are not domiciled there provided that the income is

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[58] See generally on this issue Langer supra note 46..The June 2000 OECD report conceded that holding company regimes and similar preferential tax regimes in 13 of the 29 member states might constitute harmful tax competition. But the real question how will the OECD deal with this internal blow as most of these nations have refused to give up their regime even though staunch and austere measures are proposed should other smaller countries refuse to abide by the OECD recommendations.

[59] Ibid at page 670 after very intense pressure, the Austrian Parliament recently took steps to phase out Austria's anonymous passbook savings accounts by June 2002. Such accounts have existed since the days of the Austro-Hungarian Empire.

[60]Ibid It is believed that most of the accounts held are on behalf of foreigners mostly Europeans from OECD member countries who have sought to expatriate their funds in order to reduce their tax burden.

not remitted to the U.K. resident.[61]As a result of these rules, individuals who are present but not domiciled in the United Kingdom pays no U.K. tax on their income that arises abroad, unless they remit it to the United Kingdom.[62]

Even further disparagement of the tax code of Britain can be found in the words of Gordon Brown, Britain's present Chancellor of the Exchequer (i.e. Treasury Secretary) who whilst in opposition made the following statement almost three years before becoming the Chancellor in 1994:

> "Taxation of non-residents, non-domiciles and those with offshore accounts should be overhauled in line with the recommendations of the Inland Revenue (Commissioners). It is not fair that a wealthy few be allowed to work or live in the United Kingdom without making a fair contribution through taxation. In Britain it is easy for a few, even if they live or work here, to avoid substantial amounts of tax through claiming to be nonresident or non-domiciled and those who are not domiciled are able to live in the United Kingdom free of tax. In 1988, the Inland Revenue (Commissioners) recommended a radical new approach to residents and domiciles."[63]

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[61] See Langer From 1803 until 1914, U.K. residents were taxable on overseas income only if the income was remitted to the United Kingdom. Since 1914, overseas income has generally been regarded as taxable, except for non- domiciliaries who remain taxable only on a remittance basis.

[62] Ibid..He is not taxed on any remittance The U.K. Inland Revenue Commissioners published a green paper in 1998 that proposed significant changes in the way Britain taxes foreign individuals who regularly spend time in the country. If these changes had been adopted, individuals regularly spending an average of more than four months per year in Britain would be taxed on their worldwide income, much as they are in the United States.

[63] This quotation was published in Denzil Davies, Booth, Residence and UK taxation (Butterworths, Special Tax Planning, 1997) at section 1.05. It is interesting to note that the section containing this quotation was omitted by the author from the subsequent Fourth Edition of the book, published in 1999.

Interestingly, despite these very clear and precise words by Mr. Brown as what is required in order to level the playing field, The Labour Party is now the government and has been since 1997 yet no proposals have been forthcoming by Mr. Brown's Treasury department officials.

Many have questioned why not.[64] A leading and well-respected British newspaper London's Sunday Times[65] has berated the Labour Party for it's about face of this initiative to reform the preferential tax system present in Great Britain. According to an article titled 'Foreign Born millionaires save GBP10 Billion from Brown's U-turn.' hundreds of foreign-born multi millionaires living in the United Kingdom enjoy the "non-dom" loophole.[66] The article further stated, " The loophole is perfectly legal. But critics of the scheme say it is scandalous that huge amounts of personal wealth are beyond the taxman's reach".[67]

The rules as presently structured in the U.K. are very similar to the tax structure as found in some tax havens. It is submitted that the U.K. rules extend further than that found in offshore centers such as Labuan, Malaysia which despite its offshore financial center laws still taxes individuals who are resident there on their worldwide income. Even more surprisingly an official of the Internal Revenue Commissioners themselves has made the

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[64] Langer has pointed out that the government has had to respond to the special interests of the Greek shipping companies who threatened to close down their United Kingdom business or in any event drastically reduce their business.

[65] Sunday Times (London) June 18,2000 pp 12-13

[66]Ibid, Prior to the general election, Brown and his shadow treasury team were scathing about the failure of the Tories to close the loophole. Since winning the lection and becoming Chancellor Brown has chosen to retain it.

following astonishing remark with respect to the British position…"This is an anachronism, a hangover from the dark ages. It's a loophole for the wealthy few that isn't available to most of us. It has turned the U.K. into a tax haven and is hardly appropriate for a government committed to modernization."[68]

The Times article publicly has brought to light the double talk which has dominated the British governments' views with regard to the need for reform in tax haven countries. Indeed, some of its present colonies and associated territories such as the Channel Islands and Bermuda and Cayman Islands are understandably disconcerted by the refusal of the government to make the necessary changes to its tax regime. An expert in the private banking arena has commented that ' the non dom rules make Britain a tax haven under the cover of the European Union. You have all the advantages of living in a developed and stable country but with very low taxes.'[69]

It is clear that the non dom rules has placed Great Britain at a competitive edge as it provides a legal loophole for the rich and wealthy. As the expert opinion above shows, the stability and advanced climate of The United Kingdom has helped to enhance the reputation of London as the preferred center for offshore business.[70] However, as noted

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[67] Ibid page 13 One non dom, Lord Paul of Marylebone, is a Labour Party Peer who ranks among the 100 richest people in Britain. His company gave several hundred thousand pounds to the Labour Party. He is described as one of Labours's biggest benefactors.
[68] Ibid page 12
[69] Ibid page 13 Pierre Gerbier is a private banker at the Royal Bank of Canada
[70] Although Inland Revenue and the U.K. Treasury have repeatedly refused to estimate how many people in Britain claim nom dom status, there must be hundreds of thousands of them. Estimates range from 250,000 to more than one million. The French embassy in London has estimated that there are at least 180,000 French nationals living high net worth individuals. They include the French supermodel Laetitia Casta who after being selected as the face of France has moved to London

earlier there are several key states which are a part of the membership of the OECD that have preferential tax regimes present in their respective tax codes.

Briefly, a few highlights of those states includes the following:

Canada has extremely lax rules with respect to taxation of immigrant income. By setting up a pre-immigration offshore trust an immigrant to Canada can legally escape income tax on their foreign earned income for up to five years.[71]

France has allowed investors in their French overseas territories huge tax incentives.[72] As a result of changes in the French Code, since 1986 investors in overseas territories and departments have been able to deduct their entire investment and in some cases double deduction for losses they may have incurred. [73]

Hungary has now developed its own offshore center. The Wall Street Journal has reported[74] that some towns there are flourishing economically as a result of offering preferential tax regimes as low as 3 percent to foreign investors on their foreign earned income.[75]

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[71] Harmful Tax Competition: Who Are The Real Tax Havens? By Marshall J. Langer Langer makes the case that many of the OECD member states are themselves fall foul of the Harmful Tax Competition report. He suggest that the OECD should concentrate its efforts firstly on seeing that its own member states clean up their preferential tax regimes before venturing out to the smaller interdependent economies.

[72] However, beginning in 2001 the French government has proposed to curtail these benefits.

[73] Ibid

[74] See Reed, John "Corporate Giants Find Relief From Big Taxes In Tiny Towns" *Wall Street Journal Interactive Edition* February 9th, 2000

[75] Ibid

Belgium has been known for its refusal to tax most types of capital gains. Indeed, citizens of the Netherlands and some of the other European Union states have moved to Belgium for a period long enough to sell their securities tax-free.[76]

Spain has sought and gained approval for offshore business. The European Union has approved the Canary Islands Special Zone tax regime as a special low tax area where a tax rate of between 1 and 5 percent.[77]

Italy has an even more peculiar situation[78]. In the case of the village of Campione d'Italia, the residents of which pays no taxes whatsoever neither to Italy nor to Switzerland its neighbor on the borders with Lake Lugano.[79]

Ireland still has many similarities in its laws to many of the established offshore financial centers. An example of which are its laws which mirror that of the United Kingdom which allows foreign sourced income earned by non-domiciled residents to be free of taxes provided it is not remitted to Ireland.[80]

Mexico has a situation very similar to that of Italy mentioned above[81]. The Washington Post has reported in an article that in the Mexican town of San Francisco Magu, the

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[76] Ibid
[77] Ibid
[78] See Langer, Marshall J. The Tax Exile Report Chapter 41 (Scope International, 6th Edition, 1997)
[79] Ibid at page 672
[80] Ibid
[81] Jordan, Mary, "In The Mexcian Town, Only Certainty Is Death," The Washington Post, September 25th, 2000 p. A14

residents have been exempt from all taxes including income taxes for the last (260) two hundred and sixty years.[82]

Portugal has recently joined the fray as well in its new scheme. The European Commission has recently (June 2000) approved a new initiative by the Portuguese Government that would enhance and encourage corporate investments into Madeira by exempting most taxes.[83]

Iceland has taken a much bolder position. The government of Iceland enacted the new International Trading Companies legislation in 1999 which is a whole year following the OECD's publishing of its report on Harmful Tax Competition. The new companies law provides for a substantial reduced tax burden of five percent a year as compared to the normal rate of thirty percent.[84]

Luxembourg has as mentioned above voiced vehement disapproval of the entire harmful tax report as it has a very well known offshore banking sector with very strict bank secrecy laws intact. Luxembourg also has several distinct versions of International business companies all of which allow substantive tax breaks to the foreign investor on foreign earned income.[85]

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[82] Ibid
[83] Ibid
[84] Ibid
[85] Ibid

Switzerland has openly refused any agreements aimed at curtailing its offshore tax haven reputation or status. Recently, the Swiss Federal Council has said that the present structure of Swiss Bank Secrecy is a nonnegotiable condition for Switzerland to continue its membership of the OECD and its affiliation with the European Union. One commentary has quoted the Swiss economic minister as saying that the OECD project was imbalanced and unilateral" and completely untenable for Switzerland. Switzerland has of course very openly marketed its lump-sum (forfait) tax agreements to wealthy expatriates who are new residents. The agreement sets out the level of taxation to be paid by the new resident to the cantonal tax authorities.[86]

It has been recommended by several international tax experts that a thorough review of all of the preferential tax regimes worldwide is conducted with a view to reducing the trend globally and not simply in some pockets of the world such as the Caribbean or in the Pacific Islands. Without a doubt the OECD report is not as conclusive nor is it as far reaching in its attack on so called preferential tax regimes.[87]

It is submitted that it should be the job of the United Nations or the World Trade Organization or the International Monetary Fund or any other global groupings of rich and poor nations that decides how the problem of preferential tax regimes should be solved in an equitable and ethical fashion. The self interest of the OECD countries in

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[86] Ibid

[87] Marshall Langer at page 672 argues that the OECD has been very arbitrary in deciding which countries and which part of the world it would attack Specifically, Langer argues.."The OECD has been somewhat arbitrary in its designation of harmful tax havens. In addition to omitting many harmful practices by its own member countries, it has omitted other countries that regularly appear on blacklists named by OECD and non-OECD countries. It would be interesting to find out why the OECD refused to include in its report

setting out the Harmful Tax Competition Report has led to some experts including United States Republican Congressman Richard Amey as labeling the OECD "A Tax Cartel"[88].

Further, it follows that the smaller and less developed nations do have a legitimate grievance in the handling of the problem by the OECD. It is clear that no sanctions have been made against the membership of the OECD should they refuse to abide by the report. On the other hand, third world countries, which refuse to collaborate with the OECD, have been threatened with numerous actions ranging from refusal of aid, and government backed loans to economic sanctions.

The developed world has shown through its report of the OECD that it does not intend to provide a fair basis upon which the worldwide problem of preferential tax regimes can be solved. Interestingly, the double standards of the OECD nations can similarly be viewed in a recent edition of The London Financial Times. The Australian Federal Government placed an ad in the magazine which touted one of the Southwestern states as having a new three billion dollars funding from the federal government in order that it can provide detailed, expedient and confidential offshore financial center type business.[89]

As illustrated in the list of the twelve OECD member states above there are considerable tax advantages that the membership of the OECD still are delivering to the wealthiest

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countries such as Costa Rica, Cyprus, Guam, Hong Kong, Malaysia (Labuan), Malta, Singapore and Uruguay, all of which can be and has been used as tax havens."

[88] Supra note 47 above

[89] The Financial Times Newspaper February 9th, 200 edition

individuals and companies in the world in an effort for the most part to attract capital and infrastructural investment.

Indeed, in the very recent case of the California electricity debacle it has been reported in the news media in the United States that one of the global British electricity supply companies has been consulted with a view to help supply and ameliorate the conditions with respect to electricity in California. As is the case in this situation the need for electricity in such a short time frame has meant that the Californian government has considered numerous tax concessions.

CHAPTER III

THE EVIL BANK SECRECY LAWS

" A spectre haunts the worlds governments. They fear that the combination of economic liberalization with modern information technology poses a threat to their capacity to raise taxes.[90]"

A fundamental area of contention which the OECD has targeted as an area which requires drastic reform and or total elimination is the Bank Secrecy Laws found in many of the leading offshore centers. Strangely enough, several of the members of the OECD club have very entrenched and established laws pertaining to financial privacy rights.[91]

According to the Harmful Tax Competition Report, the lack of access to information whether through bank secrecy laws or vehicles such as International Business Companies which are able to have bearer shares collectively causes one of the most harmful characteristics of a regime. The report continues that availability of protection from enquiries by tax authorities is one of the biggest attractions of many of the offshore centers.[92] The report further stated that the limited access that certain countries have to bank information for tax purposes is inadequate to detect and prevent abuses by

[90] Financial Times of London July 19, 2000
[91] See for eg. The Financial Privacy Act of the United States, For an interesting review of the Bank Secrecy Laws of Switzerland, Austria, Germany, France, Italy Spain, Sweden and Denmark see Int'l Bus. Law 221-251 (October 1979)
[92] Harmful Tax Competition 'An Emerging Global Issue" OECD 1998 at page 33

taxpayers.[93] This in turn leads to ways in which taxpayers may minimize or completely avoid certain taxes and obtain a greater degree of financial privacy.

According to the OECD, the following three main characteristics are found in offshore financial centers;

(1) To provide a location for holding passive investments,

(2) To provide a location for "paper" profits to be booked, and

(3) To enable taxpayers but particularly with reference to their bank accounts and financial affairs to be effectively shielded from scrutiny by tax authorities in their home countries.[94]

The resulting recommendation clearly is an attempt to dismantle the bank secrecy provisions which are pivotal to many offshore centers. Recommendation 7 of the Report states that countries should review their laws, regulations and practices relating to access to banking information for tax purposes with a view to removing all "impediments" to the access to such information by tax authorities.[95] Despite the somewhat diplomatic language used in this section of the report, it is suggested at a later portion of the same report that various actions would be undertaken against regimes deemed harmful tax competitors. Specifically, the report says it is worth exploring the possibility of

[93] Id at page 30. The Report also included mention that the Committee has commissioned a survey of country practices regarding access to bank information for tax purposes.
[94] Id at page 21-22
[95] Id at page 45

addressing harmful tax competition encouraging its member states to utilize a range of non-tax measures at their disposal. [96]

This entire effort has been criticized as an attempt by governments of high tax countries to protect their tax revenues at the expense of the approximately forty nations, which have little or no taxes.[97] Coupled with this criticism, have been commentaries which have been highly critical of the report within the leading member states of the OECD. One commentary exclaimed that the fact that low tax jurisdictions are a "magnet" for jobs, capital and entrepreneurial talent is the sort of development that should be generally encouraged and not discouraged as this has repercussions on other national concerns such as immigration and capacity of developed countries to properly cater for the health services of their citizens.[98]

Further, Dick Armey US House Majority Leader has opposed what he calls ' financial protectionism aimed at low tax regimes." Congressman Armey added that the essence of the Report would be against the national interests of the United States and would endanger the economic policies of other nations. He expressed grave concern over the US government's active support and involvement in the OECD's efforts to stamp out tax competition, claiming that the OECD report was designed in effect to create a tax cartel." If the OECD succeeds our nation will face the risk of higher taxes and a weakened

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[96] Id at page 62

[97] Commonwealth Secretariat "Harmful Tax Competition paper" prepared for the Meeting of Law Ministers and Attorney Generals of Small Commonwealth Nations LMSCJ (00) 12, May 15- 17, 2000, p 3

[98] Michael Allen, "Wealthy Nations Plan Crackdown on Tax Evasion, Offshore Havens," The Wall Street Journal May 21, 1998

economy while developing nations will be hamstrung in their attempts to promote economic growth. ‘‘[99]

Nevertheless, judging from the general endorsement given to the OECD Report it is clear that the leaders of several of the industrialized nations have a concern that a major element of tax reform for the offshore financial centers is a requirement to curtail bank secrecy. This is particularly true as the world economy becomes more integrated and technology improves it, thus makes it easier for taxpayers to avoid excessive taxation. Senor Vito Tanzi, a senior International Monetary Fund (IMF) economist has noted that ‘ today, individuals may be able to choose among many countries in deciding where to work, to shop, to invest their financial capital, to allocate the production activities of the enterprises they control and so on. In these decisions, they take into account the impact of taxes, especially as long as the tax systems of different countries diverge as much as they do today.’[100]

It follows from this, that there is ample evidence that tends to support the view taken by Mr. Tanzi.[101]This insight is particularly relevant to international investment flows but is also an issue to the sportsman or entrepreneur as well. The evidence can be found in the fact that it is becoming much more customary for citizens of the industrialized nations to adopt a new domicile in order to reduce their tax burdens. Some famous individuals have

[99] Letter sent by US House of Representatives Majority Leader Dick Amey to United States Treasury Secretary Lawrence Summers reported Article Autumn 2000 Edition of the Journal of Society of Trust and Estate Practitioners.
[100] Vito Tanzi, ‘Globalization, Tax Competition, and the Future of Tax Systems,’ International Monetary Fund Working Paper No. 96/141, December 1996
[101] See note 11

also capitalized on this trend. Notably, British sports millionaires like cricketer Ian Botham, Formula I driver Nigel Mansell and golfer Ian Woosnam live in the Channel Islands or the Isle of Man, two of the leading offshore financial centers. Boris Becker and Luciano Pavarotti have themselves taken up residence in Monaco.[102] Fruit of the Loom moved its headquarters to the Cayman Islands saving an estimated $100 Million in taxes each year. U.S. Insurance companies are moving some of their operations to Bermuda to avoid America's 35 % percent corporate income taxes.[103]

The Wall Street Journal has titled this era of tax competition as, "taxpayers voting with their feet." Indeed the Journal says any attempt to restrict the right to move their funds and domicile as they wish may be viewed by some as an attack on freedom and a threat to their prosperity.[104]

The OECD has itself openly acknowledged that the open financial markets have resulted in more economic growth. Perhaps more notable is that the OECD says that the tax havens are genuinely responsible for these open markets since deregulation was:

" in part a response to the threat to financial markets posed by such offshore centers. The resulting liberalization and harmonization of financial markets greatly facilitated the free flow of capital across national borders, which improved the allocation of capital and reduced its cost."[105]

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[102] Patrick Jenkins " Idylls Where the Jet Set Find Life Not Too Taxing," Financial Times , July 28, 2000 and Ulrika Lomas, Boris Becker Meets Taxman on Centre Court," Tax-News. Com August 2000
[103] Bruce Bartlett Internet Low Tax Sightings, The Washington Times July 10, 2000 and Dow Jones Newswire Six Offshore Centers Plan to End Tax Haven Practices June 19, 2000
[104] The Wall Street Journal Europe "Tax and Trade" Spet. 22, 1999
[105] OECD Improving Access to Bank Information for Tax Purposes," 2000 p. 23

Accordingly, the initiatives by the OECD to greatly limit or abolish the bank secrecy provisions have met some resistance. It is clear that the self-interest of the OECD has not permeated the citizenry of their member states as there is widespread disagreement as to the purpose, effects and benefits, if any, that will occur. Moreover, the entrepreneur and the private investor would be severely limited in terms of his/her freedom of choice as to the forum for choosing where to invest. This will, unequivocally, have an adverse impact upon the major development of small states and of the developing world much of which relies on the inbound investments from taxpayers in developing states. This undermining of the success of small state economy as suggested by Congressman Dick Armey[106] and others will have some unpleasant repercussions for the major economies of scale in particular the United States.

As a result, any negative impact on employment or lack of resources in the smaller states within the Western Hemisphere will translate into an increase in immigrants. This further strategically affects educational standards, as individuals from different backgrounds must be educated differently, the health services become less accessible as demand exceeds capabilities and, perhaps the worst of all, is the poverty is exacerbated. It is generally accepted that an increase in immigrants does have an impact on the crime level along with other societal problems as new citizens attempt to adjust to their new home and new laws.

US Congressman Armey, however, against the actions suggested by the OECD precisely espoused a key tenet; 'We have made considerable progress convincing many offshore

[106] Supra at note 10

financial centers to cooperate in the fight against money laundering. Yet what incentive will these nations and territories have to support US criminal investigations if we threaten their ability to maintain pro-growth policies?

If developing nations are not allowed to create an attractive investment climate, their economies will doubtless suffer. The end result would be less cooperation and fewer resources devoted to fighting international crime.'[107]

These critical words can be illustrated through an examination of the United States policy and case law with respect to the offshore financial centers. Traditionally, bank secrecy provisions have been used as a shield against investigations by tax authorities where the taxpayers had an account that was subject to laws of this nature. An apt example is seen in the case of the Cayman Islands where The Bank and Trust Companies Regulation Law is representative of the type of bank secrecy laws that may be found in most offshore centers.[108] It follows, that US authorities may by several different means attempts to gain access to confidential bank records held in an offshore center. One avenue that has been

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[107] Supra note 10

[108] The pertinent provision of that law- Bank and Trust Companies Regulation Law, Law 8 (1966) – provides as follows:
Section 10_ Preservation of Secrecy
Except for the purpose of performance of his duties or the exercise of his functions under this Law or when lawfully required to do so by any court of competent jurisdiction within the Islands or under the provisions of any Law of the Islands, no person shall disclose any information relating to any application by any person under the provisions of this Law or to the affairs of a licensee or any customer of a licensee which he has acquired in the performance of his duties or the exercise of his functions under this Law.
(2) Every person who contravenes the provisions of subsection (1) of this section shall be guilty of an offense against this Law and shall be liable on summary conviction to a fine not exceeding one thousand pounds or to a term of imprisonment not exceeding one year or to both such fine and imprisonment.

explored is naming foreign banks as nominal defendants rather than as witnesses in a case brought by the Securities and Exchange Commission.[109]

Under Internal Revenue Service Code Section 7602 the IRS has the power to issue summonses in tax related investigation. Section 7602 says, "the district court for the district in which…the summoned person resides or may be found shall have jurisdiction by appropriate process to compel attendance, testimony or production of books, papers or other data."[110] Evidence of the success of the use of such methods can be seen in the case of Switzerland which reportedly in response to strong pressure from the United States capitulated in enacting laws which made insider trading a crime that is subject to imprisonment upon conviction plus a fine.[111]

Hence, at present, the authorities in tax investigations involving offshore jurisdictions that have extensive bank secrecy laws face three main issues. [112]

(i) The US authorities' ability to reach records and the effect of bank secrecy laws in thwarting these efforts.

(ii) The ability of a foreign trustee to refuse to disclose or exchange information to US authorities based on the lack of competent jurisdiction or the lack of proper legal service of process.

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[109] International Tax and Estate Planning Robert C. Lawrence III 1989 page 510
[110] 26 U.S.C. (1954 I.R.C.) Section 7602 (b)
[111] International Tax and Estate Planning Robert C. Lawrence III 1989 Practicing Law Institute
[112] Supra note 20 at page 510

(iii) The continuing vitality of constitutional and comity consideration that may perhaps lead the US court to refuse to exercise the judicial authority which it has, but only under United States laws.

However, the United States has shown in recent times its willingness to use its economic prowess to extract fiscal information and has even offered economic incentives to add to this. [113]This attitude has been reflected in recent legislation known as the 'Caribbean Basin Economic Recovery Act.' The countries that qualify under the act are allowed to export most products to the United States free of US customs duties for a period of twelve years. A United States tax deduction is also possible for expenses of attending business or investment conventions in countries that qualify.

In order to qualify, states must be prepared to sign bilateral executive agreements with the United States that provides for exchange of such 'information as is necessary and appropriate to carry out and enforce the tax laws of the two countries.' [114] Hence, nondisclosure (bank secrecy) laws must be modified.

In the case of foreign banks, it is important for there to be a clear classification by the US court of the type of foreign banking entity. Foreign banks can therefore be classified in the five following categories: [115]

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[113] Supra note 20 at page 521 The acts sets strict standard for such agreements, which must extend to civil and criminal matters and to United States, Act country and foreign residents. The agreements must not be limited to information required to be divulged under local law or administrative practice, as is true of some U.S. tax treaties.
[114] Id at page 522
[115] Id at page 524

1) A foreign branch of a U.S. bank,
2) A foreign subsidiary of a US. Bank,
3) A foreign bank (including a foreign trust company),
4) A US branch of a foreign bank, and
5) A US subsidiary of a foreign bank.

With respect to branch and subsidiary entities, the element of control by the parent entity is of critical importance. This is always looked at as a question of fact. If as is the case in some of the offshore jurisdictions, such as the Isle of Mann, that the bank is simply a "name plate" or plaque only with no active business presence physically, then the court will regard the bank as controlled only by the parent entity and the offshore presence as only a booking center.

Further any, parent, branch, or subsidiary bank that has sufficient contact with the United States is amenable to service of process their in personam jurisdiction.[116] This approach was taken in the Bank of Nova Scotia case United Sates v Davis(2nd Cir 1985) as discussed above. Another case which shows the sheer determination the United States courts have in enforcing the IRS summons is revealed in the case of United States v Toyota Motor Corp. (D.C. Cal. 1983). The definition of a tax haven according to the OECD[117] includes states that have inter alia, the lack of transparency and strict bank secrecy requirements.

[116] Id at page Id at page 526
[117] Supra note 10

Judging from these factors the offshore centers located in the Western Hemisphere have argued that the muted response by the OECD with respect to Switzerland and Luxembourg and to a lesser degree Ireland is untenable.

Luxembourg in its statement on the report at the Council of Ministers stated[118]:

> "Luxembourg does not share the Report's implicit belief that bank secrecy is necessarily [119]a source of harmful tax competition. It cannot accept that an exchange of information that is circumscribed by the respect of international laws and respective national laws be considered a criterion to identify a harmful tax regime and a tax haven. The report gives the impression that its purpose is not so much to counter harmful tax competition where it exists as to abolish bank secrecy."
>
> Luxembourg concluded that in view of this it cannot be bound by the recommendations or the report as there are fundamental flaws in its view particularly as it relates to the offering of private financial services to corporate and personal clientele with bank secrecy as a key component[120].

In a similar statement condemning the Report's ostensible abolition of bank secrecy Switzerland has stated:[121]

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[118] OECD Report Harmful Tax Competition An Emerging Global Issue Annex II Statements by Luxembourg and Switzerland page 73
[119] Id at page 74
[120] Id at page 75
[121] Id at page 76

> " Although the report recognizes that it is essential that each state has sovereignty over its tax system and that levels of taxation can differ from one state to another, however, the same report presents the fact that tax rates are lower in one country than in another as a criterion to identifying harmful preferential tax regimes. This results in unacceptable protection of countries with high levels of taxation, which is moreover, contrary to the economic philosophy of the OECD."

The Swiss concluded "it is legitimate and necessary to protect the confidentiality of personal data. In this respect, the Report and Recommendations are in certain aspects in conflict with the Swiss legal system."[122] Switzerland was also of the view that at present the international judicial assistance that is presently in effect has had enormous positive effects in combating tax fraud and that the system of withholding tax (the rate of which is the highest among OECD countries) aims to prevent tax avoidance[123]. As a result of both of the above statements to the OECD the main efforts to reduce so called Harmful Tax Competition has been the targeting of smaller states such as The Bahamas, Aruba, Barbados, Seychelles, Mauritius and dependent territories such as Cayman Islands and Bermuda.

On June 22, 2000 the Financial Action Task Force which was formed by a G-7 initiative at the Paris Summit 1989 and is working in collaboration with the OECD on reducing Harmful Tax Competition, listed the following countries as having serious systematic

[122] Id at page 76
[123] Id at page 77

problems which made them conducive to money laundering and harmful to the tax competition:

The Bahamas	Cayman Islands
Dominica	Israel
Liechtenstein	Marshall Islands
Russia	St. Kitts and Nevis

This resulted in the July 200 blacklisting of The Bahamas and other similar jurisdictions by the OECD and The United States Department of the Treasury Financial Crimes Enforcement Network which issued an advisory warning banks and financial services institutions of the deficiencies in the system.[124]

This clearly offensive and erroneous act by the Treasury Department and the OECD was sharply criticized by US House Majority Leader Republican Dick Armey as financial protectionism. Mr. Armey has pledged his disapproval of the OECD report and the tactics that are being used to force small nations into compliance of the OECD's recommendations. He stated:[125]

"If the OECD succeeds, our nation will face higher taxes and a weakened economy while developing nations will be hamstrung in their attempts to promote economic growth. This competition between nations forces fiscal responsibility and lower taxes which in turn promotes economic growth. The OECD is trying to impose its will on nations that are not even members, calling for draconian sanctions against so-called tax

[124] Advisory Issue number 13 dated July 2000 Subject: Transactions Involving The Bahamas issued by the United States Department of The Treasury Financial Crimes Enforcement Network

havens. American citizens would not respond well if other countries tried to dictate our tax laws, and it hardly seems right for us to participate in a campaign to force other nations to change their tax laws. Likewise it is not our job to tell other countries to dismantle their financial privacy laws. We should seek cooperation when investigating specific cases of wrongdoing but this does not require wholesale destruction of personal privacy."

This defense of small nations and rejection of the OECD Report has been further enhanced by the respected conservative think tank The Heritage Foundation. According to the leading Heritage Foundations expert on Tax Issues Dr Daniel Mitchell the OECD proposal is filled with 'double talk and double standards'[126] moreover a degree of tax competition is healthy and is conducive to good governance as governments have to be more prudent in its expenditure of public funds.

The only way to stop taxpayers from fleeing to lower tax environments, however, is to have all governments agree to maintain high tax rates in effect establishing a tax cartel. The creation of a tax cartel may be just the beginning of a process that results in higher taxes and a more costly government.[127]

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[125] Supra note 10

[126] OECD Tax Competition Policy Proposal: Higher Taxes and Less Privacy by Daniel Mitchell dated November 6, 2000 and reported in Tax Notes as a special report. Globalization is making it harder for governments to overtax because it is increasingly easy for taxpayers to shift their productive activities to lower tax environments. Unfortunately, not everyone favors this development. One such grouping that has serious reservations about this phenomenon is the OECD.

[127] Id note 37

Accordingly, if strict bank secrecy in many of the offshore financial centers are abolished it is anticipated that the industrialized countries will substantially increase the amount of capital that remains within their borders, as they would have eliminated a key element of obstruction to finding financial records of its citizens.

The critics of this such as Rep. Dick Armey and the Heritage Foundation's Dr. Daniel Mitchell have rightly stated that this will seriously impugn the ability of some countries in the developing world ability to attract capital investment on a global basis. Indeed, Rep. Armey suggests that the entire situation may backfire on the United States and other OECD members as countries that have been traditional allies will now view this new initiative as an all out threat on their territorial sovereignty.

Moreover, the increase of taxable income may, it is suggested, have adverse effects on the very same governments that were supporters of the OECD's proposal. There is a cogent argument that the increase of taxable income may lead to radical and unnecessary wastage of public expenditure by governments. In addition, a tighter and more fiscally well-planned budget is widely known to be much more responsive to good governance as governments have to be prudent in their expenditure of funds available.

Exchange of Information

A pivotal element of the OECD'S and indeed the industrialized nations attack upon so-called tax havens has been the lack of proper exchange of information agreements. Traditionally, most of the offshore centers have avoided signing any exchange of information agreements with respect to tax avoidance. There has been a much more cooperative atmosphere in signing agreements to aid the combating of illegal money launderers and tax perpetrators in certain defined cases.

It has been reported that the OECD applauds all of those offshore centers which have made very drastic changes to their laws in order to eliminate criminal activities such as money laundering and drug dealing. Despite this the OECD feels that states must be prepared to go further in dealing with any illegal practices including tax offences.[128] However, to this point wholesale exchange of information agreements or treaties have not been signed by the major offshore financial centers as it is considered detrimental to the survival of the industry.

The argument here has been that many legitimate clients prefer a financial center that provides them with some level of personal privacy that would not normally be afforded in their home country particularly any of the industrialized countries. Hence,

[128] Jeffrey Owens, Head, Fiscal Affairs OECD, Promoting Fair Tax Competition " We believe we have to go further. As long as any government tolerates that the residents of other countries can use their jurisdictions to facilitate any illegal non-reporting of income then the criminal dishonest element will continue to undermine the integrity of that offshore financial center. Tainted money will always corrupt.'

instruments such as the International Trust have been used in order to avoid sometimes contentious and litigious probate proceedings.

Recommendation twelve of the OECD's report[129] states that all member states should consider terminating any tax treaties with offshore centers where the treaties do not cover adequate exchange of information procedures. The seriousness of the OECD's view on this is enhanced by the fact that it clearly states that " [130]most states recognize that termination of a treaty may raise significant political and diplomatic difficulties both for the countries concerned and possibly for other countries as well."

Accordingly, it is felt that the exchange of information treaty represents a basic tool that has not been forthcoming in the past from offshore centers and even where there may have been some interpretation of existing agreements, which would have allowed exchange of information, national courts of the offshore financial centers have not always been forthcoming.[131]

Interestingly, the provision of extensive exchange of information treaties as proposed by the OECD report between the OECD membership and the offshore centers would cure a

[129] Recommendation 12 page 59 OECD Report Harmful Tax Competition An Emerging Global Issue 1998
[130] Id at page 50
[131] See note 23 above Bank of Nova Scotia Case and others.. similarly paragraph 131 of the OECD s report states.. in considering whether they should terminate or enter into a tax treaty with a tax haven, countries should take account of all relevant factors, including the effect of their decision on exchange of information. I f the exchange of information provision of a treaty with a tax haven can be used effectively to obtain information the benefit if the treaty in relation to the exchange of information may offset the disadvantages of that treaty for countries as a whole'

very problematic and unwanted inter-state territorial argument.[132] The traditional view has been that the solution to the regulation of the multinational enterprise or private investor is through bilateral or multi-governmental agreements setting forth general guidelines. "However, such treaties seem far off. In the meantime, the United States is forced to act unilaterally.[133]"

This has led to several divergent views but the main principle is that United States investigators in tax matters, which had an element of involvement with offshore financial centers with strict bank secrecy laws, were empowered to either pursue the process through domestic courts or through diplomatic means to obtain information from a foreign state. Further, because United States investigators have preferred the approach of the domestic courts over foreign tribunals in such matters this has developed into an ad hoc a way of circumventing the involvement of the foreign courts.[134] It follows from this that the OECD's adamant attitude with regard to exchange of information is a necessary

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[132] United States v Davis 767 F. 2d. 1025 Cayman Islands branch of Bank of Nova Scotia refusal to release certain bank records as bank employees would be subject to criminal penalty in contravention of bank secrecy laws

[133] Domestic conflict of laws applying internationally. See RESTATMENT (SECOND) OF CONFLICT OF LAWS 10 (1971) extraterritorial Application of United States Laws: A conflict of Laws Approach 28 STAN L. REV. 1005

[134] See Paikin, Problems Of Obtaining Evidence in Foreign States for Use in Federal Criminal Prosecutions 22 COLUM J. TRANSNAT'L 233, 243-263. United States investigators have asserted that domestic process is faster and less costly than using diplomatic measures such as letters rogatory or attempting to use a foreign judicial system or foreign counsel. See Crime and Secrecy

element of its objective of securing more precise, accurate and credible information on its citizens who have invested in offshore financial centers. Whilst its motives may be plausible, its methods seem misguided.

CHAPTER IV

CONCLUSION

It is worth reiterating that the reduction of preferential tax regimes as an international fiscal policy goal is a positive step in the right direction. This thesis maintains that the goals of the OECD specifically as they relate to harmful tax practices can be accommodated and reconciled to the benefit of both the developed nations and the smaller third world states that function as offshore centers. However, as the above study has shown, the OECD in its report has overemphasized the role of bank secrecy and exchange of information practices in offshore centers.

Further, the austere standards recommended by the body have done little to help reconcile the differences between the two parties. Subsequent to the report, the deliberations and other public acts by the body has shown a level of belligerence by the OECD that leaves much to be desired from an internationalist perspective.

This thesis concludes, inter alia, that a better solution would be a negotiated amendment to Recommendation 7 of the OECD Harmful Tax Competition Report concerning access to banking information for tax purposes. Firstly, this recommendation of the report should not interfere with the sovereign right of states to enact bank secrecy legislation.

As Luxembourg has concluded in its statement of 'The 1998 Report,' the OECD appears prepared to abolish bank secrecy in all offshore financial centers when in fact the United Kingdom and the United States have very comprehensive financial privacy laws protecting their citizens from abuse by state or federal authorities.

Rather, as a consolation as in the case of Austria, which has an estimated 25 million anonymous bank accounts, states may be led to review their bank secrecy laws with a view to increase the circumstances upon which the veil of secrecy may be lifted in the case of future accounts.

Secondly, as outlined earlier, the courts of the United States have with the Bank of Nova Scotia case lowered the threshold. The court has done this, with respect to the circumstances in which it will require a nominal defendant of a foreign state to produce documents through a subpoena duces tecum or to give oral evidence even if the evidence presented results in a criminal penalty in that other state.

Whilst this may be more time consuming and adds a higher level of complexity when dealing with tax cases, it is submitted that the proper procedure should be obtaining the evidence directly through the courts of the foreign state. Cases such as Banco Ambrosiano Holdings v Calvi[135] illustrate that through the use of interlocutory remedies

[135] (Unreported) No. 237 of 1987, The Bahamas, (Sup.Ct.)

such as the Mareva Injunction and Anton Piller orders courts of offshore financial centers are capable of fairly adjudicating in such multi-jurisdiction cases.

It is clear that too many tax abuses occur regularly in the developed states. Hence, the credibility of the argument that the preferential tax incentive offered by offshore financial centers causes a decline in the tax base of the developed world loses its strength. A recent report by the OECD [136]notes that, "

In 1998, OECD governments collected almost US $8 trillion dollars in taxes: The equivalent of 37.2 percent of the aggregate GDP of their economies and the highest figure recorded since revenue data began being collected by the OECD.[137]" In addition, the OECD states that, " there has been a continuing trend towards higher tax levels: from 29 percent of the GDP in 1970 to 33 percent in 1980 to 36 percent in 1990 and more than 37 percent in 1998."[138] As the experts would agree, it appears that the problem within OECD countries is that the tax bases in most cases are much too high. Moreover, the above reports gives credence to the argument that offshore centers are necessary to the world economic environment.

The criticisms leveled against offshore centers have not considered that low tax regimes have helped to reduce an even larger tax burden on companies and individuals who evidently are overtaxed.

Additionally, this thesis agrees with the proposal made by at the Joint Working Group meeting in Barbados that the entire process of reducing or eliminating harmful tax competition should be chaired by a global organization such as the United Nations or a

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[136] This report was produced by the Fiscal Affairs Unit of the OECD 200, P. 12.The report itself provides ample evidence as to why the measures proposed against so called tax havens are unnecessary and beyond what is required, because there is no erosion of the tax bases of OECD countries.

[137] Ibid

specially empanelled commission made up of representatives from both spectrums, i.e. the developed nation and the recognized offshore centers. This would certainly give credence to any recommendations because the offshore centers would have a forum to not only voice their opinions but the ability to partake in the final decision making process.

One problem that the OECD has not adequately solved is the appearance that the Harmful Tax Competition Report 1998 is simply an arbitrary act aimed at creating a tax cartel for the rich countries at the expense of the smaller developing states.

This thesis also calls for, which is in agreement with one expert[139], governments to consider the establishment of a World Tax Organization (WTO) in which all countries would ideally be members. The (WTO) chief aims would be to coordinate and negotiate an acceptable balance between the tax systems of competing states with a view to providing a more equitable tax environment. It is submitted that until such a global organization is chartered governments will continue to provide extensive loophole and non-dom rules in order to effectuate an increase in capital investments.

As shown in the previous chapter most of the developed countries themselves have very extensive measures aimed at simply attracting the foreign investor via preferential tax incentives.

Without some of the above recommendations it is clear that the following quote may very well become reality in the near future:

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[138] Ibid

[139] Langer, Marshall J. Harmful Tax Competition: Who Are The Real Tax Havens? Tax Notes, January 29,th 2001

> "One can already visualize that the day is (fast) approaching when these tax haven country islands are surrounded by more superior military forces of mighty organizations, perhaps the North Atlantic Treaty Organization, or perhaps the military arm of the OECD at that time and eventually have to give up.
>
> The final act might be at some place in Nassau or Georgetown where the last resisting heroes, perhaps a handful of courageous bank directors, trust officials, solicitors and tax advisers, stand behind a huge pyre in which they are destroying, as they feel obliged to do, their clients' secrets bank accounts, trust documents, and other confidential material, then descend into the flames and slowly disappear. At that point a tremendously loud scream is heard. It is the word
>
> F – R – E – E – D – O – M

It is so loud that it can be heard in Miami, Washington, and even at the OECD headquarters in Paris, but, like in the case of Braveheart, the Scottish freedom fighting hero of the sixteenth century, it is of no avail. It would then be all over. On the next day, a new dawn would arise over the world. While former tax haven countries and a few other remaining countries with "harmful preferential tax regimes" would be rather desolate and ruined (some of the population of the former Caribbean tax havens immigrating to the United States adding to the illegal immigration problem there), the rest of the world would be happy, stable and prosperous …(and)…would live in harmony

with each other, knowing that the evil harmful tax competition has now been eliminated for good.[140]."

[140] Mihaly, Zoltan M., Ever Increasing Conflicts, Tensions and Exposures in The International Tax Arena

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