THE INTERNATIONAL LEGAL RAMIFICATIONS OF THE OECD'S HARMFUL TAX COMPETITION CRUSADE

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ABSTRACT

In 1998 the Organization for Economic Cooperation and Development (the "OECD") commenced a campaign to eliminate harmful tax competition focusing on geographically mobile activities. The OECD targeted 35 jurisdictions and demanded that those nations amend their tax laws to remove the harmful features that provided more favorable tax treatment to geographically mobile capital than was available in some of its Member States. This thesis examines the international responsibility of the OECD and its Member States to determine whether their conduct in waging this campaign is in accordance with the international legal principles of state sovereignty and non-intervention. As an international actor with legal personality, the conduct of the OECD is found to engage its international responsibility for the breach of state sovereignty and non-intervention. The Member States in support of the OECD's actions are found to have primary and secondary responsibility under international law for the OECD's actions.

RÉSUMÉ

En 1998, l'Organisation de coopération et de développement économiques (OCDE) est partie en campagne contre la concurrence fiscale dommageable portant sur les activités géographiquement mobiles. L'OCDE a mis au ban trente-cinq juridictions taxées d'être fiscalement dommageables puisqu'elles traitaient favorablement les activités géographiquement mobiles, ceci en comparaison avec la situation fiscale des autres États-membres. L'OCDE a donc requis de ces nations qu'elles amendent tous lesdits traits dommageables de leurs lois fiscales. Ce mémoire analyse la responsabilité internationale de l'OCDE et de ses États-membres de façon à déterminer si leur conduite dans cette croisade concorde avec les principes de droit international de souveraineté et de non-intervention. En tant qu'acteur – ayant une personnalité juridique - de la scène internationale, le comportement de l'OCDE engage sa responsabilité internationale pour son atteinte à la souveraineté étatique et au principe de non-intervention. Les États-membres qui soutiennent les actions de l'OCDE voient, *de facto*, leur responsabilité première et secondaire engagées sur le plan du droit international.

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INTRODUCTION

In 1998, a collection of states, represented by the Organization for Economic Cooperation and Development (the "OECD"), embarked upon an international mission to eradicate what they described as "harmful tax competition" – tax regimes that rely on no or low income tax rates with the intention to attract certain geographically mobile activities. In an effort to "capture" tax revenues believed to be lost as a result of such "harmful tax competition", the OECD's message was delivered in unequivocal terms: adopt our recommendations, as suggested, or risk being blacklisted as an "uncooperative tax haven". The OECD went further to put such nations on notice by reserving the right of its Member States to take unilateral and coordinated "defensive measures" against those nations that did not commit to its project.

As one fairly important result of trade liberalization and globalization, fiscal or tax competitiveness has emerged as both a weapon and a threat to the OECD nations. While not denouncing tax competition in its entirety, the OECD instead focused on "harmful" tax practices that affect the location of financial and other service industries, and facilitate money laundering, tax avoidance and tax evasion. The OECD accuses countries it has determined to be "tax havens" or countries with "preferential tax regimes" of engaging in so-called harmful tax competition, which they deem to be a "global problem".

This thesis will consider the ramifications at international law of the actions taken by the OECD in pursuance of its campaign against harmful tax competition. In this context, the analysis will also take into account the international responsibility of the Member States that may arise, not only by virtue of their membership to the organization, but also as a consequence of supporting the actions of the OECD. In other words, it will be determined whether the Member States are shielded of any international responsibility that may arise behind the veil of the OECD.

In its 1998 report entitled *Harmful Tax Competition – An Emerging Global Issue* (the "1998 Report"),[1] the OECD unveiled this Harmful Tax Competition Initiative ("HTC Initiative"), by first delineating the key criteria to be used to identify tax havens and preferential tax regimes, and establishing a timetable for the identification of such

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[1] (Paris: OECD, 1998) [OECD, "1998 Report"].

jurisdictions. It then outlined recommended countermeasures for its Member States to implement to "protect" themselves against the detrimental effects of the actions of other countries engaged in harmful tax competition. In closing, the OECD asserted that endorsement of its HTC Initiative, which included the preparation of a list of offending jurisdictions, "will provide a clear political message that the OECD Member countries are prepared to intensify their co-operation to counter harmful tax practices".[2]

In its report published in 2000, *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices* (the "2000 Report")[3], the OECD identified 35 jurisdictions as "tax havens" and the existence of 47 "potentially harmful preferential tax regimes" in OECD Member States. Speaking only to those jurisdictions identified as "tax havens", the OECD warned that if such jurisdictions did not commit to its HTC Initiative, as established by the 1998 Report, they would be proclaimed "uncooperative tax havens" and threatened with the use of coordinated defensive measures for such non-compliance.

The purpose of this thesis is to examine the legality under public international law of the OECD's HTC Initiative. Do the blacklisting and threats of sanctions, as outlined in the 1998 and 2000 Reports, breach the general international legal principle of non-intervention? As a result, has the OECD, or have the Member States themselves, violated the sovereignty of the targeted jurisdictions, through naming and shaming and threatened countermeasures?[4] Are the OECD's justifications for mounting this campaign to eradicate "harmful" tax competition valid according to the principles of international law? Is "harmful" tax competition a global problem that warrants international action?

From the perspective of the targeted jurisdictions, mostly small developing or transitional economies, the OECD has engaged in political coercion, evidenced by its "naming and shaming" of so-called tax havens and threatened inclusion on a list of

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[2] *Ibid.*, at para. 90.

[3] (Paris: OECD, 2000) [OECD, "2000 Report"].

[4] The inspiration for this thesis comes from comments made by David Simmons, former Attorney-General of Barbados, based on a speech given at the High Level Consultations on the OECD Harmful Tax Competition Initiative, Barbados, 8-9 January 2001. See David Simmons, "Some Legal Issues Arising Out of the OECD Reports on Harmful Tax Competition" in Rajiv Biswas, ed., *International Tax Competition: Globalisation and Fiscal Sovereignty* (London: Commonwealth Secretariat, 2002) [Simmons, "Legal Issues of the OECD Reports"] at 285.

"uncooperative tax havens", and in economic coercion, by threatening the use of "coordinated defensive measures", if the targeted jurisdictions do not accede to the OECD's "recommendations" and change their tax systems in accordance with the principles enunciated in the 1998 and 2000 Reports.

In order to explore these issues, I have divided this thesis into the following segments. The first part involves an examination of the international actors involved in the HTC Initiative to determine their identity and legal status at international law. Before looking at the issue of the legal effect of the HTC Initiative, one must first establish that the international arena is the appropriate forum in which to proceed with such an analysis. In this respect, consideration must be given to the following questions: what is the OECD and what, if any, is the scope of its legal personality? It is important to consider who and what this organization represents in order to determine the nature and effects of its actions under international law.

The second part will focus on the OECD's allegation of harmful tax competition. It is on this basis that the OECD proceeds to identify the targeted jurisdictions and threaten coordinated and unilateral defensive measures for noncompliance. It is important to note that the OECD supports tax competition, which begs the question of when does tax competition become "harmful"? Can such a line be drawn? Is there any such thing as "fair" tax competition? The OECD's characterization of tax competition as "harmful" is relevant to the determination of the implications of the HTC Initiative pursuant to international law because by calling on the international community for international cooperation and threatening defensive measures, the OECD is implying that the targeted jurisdictions behaved in a manner contrary to some international principle.

The final part will examine the legal implications of the HTC Initiative through an analysis of the legality of the OECD's actions, namely the blacklisting of jurisdictions, initially as "tax havens" and potentially as "uncooperative tax havens", and threatening the use of "coordinated defensive measures". Given that it is the OECD that has accused the targeted jurisdictions of engaging in harmful tax competition, the first issue that arises is whether the OECD is justified in doing so. The allegation of engaging in behavior that is harmful, and threatening the use of defensive measures, implies that the targeted jurisdictions have violated an international obligation owed to the OECD or its Member

States. However, from the perspective of the targeted jurisdictions, the HTC Initiative itself appears to be in violation of the principle of non-intervention and a breach of state sovereignty.

To resolve this issue, of whether the OECD is acting on the defensive or, rather, on the offensive, the discussion will focus on the consequences at international law of acts taken by states and international organizations, specifically in regards to taxation matters, but also in general terms. The focus will be on whether any international tax, or other relevant principles exist, such that one can point to a breach of such principles on the part of the targeted jurisdictions in respect of the OECD or its Member States, or perhaps to a breach of such principles on the part of the OECD or its Member States in respect of the targeted jurisdictions. If international tax standards were universally agreed upon by the subjects of public international law, then the OECD or its Member States could arguably justify the application of the recommended defensive measures toward the states that do not comply with these standards.[5] In contrast, if there are no such standards, then perhaps the OECD or its Member States have overstepped their bounds.

For many, the HTC Initiative is effectively dead, since the OECD has backed off from its original position first detailed in the 1998 and 2000 Reports. Nevertheless, it is an important aspect of international relations that deserves consideration, as even though the HTC Initiative no longer exists in its original form, it continues in an altered state that still raises concerns. The same organization, targeting the same jurisdictions, is continuing in its attempts to thrust forward a particular fiscal agenda under the guise of establishing international principles. Thus, it is important to consider the legality of the HTC Initiative in its original form so as to fully comprehend the implications of the OECD's revised mission in the context of its efforts to level a playing field that may be inherently unleveled.

[5] Jacob B. Gross, "OECD Defensive Measures against Harmful Tax Competition: Legality under the WTO" (2003) 31 *INTERTAX* 390 [Gross, "Legality under the WTO"] at 392.

<u>PART ONE INTERNATIONAL ACTORS</u>

I. SOVEREIGN STATES

Since international law only applies to the subjects of international law, the analysis of the legal implications of the OECD's HTC Initiative will begin with an examination of the relevant international actors, the targeted jurisdictions and the OECD. Generally, an entity that is capable of possessing international rights and duties and having the capacity to maintain its rights by bringing international claims is normally regarded as a subject of international law with legal personality.[6]

Public international law has traditionally been considered as a system of principles and rules designed to govern relations between sovereign states.[7] The state, having given life to the international system through recognition of the sovereignty of other states, is the main subject of international law.[8] It is generally accepted that "[s]ince the international community is primarily a society of legally independent states, it appears only natural that these entities are possessed of international personality."[9] For this reason, states are considered to have inherent legal personality.[10] Given that the targeted jurisdictions are mostly sovereign states, [or overseas territories or dependencies

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[6] *Reparation for Injuries Suffered in the Service of the United Nations* [1949] I.C.J. Reports 174 ["*Reparation Case*"] at 179. Legal personality is comprised of two elements: capacity and recognition. Capacity refers to the ability to perform juridical acts; to be an object and subject of international law possessing certain rights and obligations. Recognition refers to the ability to bring a dispute and to participate in a process that has legal consequences.

[7] Hugh M. Kindred et al., *International Law Chiefly As Interpreted and Applied in Canada*, 6th ed. (Toronto: Emond Montgomery, 2000) [Kindred, "International Law"] at 1.

[8] The international legal system has its roots in the Treaty of Westphalia of 1648,which marked the formal recognition of states as sovereign. See generally Christopher C. Joyner, *International Law in the 21st Century: Rules for Global Governance* (Maryland: Rownan and Littlefield, 2005) [Joyner, "International Law in the 21st Century"] at Chapter 1; Athena D. Efraim, *Sovereign (In)equality in International Organizations* (Boston: Martinus Nijhoff Publishers, 2000) [Efraim, "Sovereign (In)equality"] at 2.

[9] Hugo J. Hahn, "Euratom: The Conception of an International Personality" (1958) 71 *Harvard Law Review* 1001 [Hahn, "International Personality"] at 1044.

[10] See Ian Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: Oxford University Press, 2003) [Brownlie, "Public International Law"] at 70-76 on Legal Criteria of Statehood. With respect to the 'dependent' states, provided the conditions for statehood exist (a permanent population; defined territory; a government; and the capacity to enter into relations with other states), then the 'dependent' state retains its personality. See Brownlie, *ibid.*, at 58 et seq. 72-74. Of the 35 jurisdictions listed in the OECD's 2000 Report: 20 are states; 5 are overseas territories of the United Kingdom; 2 are fully self-governing in free association with New Zealand; 1 is an external territory of the United States; 2 are part of the Kingdom of Netherlands; and 3 are dependencies of the British Crown. See Appendix IV for a full list of the targeted jurisdictions listed in the 2000 Report.

of sovereign states], it is obvious that they are recognized as international actors with legal personality.

Since the OECD is not a sovereign state it is important to consider what exactly it is, i.e., whether the OECD is a subject of international law, and whether or not it can be said to have legal personality as a distinct entity pursuant to international law. If the OECD does not have legal personality, then it is not a solitary international subject. Therefore any rights, duties, powers and liabilities of the OECD vest collectively in all the Member States which has important consequences to the international responsibility of the actions of the OECD.[11]

II. INTERNATIONAL ORGANIZATIONS

The OECD is a group of 30 sovereign states who, through a multilateral treaty, have created an international organization for the purpose of furthering economic cooperation and development among states that share certain attributes, namely a market economy and a pluralistic democracy.[12] Whether the OECD has a separate legal identity from its members, or whether it shares a collective identity, is relevant to determining the issue of the legality of the HTC Initiative because one must ascertain what law governs the actions of the OECD.

If the OECD is a separate legal person from its Member States, then the determination of the legal effects of the HTC Initiative would be undertaken according to the law applicable to international organizations.[13] If the OECD is not a separate legal entity, such that its Member States would ultimately be responsible for its conduct and obligations, the analysis of the implications of the HTC Initiative would be undertaken

[11] See C. F. Amerasinghe, *Principles of the Institutional Law of International Organizations*, 2nd ed. (Cambridge: Cambridge University Press, 2005) [Amerasinghe, "International Organizations"] at 67 to 100 for a discussion on legal personality and international organizations.

[12] OECD, *Overview of the OECD: What is it? History? Who does what? Structure of the organisation?*, online OECD <http://www.oecd.org> [OECD, "Overview of the OECD"].

[13] While some authors take the view that no such law exists, rather that it is the laws of international organizations, it is not the purpose of this paper to undertake that debate. For the purposes of this paper, it is accepted that general principles of international law in regards to international organizations have emerged. Amerasinghe, "International Organizations" *supra* note 11 at 15-21; see also José E. Alvarez, *International Organizations as Law-Makers* (Oxford and New York: Oxford University Press, 2005) [Alvarez, "International Organizations"] at 3: "International organizations tend to share characteristics that make *legal* generalizations possible [emphasis in original]".

according to principles of international law relating to state behaviour and relations. As will be seen, the law applicable to international organizations has, in most cases, been drawn from analogies to the international law applicable to states, albeit in a more narrow sense. Thus, to some extent and in some cases, this may be a distinction without much of a practical difference, but an important distinction nevertheless.

Nation-states were the only international actors until the late 19th century when a new construct of the international legal order emerged. The creation of international organizations came about as a result of the increasingly multilateral nature of the concerns that states began facing.[14] In the past, international issues typically involved disputes between two states and were therefore resolved through bilateral relations. By the late 19th century, the world was becoming more integrated and interdependent, and the concerns that were arising on the international plane required multilateral efforts through the coordination of policy. In acknowledgment of the fact that these issues could not be effectively resolved by states on their own, nations began to convene international conferences by invitation to all interested states. The intention in convening such conferences was to provide an international forum where all interests could be heard, something that could not be achieved through bilateral, or even multilateral, relations.[15]

It is in this context that one can better understand exactly what the OECD is. As previously mentioned, the OECD is comprised only of states. Therefore, it is reasonable to conclude that it is an international governmental organization (or "international

[14] Amerasinghe, *ibid.*, at 1-6.

[15] As situations became more complex, global issues emerged requiring nations to do more than coordinate their policies through temporary ad hoc international conferences. Eventually, these conferences developed into international associations, or organizations; for example, the establishment of the Organization for American States ("OAS") in 1888 was the result of Pan-American Conferences that began in 1826. Although not all organizations were alike, in both substance and form, there were some similarities that distinguished this new group of international organizations from their previous incarnation as international conferences. First, the conferences were convened periodically at a date set by the members rather than at the invitation of a particular nation. Second, these new associations generally involved the creation of a permanent institution, in that the mandate of the organization was not concluded upon resolution of one particular issue. Instead, a permanent governing body and other necessary organs were established to continue the work of the organization between conferences. Although a creation of the late 19th century, there has been a dramatic expansion in the number of international organizations since the end of the Second World War. The Yearbook of International Organizations 2002/2003 records a total of 55,282 international organizations, of which 48,202 are non-governmental organizations and 7,080 are inter-governmental organizations. See Amerasinghe, *ibid.*, at 1-6.

organization", or "IO"), as opposed to a non-governmental organization (or "NGO"), which is comprised of private actors.

But what exactly is an "international organization"? Neither treaty, nor case law, provides a definition of the term. It is, consequently, necessary to examine legal writings.[16] Though no complete, or universally agreed upon, definition of an international organization exists, one definition that is most commonly accepted refers to the following three characteristics: (i) it must be a formal and continuous structure; (ii) established by agreement between two or more sovereign states; and (iii) its objective must be to pursue the common interests of its members.[17] To determine if the OECD satisfies these three elements, it is useful to go back and look at how the OECD came into existence.

(a) The OECD as an International Organization

The OECD first came into being as the Organization for European Economic Cooperation (the "OEEC"), which was established following the end of the Second World War to oversee the administration of the Marshall Plan in Europe.[18] When the OEEC finished its original mandate the nations involved recognized a need for continued economic cooperation in the face of growing interdependency. On December 14, 1960, the OECD was established by the *"Convention of the OECD"*, (the "Convention") which replaced the constituent instrument of the OEEC.[19] The reconstitution of the OEEC as

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[16] Although the *Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations* (21 March 1986) online United Nations <http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_2_1986.pdf>, provides a definition it is not particularly useful. See Article 2 para. 1 lit. (i) "For the purposes of the present Convention…(i) 'international organization' means an intergovernmental organization".

[17] Clive Archer, *International Organizations*, 2nd ed. (London and New York: Routledge, 1992) [Archer, "International Organizations"] at 37; see Alvarez, "International Organization", *supra* note 13 at 1 where the author states: "This simple, albeit vague, definition is the most commonly accepted in the field"; see also Palitha T. B. Kohona, "International Organizations" online UN <http://untreaty.un.org/English/Seminar/Laos_03/ intorganizations. ppt > at 3 where the author cites the Yearbook of International Organizations which defines an international organization as "a body … based on a formal instrument of agreement between the governments of nation states; including three or more nation states as parties to the agreement; and possessing a permanent secretariat performing ongoing tasks".

[18] OECD, "Overview of the OECD", *supra* note 12.

[19] (Paris: OECD, 1960). See Appendix I.

the OECD changed it from a regional organization focusing on the rebuilding of Europe to an international organization with a more global perspective.

The founding parties to the Convention are 20 sovereign states, which fulfills one of the identifying factors of international organizations listed above requiring that the OECD be established by an agreement between two or more sovereign states.[20] Articles 7 through 11 of the Convention, which deal with the establishment of the Council, the Secretary-General and other necessary subsidiary organs, provide evidence that the OECD is a continuous and formal structure, satisfying another factor used in identifying international organizations.

To satisfy the final characteristic used in identifying an international organization, the OECD's objective must be to pursue the common interests of its members. Article 1 of the Convention lays out the basic objectives of the newly formed OECD:

> (a) to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the world economy;
>
> (b) to contribute to the sound economic expansion in Member as well as non-member countries in the process of economic development; and
>
> (c) to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

On the basis of Article 1 of the Convention, it may reasonably be inferred that the aim of the OECD is to promote trade and economic development through the liberalization of markets, both in its Member States and in non-member states. This provides enough information to conclude that the goal of the OECD involves a shared objective (e.g., expansion of worldwide trade) to pursue the common interests (e.g., highest level of sustainable growth and employment and a rising standard of living) of its Member States.

The characterization of the OECD as an international organization is important because it establishes its identity on the international plane. While the assertion that an

[20] The 20 founding states are: Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The remaining members of the OECD are: Japan (1964), Finland (1969), Australia (1971), New Zealand (1973), Mexico (1994), Czech Republic (1995), Hungary (1996), Poland (1996), Korea (1996) and Slovak Republic (2000).

international organization is a subject of international law is generally accepted today, it does not necessarily follow that because the OECD is an international organization legal personality attaches.[21]

(b) Legal Personality & the OECD

Although states are considered to have inherent legal personality the same does not hold true for international organizations as the determination of personality requires more than simply defining an entity as an international subject. Furthermore, "[n]o international organization should be considered an international personality per se, since the extent of its participation in international relations is subject to the particularities of each case."[22]

International law determines who shall have legal personality in the international context, and the nature of this international personality will vary from one subject to another.[23] Legal personality reflects the autonomy of the organization and its ability to act on its own. Where it is found that an international organization has legal personality, it may be concluded that the international organization possesses certain rights, duties and powers separate from its member states. What these rights, duties and powers are and how they are established is a subsequent question.

If the OECD does not have legal personality, then any rights and obligations arising from its conduct would vest collectively in all the Member States. This means that the actions of the OECD would be considered actions of all its Member States, the OECD itself being an agent of some or all the Member States.[24] In other words, the question

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[21] The status of international organizations, both inter-governmental organizations and non-governmental organizations, has been long debated and there has been little jurisprudence to date that has dealt with this issue. The debate revolves around the following issues: do international organizations have legal personality and how do they acquire it?; and what are the consequences of the attribution of legal personality. See Amerasinghe, "International Organizations", *supra* note 11 at 66.

[22] Hahn, "International Personality", *supra* note 9 at 1045.

[23] Legal personality in domestic law is determined pursuant to the laws of each state. Since the HTC Initiative occurs on the international plane, there is no need to determine national legal personality which is relevant only to acts and defaults committed within the domestic legal arena. See Amerasinghe, "International Organizations", *supra* note 11 at 6; see also Hahn, *ibid.*, at 1045.

[24] Amerasinghe, *ibid.*, at 412 where the author notes that separate legal personality is crucial in order that the actions be more than actions of all member states is implied in the *Certain Phosphate Lands in Nauru Case*, [1992] I.C.J. Reports at 240: "There was a tripartite administering power in the trusteeship

that remains is whether or not the OECD is simply an association through which the Member States are exercising their collective will, or does it have a personality independent of those of its Member States? If the legal personality of the OECD is not established, then in considering the legal implications of the HTC Initiative at international law the analysis would be based on international principles applicable to states, not international organizations.

The determination of the legal personality (or lack thereof) of the OECD may also be important for another reason – even if it is found that the OECD has legal personality, does that mean that the Member States are immune from any responsibility or liability under international law for the acts of the OECD? This query involves consideration of whether or not it may be said that states have primary or secondary liability in relation to acts of international organizations, a question which relates to state responsibility and the obligation to repair an internationally wrongful act. This matter will be dealt with in more detail in Part Three of this thesis, which focuses on the international responsibility of states and international organizations. For the present purpose, consideration of whether or not the OECD has legal personality is undertaken solely to determine the legal nature and identity of the parties involved in this matter.

There are two main approaches to the problem of determining the legal personality of international organizations. The first approach considers that since international organizations are created by other subjects of international law, mostly by states[25], the approach to be taken should be based on the will of the member states, either expressed or implied, in the constitution.[26] The idea is to determine whether, in establishing a new entity through a constituent treaty, the founding states intended to set

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arrangements in that case, but the Court implied that one of the states could be held responsible in its own right. In doing so it stressed that the administering authority was not a separate legal entity from the three states: see *ibid.* at p. 258, per the Court, and at p. 271, per Judge Shahabuddeen (separate opinion)."

[25] It is possible that an organization might be set up by other subjects of international law. See F. Rousseau, "Joint Vienna Institute; - Brèves remarques relatives à la création de l'Institut commun de Vienne", (1995) 99 *RGDIP* 639 et seq.

[26] Amerasinghe, "International Organizations", *supra* note 11 at 79; see also Philippe Gautier, "The Reparation for Injuries Case Revisited: The Personality of the European Union" in J.A. Frowein and R. Wolfrum, eds., *Max Planck Yearbook of United Nations Law* (Netherlands: Kluwer Law International, 2000) 331 [Gautier, "Reparation Case Revisited"] at 334.

up an international organization possessing legal personality distinct from its member states.

The second approach opts for a more objective test, preferring to determine the issue of legal personality on the basis of general international law, rather than focusing solely on the subjective will of the founders.[27] This approach is based on the argument that international organizations come into existence on the basis of certain objectively determinable criteria that exist in fact and are significant in themselves at general international law, and that this is what endows the organization with personality, quite apart from its constituent instrument. This approach asserts that the foundation of legal personality is to be identified in general international law, and does not depend on the will of the member states.

In light of the debate about how to approach the problem of legal personality of international organizations it is useful to consider the leading case on the matter. The issue of the legal personality of international organizations was first dealt with in an Advisory Opinion given by the International Court of Justice ("the Court") in 1949 regarding the *Reparation for Injuries Suffered in the Service of the United Nations* (the "*Reparation Case*").[28] At issue in the case was the capacity of the United Nations ("the UN") to make claims on behalf of its staff members against non-member states. Although the legal personality of the UN was not the issue that was put before the Court, the personality of the UN was nevertheless addressed as a preliminary question to be answered before considering the capacity of the organization. An analysis of the Court's decision in the *Reparation Case* illustrates that its method was not quite in accord with the second approach referred to above.

Before looking at the issue of the capacity of an organization to bring an international claim, the Court stated that it had to determine "whether the Charter has given the organization such a position that it possesses, in regard to its Members, rights which it is entitled to ask them to respect".[29] In observing that it was faced with a new situation, the Court stated that "the question ... can only be solved by realizing that the

[27] Gautier, *ibid.*, at 335; see also Amerasinghe, *ibid.*, at 79.

[28] Reparation Case, *supra* note 6.

[29] *Ibid.*, at 174 et seq.; see also Gautier, "Reparation Case Revisited", *supra* note 26 at 337.

situation is dominated by the provisions of the [UN] Charter considered in the light of the principles of international law".[30] Citing the lack of a provision in the Charter expressly conferring upon the organization the capacity it sought, the Court referred to the principles and purposes of the UN as contained in the Charter and concluded that in order to achieve the objectives set out therein, the attribution of international personality was indispensable:

> In the opinion of the Court, the Organization was intended to exercise and enjoy and is in fact exercising and enjoying, functions and rights which can only be explained on the basis of the possession of a large measure of international personality and the capacity to operate upon an international plane. It is at present the supreme type of international organization, and it could not carry out the intentions of its founders if it was devoid of international personality. It must be acknowledged that its Members, by entrusting certain functions to it, with the attendant duties and responsibility, have clothed it with the competence required to enable those functions to be effectively discharged. ... Accordingly, the Court has come to the conclusion that the Organization is an international person.[31]

While the Court held that the international personality of the UN was necessary to achieve the objectives assigned to the organization, it went further and found evidence of this in the Charter by mentioning the following relevant factors: the existence of organs and specific tasks; the obligation of the members to give assistance to the organization in respect of any actions undertaken by it and to respect decisions taken by it; the recognition of its legal capacity and privileges in the municipal systems of members; and its conclusion of international agreements.[32] Some would argue that the Court proceeded in an 'objective' manner by listing these factors[33], however this can only be inferred as

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[30] *Reparation Case* cited in Kindred, "International Law" *supra* note 7 at 44.

[31] *Reparation Case supra* note 6 at 179.

[32] *Ibid.*, at 178-179, where the Court stated: "The Charter has not been content to make the Organization created by it merely a centre 'for harmonizing the actions of nations in the attainment of these common ends' (Article I, para. 4). It has equipped that centre with organs, and has given it special tasks. It has defined the position of the members in relation to the Organization by requiring them to give it every assistance in any action undertaken by it (Article 2, para. 5), and to accept and carry out the decisions of the Security Council; by authorizing the General Assembly to make recommendations to the members; by giving the Organization legal capacity and privileges and immunities in the territory of each of its members; and by providing for the conclusion of agreements between the Organization and its members."

[33] Amerasinghe, "International Organizations", *supra* note 11 at 82.

the Court did not clearly articulate that certain objective criteria had to be fulfilled in order to establish that an organization has legal personality.[34]

On the basis of the Court's opinion, it cannot be said that the establishment of legal personality for an international organization depends alone on identifying certain objective criteria. Nevertheless, it is also not entirely clear that such a determination is to be made on the basis of some subjective intention of the founding members.[35] Instead, the Court's approach seems to be balanced, in that the determination of "intention" was based on the Court's observations regarding "objective intention", found in the circumstances of the creation and the constitution of the organization, which involves the subjective will of the founding members.[36]

Although the Advisory Opinion in the *Reparation Case* begins with an examination of the legal personality of the UN *vis-à-vis* its *members*, the Court extends the application of its conclusions with respect to the legal personality of the UN to *non-members*. That being said, it is important to consider the following comments made by the Court:

> On this point, the Court's opinion is that fifty States, representing the vast majority of the members of the international community, had the power, in conformity with international law, to bring into being an entity possessing

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[34] *Ibid.*, at 82.On this basis, some authorities have suggested that the following objective criteria are basic to the concept of international personality for international organizations: (i) an association of states or international organizations or both (a) with lawful objects and (b) with one or more organs which are not subject to the authority of any other organized communities than, if at all, the participants in those organs acting jointly; (ii) the existence of a distinction between the organization and its members in respect of legal rights, duties, power and liabilities, etc. (in the Hohfeldian sense) on the international plane as contrasted with the national or transnational plane, it being clear that the organization was 'intended' to have such rights, duties, power and liabilities.

[35] That the Court solely relied on the subjective intent of the founding members is not clear as it examined various factors surrounding the creation of the organization, the provisions of its constitution and even the subsequent practice of the international community, to confirm its findings. Regarding state practice, the Court stated: "[p]ractice -- in particular the conclusion of conventions to which the Organization is a party -- has confirmed this character of the Organization . . ." On the other hand, the Court did make reference to subsequent practice in confirming the conclusion it seems to have already reached (i.e., that the UN had international personality). In addition, it is possible that the Court was using this factor only as supporting evidence because, on its own, it seems to assume rather than to prove the capacity to act. See Amerasinghe, *ibid.*; see also, Gautier, "Reparation Case Revisited", *supra* note 26 at 339-340 where the author discusses that the importance of practice was also underlined in the report of the Chairman of the United States delegation to the San Francisco Conference and that the 1986 Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations recognizes the input of practice as well.

[36] Amerasinghe, *ibid.*, at 81-82; see also Gautier, *ibid.*, at 335-337 where the author reconciles the two approaches regarding international personality of international organizations.

> objective international personality and not merely personality recognized by them alone, together with capacity to bring international claims ...

Thus, it does not necessarily follow that in every case the legal personality of an international organization *vis-à-vis* a non-member will exist where it is found to exist *vis-à-vis* members. It seems reasonable to conclude that only respecting those organizations whose circumstances warrant the inference of recognition by non-members, or at least of the willingness of the latter to extend recognition in one way or another, may it be established that legal personality exists in relation to non-members.

(c) The Principles of the Reparation Case as Applied to the OECD

Keeping in mind the principles established in the *Reparation Case*,[37] could it be said that the OECD has a legal personality separate from the Member States? That the OECD, as an international organization, is a subject of international law, has already been established. Thus, the question here is whether it is an entity capable of possessing international rights and duties with the capacity to enforce its rights by bringing international claims. In other words, does the OECD have legal personality according to international law?

In the *Reparation Case*, the Court noted the lack of a provision in the UN Charter expressly conferring legal personality on the organization. As a result, the Court attributed legal personality to the UN as a necessary implication of its rights and functions emanating from its constituent instrument. With respect to the OECD, the Convention explicitly provides for the legal personality of the organization in three separate articles: Article 5 states that the OECD may take decisions, make recommendations and enter into agreements with the Member States, non-members and other international organizations, which indicates an intention of the founding Member States to confer a separate legal personality on the organization so that the OECD could take action in its own name and make claims at international law. Article 15 provides for the continuance of the legal personality possessed by the OEEC in the OECD, again an

[37] The *Reparation Case* was subsequently confirmed by the *Certain Expenses of the United Nations Case* [1962] I.C.J. Reports 151 which upheld the notion of 'necessary intendment' or 'necessary implication' by finding that the "fulfillment of one of the stated purposes of the UN" is a criterion of capacity.

explicit indication that the founding members wanted to create a legal person separate from themselves. Finally, Article 19 refers to the legal capacity of the organization itself, and the privileges, exemptions, and immunities of the OECD, its officials and representatives.[38]

Without having to read beyond the text of the Convention, it is evident that the entity thereby created, the OECD, was intended to have a distinct and separate legal personality from those of the Member States.

Although it is recognized that the insertion of a provision affirming the legal personality of the organization concerned has a declaratory effect, it has been argued that "[w]hile such provision would certainly not be easily disregarded, it would not be sufficient *per se* to guarantee the recognition of such personality if it is not supported by a minimum of rights conferred to it".[39] The notion of declaratory effect is derived from the declaratory theory of recognition of states.[40] The declaratory view holds that the legal effects of an act of recognition are limited because such act is a mere declaration or acknowledgment of a factual situation – the existence of the state.[41] Proponents of this view argue that the act of recognition does not create the legal existence of that state because the existence of a state is based in fact and does not depend on the formal acknowledgement by some other state.[42]

In this respect, even when legal personality is expressly conferred upon an organization, the competence to conduct foreign relations of its own makes sense only when the substantive provisions of its constituent instrument call for a display of such

[38] See Appendix II, Supplementary Protocol No. 2 to the Convention on the OECD (Paris: OECD, 1960).

[39] Gautier, "Reparation Case Revisited", *supra* note 26 at 336.

[40] The other prevailing theory of recognition is the constitutive theory of recognition according to which the political act of recognition is a precondition of the existence of legal rights. This view asserts that it is the act of recognition that endows a polity with the legal status of statehood and infuses a government with the legal capacity to engage in international diplomatic relations. In this way, recognition becomes a formal legal act intended to attach the prescribed legal consequences of statehood on some new polity, see James L. Brierly, "The Law of Nations", rev. by Humphrey Waldock, 6th ed. (Oxford: Oxford University Press, 1963), 138-40. See also Brownlie, "Public International Law", *supra* note 10 at 87-88 where the author argues "in its extreme form that is to say that the very personality of a state depends on the political decisions of other states. The result is a matter of principle impossible to accept..." concluding that the constitutive doctrine creates a many great difficulties.

[41] Brownlie, *ibid.*, at 86-87.

[42] See Hersh Lauterpacht, *Recognition in International Law* (Cambridge: Cambridge University Press, 1947) at 23-24.

functions. It has been said, "[i]n the absence of such rules, the attribution of international personality appears to be a shell without content".[43] Hence, the contention is that the actual rights and competences given to the organization hold the key to its legal personality and not a mere insertion of a provision in its constitution: "[t]he proof of the presence of an international personality then appears to be identical with the proof of international rights and obligations incumbent on the entity."[44]

Thus, leaving aside the declaratory effect of the provisions in the Convention explicitly conferring legal personality on the OECD, can it be said that the attribution of legal personality is necessarily implied by the Convention? In applying the method followed by the Court in the *Reparation Case* to the OECD, an examination of the principles and purpose of the organization as contained in the Convention would reveal whether the attribution of legal personality is necessary for the achievement of its objectives or, in the words of the Court, "indispensable".

The principles guiding the OECD are stipulated in Article 1 of the Convention, identified earlier as the promotion of economic and trade development through the liberalization of markets. The goals and purposes of the OECD are assigned in Article 2 which provides for policy development designed to achieve economic growth and financial stability, the promotion of the efficient use of economic resources, the avoidance of developments that might endanger the economy and the contribution to the economic development of both Member and non-member states through appropriate means, though in particular by the flow of capital to those countries.

The Convention also equips the OECD with various functions, such as: holding Council meetings and ministerial sessions (Articles 7 and 8 respectively); establishing and maintaining relations with non-members as well as inviting non-members to participate in activities of the organization (Article 12). Such functions are to be carried out by the Council, Executive Committee and other requisite subsidiary bodies (Articles 7 and 9 respectively), while Article 5 furnishes the necessary means to fulfill the objectives set out in Articles 1, granting the OECD the power to take decisions, make recommendations and enter into agreements with Members, non-members and

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[43] Hahn, "International Personality", *supra* note 9 at 1045.

[44] *Ibid.*

international organizations representing its pursuance of common strategies and positions.

Pursuant to Article 3, the Members agree to fulfill the aims of the organization by providing the organization with the necessary information, consultation and cooperation, which creates an obligation for the members to fulfill the undertakings of the OECD as set out in Article 2 described above. This provides some evidence that the position of the Member States in relation to the OECD requires them to conform their actions to decisions taken by the OECD. Finally, in a supplementary protocol to the Convention, the legal capacity of the OECD and the privileges, exemptions, and immunities of itself, its officials and representatives to it of the members, are granted.[45]

Having determined the principles and purpose of the OECD, one must then consider whether the existence of legal personality is necessary to achieve the stated objective(s). This involves the consideration of whether the position of the Member States in relation to the OECD requires them to conform their actions to decisions taken by the OECD. As indicated above, Article 5 provides for the OECD to make decisions, which, unless otherwise provided, are legally binding on the Member States. This constitutes clear evidence of the intent to establish an entity separate from its founding Members. In addition, the ability to conclude agreements with all states, be they members or not, as well as other international organizations, strongly suggests that legal personality should be considered to be a *necessary* aspect of fulfilling the objectives of the OECD, if it is to function in accordance with its design as an entity that would have the requisite capacities to partake in international relations.

The OECD is possessed of institutions assuring the continued exercise of its powers, rights and duties. The Convention has given it special tasks to promote the objective of its creation, as well as defining the position of the Member States in relation to the organization by requiring them to cooperate closely, take coordinated action where appropriate and binding them legally through its decisions. Further, the language used in

[45] See Article 19 where reference is made to Supplementary Protocol No. 2 *supra* note 38 (see Appendix II).

the Convention is not consistent with the characterization of the OECD as "merely a centre 'for harmonizing the actions of nations in the attainment of ... common ends'".[46]

It has been suggested that it would be "erroneous to consider the actions of international organizations as merely the display of the foreign-affairs power of all the member states".[47] The above discussion has shown that the organizational framework of the OECD has made ample provision for the existence of legal personality. This becomes apparent in several substantive provisions as the Convention does not content itself with the formal proclamation of legal personality, despite doing so in Articles 5, 15 and 19. In view of its purpose, the founding Members of the OECD have left no doubt that they intended to bring into being an entity possessed of a number of rights usually accorded to international persons.

In the *Reparation Case*, aside from looking at the provisions of the constituent instrument of the organization, the Court also looked at the subsequent practice of the international community to support its conclusion that the UN had legal personality. In the first place, in ratifying the Convention, the Member States have recognized the international-law status of the OECD.[48] To date, the Council has adopted more than forty decisions creating legal obligations between the organization and its Members.[49] There have been more than 150 recommendations, and though not legally binding, "practice accords them great moral force as representing the political will of the Member countries and there is an expectation that Member countries will do their utmost to fully implement a Recommendation".[50] The common positions and joint actions adopted in the decisions and recommendations are relevant to its relations with its Members, as well as non-members, for example by defining the policy of the OECD towards third countries and taking commitments in this respect.[51] Since its creation, the OECD has affirmed its

[46] Kindred, "International Law", *supra* note 7 at 43.

[47] Hahn, "International Personality", *supra* note 9 at 1046.

[48] *Ibid.*, at 1053.

[49] OECD, Nicola Bonucci, The legal status of an OECD act and the procedure for its adoption (Paris: OECD, 2004).

[50] *Ibid.*

[51] An obvious example of such action is the OECD's HTC Initiative.

identity and visibility on the international arena and subsequent practice confirms the existence of a legal personality.[52]

To summarize, the effects of the attribution of legal personality to the OECD means it possesses certain rights, duties, powers, liabilities, etc.,[53] as distinct from the Member States on the international plane. However, as stated earlier, the existence of legal personality *vis-à-vis* members of the organization is not sufficient to establish legal personality *vis-à-vis* non-members. Thus, since none of the targeted jurisdictions are party to the OECD Convention, the issue of whether the OECD has legal personality in relation to non-members must be resolved.

(d) Legal Personality of the OECD vis-à-vis Non-Member States

That member states of an organization are bound by provisions in the constitutive instrument conferring legal personality on that body, either expressly or by necessary implication, has been established on the basis that, as with any treaty, "an organizational compact calls for compliance by its parties".[54] With respect to non-member states and other international organizations it is open to doubt whether such rules have the same effect.

Some authorities put forth the view that organizations, like states, must be recognized by non-members in order to have legal personality in respect of such non-members on the basis that those states, which are not parties to the constituent instrument, are not bound by it.[55] That notion is grounded in the fact that, unlike member states, non-member states do not share a legal nexus with the constituent instrument establishing the legal identity of the organization. In this respect, by definition, non-members have no

[52] Although some academics (see footnote 34 above) suggest the use of 'objective criteria' to identify the international personality of an organization, such criteria are derived from various interpretations of public international law and the *Reparation Case*. For these reasons, it is sufficient for the purposes of this examination that the determination of the international personality of the OECD is based on the principles established by the Court in the *Reparation Case*.

[53] For ease of reference these will be collectively referred to as "capacities" throughout the rest of the paper.

[54] Hahn, "International Personality", *supra* note 9 at 1048.

[55] Amerasinghe, "International Organizations", *supra* note 11 at 88.

obligation under the constituent instrument to accept the personality of the organization since they are not party to it.[56]

As noted above, the prerequisite for recognition of the existence of the legal personality of an organization *vis-à-vis* third parties has been analyzed by analogy to the position with regard to the recognition of states.[57] The conclusion reached in that respect, at least by some, is that if the criteria for statehood have been objectively found to exist, then recognition is not a prerequisite for the legal existence of a state.[58] Admittedly, the analogy drawn between states and international organizations is not entirely persuasive. However, it has been argued that since the requirement of recognition for statehood is no longer emphasized it should also be irrelevant to the existence of legal personality of organizations.[59]

Although the analogy is not complete, in that states and international organizations do not hold equal status in international law[60], they are both international subjects, and the development of principles relating to states forms part of the corpus of international law. This could provide some help in and support for interpreting the relevance of and applying broader international law concepts in the context of international organizations.[61] The conclusion that recognition is irrelevant would mean that personality would depend on a legal status that emanates from the existence of

[56] Maurice Mendelson, "The Definition of 'International Organization' in the International Law Commission's Current Project on the Responsibility of International Organizations" in Maurizio Ragazzi, ed., *International Responsibility Today: essays in memory of Oscar Schachter* (Netherlands: Martinus Nijhoff Publishers, 2005) 371 [Mendelson, "Definition of International Organization"] at 384.

[57] Amerasinghe, "International Organizations", *supra* note 11 at 90.

[58] *Ibid.*, at 91 where the author discusses that "just as recognition is not in principle relevant to the objective determination of the legal status of statehood, though it continues to be in practice… it is also an acceptable position that recognition by non-member states is not necessary for the legal effectiveness of that personality vis-à-vis those states, unless as in the case of states, there are exceptional or ambiguous circumstances"; see generally 86-91 for a discussion on "objective personality"; see also Brownlie, "Public International Law", *supra* note 10 at 85-101 on Recognition.

[59] Amerasinghe, *ibid.*

[60] In the *Reparation Case* when discussing the legal personality of the UN, the Court stated that the subjects of law "are not identical in their nature or in the extent of their rights, and their nature depends upon the needs of the community" implying that legal personality is not equal in all cases. Indeed, the Court did remark that while it found legal personality of the organization, "that is not the same thing as saying that it is a State, which it certainly is not, or that its legal personality and rights and duties are the same as those of a State." See Kindred, "International Law", *supra* note 7 at 43.

[61] Amerasinghe, International Organizations", *supra* note 11 at 90.

certain facts associated with the creation of the organization – so-called "objective personality".[62]

To determine whether the OECD has such "objective personality", in the sense that its personality is opposable to non-members without recognition,[63] the same facts examined above in respect of its Member States would be relevant. The provisions of the Convention identified above establish that the OECD is the type of organization whose situation warrants the recognition of its legal personality *vis-à-vis* third parties because, aside from explicitly providing for legal capacity, it does so through the statement of objectives in relation to both Member and non-member states, which can only be achieved if personality is attributed to the organization.

On the basis of subsequent practice (not just of the Member States) one can also show a willingness of other international subjects (i.e., states and other international organizations), to extend recognition of legal personality to the OECD, as it has formal relations both with non-member states and other international organizations. Examples of such relations include: an assistance program implemented in 1989 after the fall of the Soviet bloc, for the benefit of the affected Easter European Countries; in 1998 a new "Centre for Co-operation with Non-Members" was created to co-ordinate charge of all activities concerning non-members; also, the OECD has official relations with other international organizations and bodies, such as the International Monetary Fund, the World Bank, the International Labour Organization and many other UN bodies.[64] In this

[62] *Ibid.* The mere fact of recognition does not prove anything one way or another as to officially recognize may just be an acknowledgement of the existing legal state of affairs; see Mendelson, "Definition of International Organization", *supra* note 56 at 387.

[63] Amerasinghe, *ibid.*, at 86.

[64] A recent example of the OECD establishing relations with non-OECD members is a Memorandum of Understanding with Hungary on the implementation of a multilateral tax programme at the OECD-Budapest Multilateral Tax Centre. See OECD Press Release dated 30 November 2005 announcing the signing of the Memorandum between Hungary's Minister of Finance, Dr Veres János, and the OECD, represented by Mr Jeffrey Owens, Director of the Centre for Tax Policy and Administration: "The OECD-Budapest Multilateral Tax Centre has been established since 1992 to provide a forum for dialogue on international taxation issues between OECD countries and non-OECD economies in the region. The Memorandum of Understanding thus formalizes a long term partnership between Hungary and the OECD in the operation of the OECD-Budapest Multilateral Tax Centre."

respect, it can be said that the OECD has some "objective" personality because it is authorized to conclude agreements of its own with third states.[65]

The argument against the attribution of legal personality of organizations *vis-à-vis* third parties is mainly grounded on the fact that there is no legal nexus between the constituent instrument conferring personality on the organization and the third parties. However, where a third party enters into agreements with an organization it is reasonable to conclude that it has assented to the legal personality of the organization since a legal nexus is created by virtue of entering into an agreement with it, irrespective of formal recognition. While it is true that international organizations do not possess the same capacities as states, that is not to say that whatever capacities they do possess are not opposable to non-members.[66] Whether or not the OECD has limited capacities, as compared to states in general, is not the issue; that it has legal personality *vis-à-vis* its Members has been established, and on the basis of the Convention and subsequent practice, it is reasonable to conclude that such personality also exists *vis-à-vis* non-members.

The international actors involved in the HTC Initiative have thus been identified as the targeted jurisdictions, sovereign states, on the one hand, and the OECD, an international organization, on the other hand, together perhaps with its Member States. Having determined that the targeted jurisdictions and the OECD (and its Member States) are subjects of international law, with the requisite legal personality, the discussion will proceed with an examination of the application of relevant international principles to their conduct in relation to the HTC Initiative.

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[65] Hahn, "International Personality", *supra* note 9 at 1050-1052.

[66] See the Advisory Opinion of the International Court of Justice in the *Legality of the Use by a State of Nuclear Weapons* [1996] I.C.J. Reports 66 at 78 where the Court states: "The Court need hardly point out that international organizations are subjects of international law which do not, unlike States, possess a general competence." See also Mendelson, "Definition of International Organization", *supra* note 56 at 380-89 for a discussion on international legal personality, specifically pages 384-389 where the author questions whether a non-member state that has not recognized an international organization is bound to treat that organization as a legal person concluding that "neither the case law, the practice, theory or policy support the suggestion ... that all organizations enjoy objective international personality."

PART TWO THE HARMFUL TAX COMPETITION INITIATIVE

I. ESTABLISHING A CASE FOR THE HTC INITIATIVE

The determination of the international legal implications of the OECD's HTC Initiative will involve an analysis of the OECD's conduct and the grounds upon which such conduct was taken. The OECD's conduct will be evaluated on the basis of the publication of the 1998 and 2000 Reports; the former being the official proclamation of the OECD's campaign against harmful tax competition, while the latter involved the publication of a list of jurisdictions deemed to be tax havens. In reviewing the grounds upon which the OECD mounted its HTC Initiative, the focus will be on the justifications provided by the OECD as set out in the 1998 Report.

In order to assess the legality of the OECD's actions pursuant to international law, that is, whether the HTC Initiative is in accordance with international legal principles, or alternatively, whether the targeted jurisdictions engaged in behaviour contrary to international law, those principles must be identified. In other words, what are the principles upon which the OECD has based its HTC Initiative? A review of the 1998 Report will reveal such principles; however, whether or not those principles constitute international principles is not clear and must also be considered.

Before assessing the particulars of the OECD's conduct, the analysis will begin by considering the justifications underlying its efforts to combat harmful tax competition. In brief, the OECD's HTC Initiative is based on the following arguments: first, that increased tax competition between states has lead to harmful tax competition through the use of harmful tax practices that have negative effects; and second, that the problems posed by such harmful tax competition are inherently global in nature requiring a multilateral effort, as proposed in the 1998 Report.

(a) The Negative Effects of Tax Competition

According to the 1998 Report, the negative effects of tax competition are identified as tax policies that are aimed at diverting financial and other geographically mobile capital[67] and which drive the effective tax rate on income from mobile activities

[67] OECD, "1998 Report", *supra* note 1 at paras. 6 and 23.

significantly below rates in other countries.[68] It is asserted that such tax practices result in harmful tax competition because they have the potential to cause harm, on the basis that they affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns, cause undesired shifts in the tax burden from mobile to immobile tax bases, constrain governments' fiscal choices (as to the level and mix of taxes and public spending), and undermine the fairness, neutrality and integrity of tax systems generally.[69] The OECD alleges that where tax policies have all of these negative effects they are harmful[70] and must be curbed because such harmful tax competition diminishes global welfare and undermines taxpayer confidence in the integrity of tax systems.[71]

Despite the OECD's belief that "the progressive liberalization of cross-border trade and investment has been the single most powerful driving force behind economic growth and rising living standards"[72], admitting that competition in general, and even tax competition in general, is a beneficial phenomenon, the OECD attempts to justify its attack on harmful tax practices as being in furtherance of its more general objectives, manifested in the taxation context as "... reducing the distortionary influence of taxation on the location of mobile financial and service activities, thereby promoting fair competition for real economic activities."[73]

Essentially, the HTC Initiative is taking aim at the tax policies of sovereign states on the belief that certain harmful effects may occur when one country's tax policies influence either the policy decisions of another country or an investor's location decisions of financial services and other highly mobile activities. The implication seems to be that if it appears that tax reasons drive investment location decisions with respect to financial and other service activities, then it should be assumed that this results from unfair tax competition, and that the related transactions do not have any real economic "substance",

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[68] *Ibid.*, at para. 31.

[69] *Ibid.*, paras. 4, 23 and 30.

[70] *Ibid.*, para. 31.

[71] *Ibid.*, para. 4.

[72] *Ibid.*, para. 8.

[73] *Ibid.*

and are therefore "harmful". The OECD asserts that jurisdictions engaged in harmful tax competition are "diverting" substantial amounts of foreign direct investment and taxable income away from its Member States.

It is on such grounds that the OECD calls for governments to take steps to halt such harmful tax competition, emphasizing the need for intensified international action on a coordinated basis "to protect their tax bases and avoid worldwide reduction in welfare caused by tax-induced distortions in capital and financial flows".[74]

(b) The Need for Multilateral Action

To justify the need for multilateral action against harmful tax competition, the OECD draws attention to the changing relationship between the domestic economies of states that has occurred since the end of World War II. Citing the globalization of trade and investment and the increased mobility of capital of the past half century, the OECD contends that these changes in the development of the international economy have altered the relationship between domestic tax systems.

In the past, international trade was limited as the economies of the developing countries were relatively closed, due to wars and depression.[75] At the same time, the flow of information was not only slow, but also limited, thus capital did not easily move across borders and foreign source income played a marginal role in domestic economies.[76] As a result, the international element of domestic tax systems was limited to the amount of tax imposed on foreign source income of residents and the inclusion in the tax base of non-residents' income earned domestically.

The OECD explains that, since international trade and capital mobility was limited, the interaction of domestic tax systems was relatively unimportant and any

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[74] *Ibid.*, para. 37.

[75] When nation states emerged in the mid-17th century, economic policy was focused on what was occurring within the territorial boundaries of states and tax laws tended to reflect matters that took place within the territory. By the turn of the 20th century, states had begun to shift their perspective from national to international, but in the inter-World War era, there was a brief retreat to protectionist policies as governments reverted back to closed economies, protectionism and pervasive capital controls through the imposition of tariffs, customs duties and other regulatory measures on trade.

[76] See also Vito Tanzi, *Taxation in an Integrated World* (Washington D.C.: The Brookings Institute, 1995) [Tanzi, "Taxation"] at 68 where the author discusses the traditional architecture of capital taxation.

international spillover effects were generally limited.[77] However, it is asserted that due to the accelerating process of globalization of trade and investment, through policies of trade liberalization, and the increased mobility of capital, a consequence of technological innovation and tax reform, the tax policies in one country are now more likely to have repercussions on the economies of other countries.[78]

The OECD contends that globalization has opened new avenues through which taxpayers can minimize and avoid taxes that countries exploit by engaging in harmful tax practices to divert geographically mobile capital to their jurisdictions.[79] As foreign source income plays a greater role in domestic economies, owing to the increased mobility of capital and increased international competition for these bases, the OECD reasons that the interaction of domestic tax systems has become more important, requiring the attention of the international community.

It is further argued that international cooperation is imperative on the basis of its view that the matter of international tax competition cannot be addressed unilaterally or even bilaterally. The contention is that if a jurisdiction were to take unilateral measures to curb the benefits of harmful tax practices, then the activity would just be relocated to a different jurisdiction that provides those benefits. Thus, the OECD deems harmful tax competition to be "inherently multilateral",[80] requiring internationally coordinated efforts through its HTC Initiative.

II. EVALUATION OF THE OECD'S JUSTIFICATIONS FOR THE HTC INITIATIVE

At the outset, a preliminary issue that arises is whether it is even possible to make a distinction between "harmful" and "fair" tax competition. The Oxford Dictionary defines "competition" as "the activity or condition of striving to gain or win something by defeating or establishing superiority over others engaged in the same attempt."[81] In general terms, tax competition involves countries competing with each other on the basis

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[77] OECD, "1998 Report", *supra* note 1 at para. 20.

[78] *Ibid.*, at paras. 22 and 23.

[79] *Ibid.*

[80] *Ibid.*, at para 4.

[81] Patrick Hanks, ed., *The New Oxford Dictionary of English,* (Oxford: Clarendon Press, 1998) *s.v.* "competition".

of their respective tax regimes in order to attract investment to their jurisdictions. The mere fact that countries are competing against each other for investment and tax revenues indicates that they are in opposition of each other as they are vying for the same investment.

The 1998 Report considers tax competition in the context of geographically mobile activities, where countries compete on the basis of capital taxation. Although attempting to distinguish between fair and harmful tax competition, the OECD does not clearly identify the former. Based on the discussion in the 1998 Report, tax policies that are designed to attract geographically mobile activities solely for tax-driven purposes are considered harmful. Presumably, in accordance with the OECD's line of reasoning, fair tax competition would consist of tax practices that are not aimed at diverting such activities from other jurisdictions purely for tax reasons. But are tax reasons not the whole point of tax competition?

The conclusion reached by the OECD may be justified if indeed there were rules regarding the manner in which countries were permitted to compete in the taxation of mobile capital. However, in the absence of such rules it is submitted that qualifications such as "harmful" and "fair" are unfounded. Before determining whether the HTC Initiative is based on any existing principles of international law, such that it can be said that there are "rules" in respect of tax competition, the OECD's concept of "harmful" tax competition will be considered in greater detail.

(a) Evaluation of the OECD's Definition of "Harmful" Tax Competition

In defining harmful tax competition, the OECD refers to tax practices that have the potential to cause harm by: creating economic distortions (e.g., affecting the location decisions of geographically mobile activities and distorting trade and investment patterns); causing a "race to the bottom" (e.g., eroding the tax bases of other countries, causing undesired shifts in the tax burden from mobile to immobile tax bases and constraining governments' fiscal choices); and facilitating tax evasion and tax avoidance (e.g., undermining the fairness, neutrality and integrity of tax systems generally). The OECD asserts that these negative effects of tax competition constitute harm and provide the rationale for the HTC Initiative.

(i) "Harmful" tax competition creates economic distortions

The OECD alleges that tax competition becomes harmful when investment decisions are based purely on tax minimization considerations causing capital to be invested based on the tax treatment of the resulting income rather than the underlying economic return. Where this occurs the OECD alleges that inefficiencies are created in the market. At this juncture, it is useful to distinguish between the two main types of capital flow that occur in the international economy which are affected by tax competition: portfolio investment and direct investment.

Portfolio investment involves the pooling of capital of a number of investors, often by a third party, which is then invested on their behalf in a portfolio of securities without the direct involvement of the investors as to investment decisions. The income arising from such investments is often referred to as passive income. By contrast, direct investment involves an investor that directs capital into a "significant" percentage stake in a particular investment (either directly or through a company or other "investment vehicle") and who is directly involved in the investment decisions. The income arising from these investments is often referred to as active business income. However, since the 1998 Report is limited to tax competition in respect of financial and other service activities, direct investment escapes the HTC Initiative to some extent.

In the case of portfolio investment, tax competition is not likely to distort capital flows since the jurisdiction in which the capital is pooled is not the jurisdiction in which the capital is ultimately invested.[82] Low tax jurisdictions are used for portfolio investment for the sole purpose of pooling the money of a large number of investors, typically taxpayers resident in high tax jurisdictions, without incurring tax at the pooling stage since such investment vehicles are typically not taxable. The use of these tax regimes removes a layer of tax that would otherwise have been incurred had the capital been pooled in a high tax jurisdiction in which the investment vehicle would probably have been a taxable entity. The capital that is pooled is therefore not diverted to the jurisdiction offering such a regime for investment purposes *per se*; rather, it is an intermediary step in the investment that reduces the tax burden of the ultimate

[82] Richard Teather, "Harmful Tax Competition?" (2002) *Institute of Economic Affairs* 61 [Teather, "Harmful Tax Competition"] at 61.

investment, which is not made in the pooling jurisdiction. In other words, portfolio investment is not distorted by tax policies of jurisdictions with attractive tax regimes for such investments because it affects only the location of the pool and not that of the ultimate investment.

With respect to direct investment, which mainly falls outside the scope of the 1998 Report, tax competition may well affect location decisions and distort trade and investment patterns. Decisions as to where to invest may be affected by the taxation regime offered by various jurisdictions. This is equivalent to making decisions based on the cost of labour or regulatory compliance costs for particular industries.[83] In this context, it may be reasonable to posit that investors do not care whether they are paying wages or taxes or other costs; their concern is an overall reduction in costs, and if costs can be reduced by investing in a jurisdiction that is offering tax incentives or a tax holiday for the particular investment, then this "tax consideration", from a foreign investor's perspective, is the same type of consideration and justification that another investor may have for moving production facilities to jurisdictions with cheap labour or lax environmental laws – reducing overall costs and thereby increasing overall after-tax profits.

Therefore, in the case of direct investment, jurisdictions that offer tax exemptions or other preferences for particular industries will likely influence the location of investments, as well as the sectors into which investments flow, thereby affecting the efficiency of the market. Such tax regimes exist in some of the OECD Member States themselves, as well as in many developing countries.[84] However, these are not the focus of the HTC Initiative.

It is important to note that within the context of direct investment there exists behaviour that exhibits elements common to the context of portfolio investment as they both derive income from the expectation of capital, typically financial capital. Multinational enterprises ("MNEs") often use intercorporate financing structures in low or no tax jurisdictions to finance the business activities of operating companies in the investment jurisdiction (typically high tax jurisdictions) in order to reduce tax that might

[83] *Ibid.*

[84] See footnotes 121 and 173.

otherwise be payable on the particular investment. The parent company (located in a high tax jurisdiction) establishes a financing subsidiary in a low or no tax jurisdiction, much in the same way that investors use pooling jurisdictions, which then loans money to the operating company that results in the following tax savings: the operating company receives a deduction for the interest paid to the financing company, which reduces the amount of taxable income otherwise payable in the investment jurisdiction; the financing company pays little or no tax on the interest income earned on the intercorporate loan; and the parent company typically earns tax free dividends from the financing company.

The use of financing company regimes reduces the overall tax liability of the MNE operations, whereas if the parent company had made the loan directly to the operating company the interest income earned on the loan would have been taxable. However, as concluded above in the context of portfolio investments, these type of financing structures do not create economic distortions as the location decision of the ultimate investment is not affected, just the way in which it gets there.

(ii) "Harmful" tax competition causes a "race to the bottom"

The OECD asserts that the 1998 Report is an attempt to halt the "race to the bottom" with respect to income tax, which it argues is actively contributing to the erosion of income tax revenues in various countries.[85] In this vein, the report is also aimed at practices that the OECD believes undermine the ability of countries to set fiscal policy regarding the allocation of the tax burden among mobile and less mobile tax bases, such as labor, property and consumption.

It is commonly argued that a "race to the bottom" has emerged as governments engage in tax competition for foreign investment by lowering their tax rates on income earned by non-residents to attract both portfolio and direct investment. It is believed that continually declining capital tax rates in lure of foreign investment will result in a shift to regressive taxation on immobile factors, such as labour, by focusing on personal and consumption taxes. In turn, it is alleged that this places constraints on the revenue raising capacity of governments, which will supposedly lead to a reduction in government expenditures. The consequence of this race to the bottom, it is argued, is that it would

[85] OECD, "1998 Report", *supra* note 1 at para. 43.

create an overall reduction in the welfare state, preventing governments from providing important collective goods.

Using the race to the bottom theory as a justification for launching the HTC Initiative is problematic because it raises an ideological question as to whether this race to the bottom is in fact desirable: "One needs to examine what sort of race to the bottom (for example, in wasting tax revenues or making would-be free riders pay for public goods) mobility is inducing in a particular case".[86] The race to the bottom theory assumes a benevolent government that acts to maximize social welfare. However, the case may be quite the opposite if in fact a government has Leviathan tendencies for overexpansion of the public sector and wasteful spending of tax revenues.[87]

Tax competition is supposed to create efficiencies, not just in the market, but also in government expenditure. The OECD relies on the race to the bottom rationale from the perspective of its Member States who wish to maintain current levels of government expenditures, which are supposedly threatened by increased tax competition. A different perspective offers the view that tax competition plays a beneficial role as it helps reduce the political and economic distortions that arise from the tendency toward governmental overprovision or inefficient provision of public services.[88] Therefore, one might ask

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[86] Daniel Shaviro, "Some Observations Concerning Multi-Jurisdictional Tax Competition", Working Paper No. CLB-00-001 online Social Science Research Network Electronic Paper Collection at <http://papers.ssrn.com/paper.taf?abstract_id=204889> [Shaviro, "Multi-Jurisdictional Tax Competition"] at 20; see also at 24 where the author concludes that there is no analytical reason why a race to the bottom in capital income taxation must reduce efficiency or undermine distributional objectives.

[87] Public choice literature contends that state politicians and government officials act as a revenue-maximizing Leviathan, maximizing their own objectives. The "Leviathan" hypothesis emerges from the work of Geoffrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press, 1980) at 15 where the authors argue that "total government intrusion into the economy should be smaller, ceteris paribus, the greater the extent to which taxes and expenditures are decentralized." Brennan and Buchanan contend that as long as some individuals and firms are mobile, tax competition serves a beneficial role as it may limit the tendency of governments to over expand, thus destroying Leviathan's monopoly on taxation and bringing government spending closer to the preferences of citizens; see also Jonathan Rodden, "Reviving Leviathan: Fiscal Federalism and the Growth of Government" (2003) 57 *International Organizations* 695 [Rodden, "Reviving Leviathan"] at 696-698; and George Zodrow, "International Tax Competition and Tax Coordination in the European Union" (2003) 10 *International Tax Law and Public Finance* 651 [Zodrow, "Tax Competition and Tax Coordination"] at 659; and Jeremy Edwards and Michael Keen, "Tax Competition and Leviathan" (1996) 40 *European Economic Review* 113 [Edwards & Keen, "Tax Competition"] at 113.

[88] See Zodrow, *ibid.*, at 652 where the author examines both arguments in relation to the European Union, and finds "that the argument that tax competition necessitates tax rate harmonization among the member states of the European Union is not yet compelling." See also Bruno S. Frey and Reiner Eichenberg, "To harmonize or to compete? That's not the question" (1996) 60 *Journal of Public Economics* 335 [Frey &

whether the OECD Member States should reexamine the level of government expenditures and the size of their public sectors, instead of trying to stop tax competition in geographically mobile activities and blaming other jurisdictions for the inability of their governments to either maintain current levels of spending or efficiently spend revenues.

Although numerous theoretical studies have been conducted as to the effects of tax competition, economists are still divided on the issue of whether tax competition should be halted in favour of tax harmonization.[89] Furthermore, there is little empirical literature on tax competition to supplement the theoretical literature. The question of whether tax competition has in fact created a race to the bottom as predicted has similarly not been settled: "there is mixed evidence on whether rate reductions in the face of increased international capital mobility predicted by the theory of tax competition are in fact occurring."[90] In fact, the 1998 Report itself offers no evidence of tax base erosion or

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Eichenberg, "To harmonize or to compete?"] at 347 where the authors conclude that economic distortions are induced by differential taxation, and political distortions (which consist in politicians deviating from the citizens' preferences) are induced by harmonized taxes. The authors argue "that economists should instead propose changes in institutions – or in the underlying constitution – which shifts the relationship between economic and political distortions inside", noting that the literature for reducing political distortions has received less attention that that regarding the reduction of economic distortions. See Shaviro, "Multi-Jurisdictional Tax Competition", *supra* note 86 at 2 where the author asserts "that no particular scale for prescribing tax rules is correct across the board or from all standpoints. Accordingly, given a particular set of jurisdictions that must decide how to coordinate their tax rules, neither tax competition nor harmonization is likely to be preferable across the board" and at 24 "[g]iven the controversiality in the literature of the choice between income and consumption taxation, perhaps it is best just to say that, while tax competition promotes and harmonization deters a race to the bottom in capital income taxation, what one should think of this race depends on tax policy views that are independent of the fiscal federalism analysis in this paper."

[89] It is important to note that most of the studies regarding the effects of tax competition are based on economic models that operate in a union, such as the European Union, not an open market. However, see Zodrow, "Tax Competition and Tax Coordination", *supra* note 87 at 661 where the author finds that extensions of the basic model suggest that tax coordination may be undesirable: "The general message of these extensions is that capital income tax competition has benefits that may partially or fully offset the efficiency costs associated with the underprovision of public services stressed in the basic model." See also Tulio Rosembuj, "Harmful Tax Competition" (1991) 27 *INTERTAX* 316 [Rosembuj, "Harmful Tax Competition"] at 325 where the author notes that one must distinguish between a single market (like the European Union) and an open market (the international economy), pointing out that the European Union's Code of Conduct may be beneficial for the European Union but it does not translate into being good for the international economy because it is not a single market.

[90] Zodrow, *ibid.*, at 664 where the author notes that while the corporate tax rates in the European Union have fallen from 38% in 1990 to 33 % in 2000, these have been accompanied by a variety of base-broadening measures which means that the marginal and effective average tax rates have declined far less: "Since effective tax rates ... are the relevant concept in theories of tax competition, this evidence suggests that tax competition has not yet had much of an impact on effective tax rates in the European Union."

a shift in the tax burden from mobile to immobile factors in the OECD Member States to support their claim that "harmful" tax competition causes a race to the bottom.

Thus, while the OECD is concerned about its Member States ability to maintain their welfare states that is not a problem that should be deflected on jurisdictions that have the ability to maintain no or low levels on capital taxation without facing a crisis in public expenditures. [91] It is not incumbent upon such jurisdictions to alter their tax rates or policies so that they are in line with OECD standards because its Member States cannot compete in capital taxation without making adjustments in their own tax systems or their government expenditures, some of which may be necessary in this era of globalization.[92] Furthermore, to suggest that, as a result of tax competition, the OECD Member States will be forced to reduce their public expenditures below their efficient levels to lessen their reliance on capital taxation may be an exaggeration perpetuated by governments who are constrained in making fiscal choices not by the tax policies of other jurisdictions but by their own electorate.

Of course, the real problem is that any attempt to cut social expenditures by a government will create political repercussions. [93] It is easier to lay blame on the tax policies of other jurisdictions than it is to reassess one's own tax and/or social welfare system. Moreover, it is politically safer and easier for governments to tax businesses (through corporate tax) and the rich (through capital tax), than it is to tax workers and other individuals (through labour, property and consumption taxes): "The argument seems to be that the electorate will not accept the true cost of government programmes in which case, in a democracy, they should not be run."[94]

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[91] See Reuven S. Avi-Yonah, "Globalization, Tax Competition and the Fiscal Crisis of the Welfare State" (2000) 113 *Harvard Law Review* 1573 [Avi-Yonah, "Fiscal Crisis"].

[92] See Rodden, "Reviving Leviathan", *supra* note 87 at 695-696: "Throughout the latter part of the 20th century, in an era of globalization and fiscal decentralization, public sectors have grown faster than private sectors around the world. On average, government expenditures accounted for around 39 percent of GDP in 1978, while by 1995 the average had increased to over 45 percent for a sample of 29 countries. The growth has been particularly pronounced in the 1990s."

[93] The recent tumult in France over the labour laws is a good example of how governments bow to political pressure from their electorates (i.e., the risk of losing an election) instead of pushing through necessary economic reforms; see "A tale of two Frances" *The Economist* (30 March 2006). France is not alone as Germany and Italy faced similar reactions that resulted in the incumbent parties losing at the polls. See "France faces the future" *The Economist* (30 March 2006).

[94] Teather, "Harmful Tax Competition", *supra* note 82 at 60.

It is important to note that different considerations are involved in the formulation of domestic tax policy versus international tax policy. Domestically, governments use taxes as a policy tool to promote economic and social objectives.[95] Governments impose taxes to raise revenues for the provision of public goods and services and income redistribution, the levels of which are set by domestic factors particular to each state. The demands of citizens for public spending are to a large extent shaped by ideological, cultural, demographic and geopolitical factors.[96] Consequently, not all countries share the same objectives in their domestic social or tax policy, which results in different types and rates of taxes. Taxes are used domestically for allocative and distributional purposes, which are not necessarily translatable to the international level, particularly with respect to redistributive purposes.

In setting international tax policy, countries are not concerned with redistributive goals at the international level – they are generally concerned with attracting as much foreign investment as they can to their jurisdiction and taxing as much domestic and foreign source income as they can get away with. Although some may argue for a system of international tax harmonization, aimed at the taxation of the rich *versus* the poor as part of a worldwide progressive redistribution system, such considerations are normally not involved in the formulation of international tax policy today, except on a purely bilateral basis.[97] Moreover, the 1998 Report is not advocating worldwide progressive redistribution: the OECD is trying to control tax competition through harmonization to protect the high tax revenue base of its Member States.[98] Thus, the HTC Initiative should not be misconstrued as some magnanimous attempt to introduce a worldwide progressive wealth redistribution system in the name of global "fairness".

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[95] Christopher Howard, "Tax Expenditures" in Lester M. Salamon, ed., *The Tools of Government: a guide to the new governance* (Oxford: Oxford University Press, 2002) [Howard, "Tax Expenditures"] at 417 but see generally 410-444.

[96] Rodden, "Reviving Leviathan", *supra* note 87 at 5.

[97] For example, tax sparing provisions in treaties. See Shaviro, "Multi-Jurisdictional Tax Competition", *supra* note 86 at 25 where the author posits the idea of worldwide progressive distribution both as desirable and undesirable.

[98] See Frey & Eichenberger, "To harmonize or to compete?", *supra* note 88 at 339 where given the policy choice between harmonization and competition, the authors find a bias towards harmonization exists amongst policymakers.

(iii) "Harmful" tax competition facilitates tax evasion and tax avoidance

A major focus of the 1998 Report is to ensure that cross-border income flows of financial and other service activities do not escape taxation by improving the exchange of information between tax authorities and enforcing the principle of transparency regarding the operation of tax regimes and tax administrations. It is argued that such policies not only facilitate tax avoidance and evasion, but also challenge the fairness and integrity of tax regimes, and weaken the broad acceptance of tax systems more generally.[99] As a result, the HTC Initiative targets those jurisdictions that use tax and non-tax incentives (i.e., reduction in regulatory or administrative constraints and financial confidentiality, such as bank secrecy laws) with respect to geographically mobile activities to attract foreign investment.

A number of comments can be made in respect of this rationale provided by the OECD. First of all, there is an important distinction between tax evasion and tax avoidance – the former is illegal under the tax laws of most jurisdictions, while the latter is not. In the words of Lord Tomlin, in the United Kingdom's House of Lords case in *IRC v. Duke of Westminster*:

> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.[100]

Thus, for the OECD to suggest that tax avoidance is an activity that must thwarted by the international community through its HTC Initiative is unacceptable since it is not even an illegal act in the jurisdictions of its Member States.[101] Efforts to prevent tax avoidance, or keep it within acceptable limits, have been left to the discretion of individual countries that attempt to frame tax rules so that there is little or no scope for unintended

[99] OECD, "1998 Report", *supra* note 1 at para. 30.

[100] (1936) 19 TC 490.

[101] Tax avoidance involves the legal use of a tax regime to one's own advantage to reduce the amount of tax that is otherwise payable by means that are within the law. In contrast, tax evasion involves the use of illegal means to evade taxes and usually involves deliberate misrepresentation or concealment by a taxpayer of the true state of their affairs to the tax authorities to reduce their tax liability.

avoidance.[102] That tax avoidance reduces government revenues is obvious, but it should not be confounded with tax evasion.

Turning then to tax evasion, what the OECD is really attacking are the actions of taxpayers who are resident in high tax jurisdictions (like the Member States) and who choose to invest their capital in jurisdictions where it can earn untaxed income and then choose to not report such income in accordance with the tax laws of the relevant high tax jurisdictions. Since most of the OECD Member States have a worldwide system of taxation that seeks to tax the worldwide income of their residents (or citizens, in the case of the United States)[103], any income earned by residents in foreign jurisdictions is liable to tax and must be reported in the resident jurisdiction. If foreign source income is not reported, then such actions constitute tax evasion, a criminal act under the domestic laws of the resident jurisdiction, and that may subject the guilty party to fines or imprisonment.[104]

The reporting of this income, however, is not the responsibility of the foreign jurisdiction – it is that of the resident taxpayer. Although the OECD has framed the issue of tax evasion in a way that insinuates that tax competition by foreign jurisdictions is contributing to tax evasion, this is really a domestic issue of ensuring compliance by resident taxpayers – that is, ensuring that resident taxpayers make full disclosure. Tax evasion is a question of fraud, which is illegal under domestic laws, committed in the residence jurisdiction. From the perspective of the foreign jurisdiction, there has been no unlawful act committed by the taxpayer in their jurisdiction.[105]

The OECD also complains about the inability of tax authorities in residence jurisdictions to compel information from institutions in other jurisdictions. Where a

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[102] For example, some countries, such as Canada, Australia and the United Kingdom, have included general anti-avoidance provisions in tax legislation for this purpose.

[103] Some countries use a territorial system of taxation in which only the income earned in the jurisdiction is subject to tax, effectively exemption foreign source income.

[104] Tax evasion is criminal in most countries, an exception being Switzerland where some acts that would be considered criminal tax evasion in other countries are treated as civil matters. For example, dishonestly misreporting income in tax returns are matters dealt with in Swiss tax courts and not the criminal courts.

[105] If tax evasion is a problem in a particular high tax jurisdiction, the imposition of tougher penalties against offenders may be an appropriate policy response for it to pursue, but the same cannot be said for the implementation of internationally coordinated measures aimed at increasing foreign tax rates or forcing information disclosure on the part of foreign authorities.

taxpayer does not disclose foreign source income and the foreign jurisdiction has bank secrecy laws and/or does not exchange information with the resident jurisdiction, then the tax authorities of the resident jurisdiction are constrained in their abilities to obtain information on the financial activities of its residents. Granted this may frustrate the ability of the resident tax authorities to enforce their laws, but, again, it is not a problem that must be solved by exporting the solution to the foreign jurisdiction by insisting that their laws be changed and that they exchange information. The OECD is using the HTC Initiative to demand that foreign jurisdictions in effect act as tax enforcers on behalf of the Member States, at their own cost, to report the income of nonresidents to the residence jurisdictions' authorities.

More specifically, there is no international legal obligation to exchange information with other jurisdictions and such arrangements are usually negotiated through bilateral tax treaties or mutual assistance agreements. If a resident country cannot secure such exchange of information commitments, then it is not incumbent upon the international community to take up its cause; nor is it fair to allege that the unwillingness of a jurisdiction to exchange information constitutes harmful tax competition or is otherwise improper when the harm is being carried out by the residence country's own taxpayer and within its own territory. Moreover, jurisdictions are neither obliged under international law, nor compelled by international practice to enforce the tax claims of other jurisdictions – it is a long established principle that countries do not enforce each other's tax laws.[106]

Another complaint in the 1998 Report is that tax avoidance and tax evasion produce results that are unfair because resident taxpayers who engage in such behaviour are in effect "free riders" who benefit from public spending in their home country and yet avoid contributing to its financing.[107] This, too, is a domestic problem, if it is a problem.[108]

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[106] *Government of India v. Taylor*, 52 [1955] AC 491.

[107] OECD, "1998 Report", *supra* note 1 at para. 24.

[108] This argument assumes that the taxpayer who is evading taxes continues to live in the residence jurisdiction, enjoying all the advantages it has to offer without paying any tax. Such a scenario is highly improbably, as the taxpayer will still be paying a substantial amount of consumption tax whenever the money is spent. See Teather, "Harmful Tax Competition", *supra* note 82 at 60. The author also points out that if the taxpayer were resident in the United Kingdom, then he would be in no better position than a non-

To summarize, the negative effects described in the 1998 Report as constituting harmful tax competition do not provide a strong basis for the HTC Initiative. The OECD failed to provide any actual evidence of harm, which is surprising considering that much of the work the organization is involved in deals with data collection and statistical analysis of economies throughout the world. Furthermore, in describing "harmful" tax competition, the OECD put forth arguments that lack theoretical clarity and coherence.

(b) Evaluation of the OECD's Call for International Cooperation

The OECD seeks international action against "harmful" tax competition, through its HTC Initiative, based on the following rationales. First, the OECD claims that the interaction of domestic tax systems has become an international issue because the tax policies of one country now have a greater effect on those of other countries as a result of the integration of the world economy, due to highly mobile capital and the globalization of trade. Second, the OECD asserts that harmful tax competition is "inherently multilateral" due to the highly mobile nature of the activities targeted.

These arguments are objectionable on a number of grounds, including the following: first, the HTC Initiative lacks an international legal basis; second, the limited scope of the 1998 Report undermines its relevance; and third, the subjective nature of the determination of "harm" undermines the credibility of the report.

(i) Lack of international legal basis for HTC Initiative

The OECD contends that the development of tax policy regarding capital taxation can no longer be looked at in isolation because of the increased mobility of capital and the globalization of trade and investment. For this reason, the 1998 Report appeals for internationally coordinated action against jurisdictions engaged in harmful tax competition through the development of tax policies and regimes that are designed to attract the investment of financial and other service activities. In so doing, the OECD is suggesting that it is in some way wrong for states to develop such tax policies. In fact, in

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domiciled person who lives in the country who is exempt on non-United Kingdom income (citing Section 65(5) of the *Income and Corporation Taxes Act 1988*) and a United States citizen is liable to tax even if he never lives in the country and thus would benefit from such arrangements only in the loosest way.

describing tax competition as "harmful", the OECD is implying that there are rules that countries must abide by in the design of their domestic tax systems regarding the taxation of capital. As stated previously, ascribing an adjective such as "harmful" to tax competition, with the implication that it is, is warranted only if there are in existence rules prescribing the permitted behaviour of countries regarding competition in capital taxation. In light of this, it is imperative to determine what, if any, international standards exist with respect to the taxation of capital so as to critically assess the basis upon which the OECD has proceeded in proclaiming that harmful tax competition is a global problem.

The 1998 Report makes mention of "internationally accepted standards" yet does not provide evidence of what those standards might be.[109] In fact, the 1998 Report reads as though there is no question as to internationally accepted standards, perhaps because the OECD has already decided what they are and is assuming away a very important consideration – what, if any, are the international principles of law regarding international taxation? Strictly speaking, based on a review of the relevant authorities, there do not appear to be any such principles at this time. There is no international tax organization that operates as a law or policy making body that makes or monitors compliance with international principles of taxation.

Despite the OECD's view of itself, the organization is not some sort of supreme authority in international taxation issues, and 30 Member States hardly represent a global perspective and is insufficient in itself to form the opinion of the majority of states, now totaling 192.[110] Furthermore, to date, there is no international multilateral agreement in existence as to the principles of international taxation that states have undertaken to comply with, as is found, for example, in the areas of human rights or the conduct of war.[111]

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[109] OECD, "1998 Report", *supra* note 1 at para. 26: "Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so."

[110] The United States Department of State online <http://www.state.gov/>. Taiwan is not considered a state, although many countries have diplomatic relations with it.

[111] Although academics have argued for the admittance of general principles of law regarding taxation, namely in the area of state avoidance and evasion, in practice such international principles have not emerged. See Rosembuj, "Harmful Tax Competition", *supra* note 89 at 317 where the author cites Klaus Vogel, *On double taxation convention*, 3rd ed., (Deventer, 1991) at p 57, who argues that the principle of counter tax avoidance must be regarded as universal and taken into account as commonly accepted by

The development of tax policy occurs wholly within the domestic sphere, to advance domestic objectives, regardless of whatever international economic element is present in the domestic economy. The OECD would like us to believe that because foreign source income plays a greater role in domestic economies it provides justification for intervention, through its HTC Initiative, in the formulation of tax policy regarding capital taxation. It does not follow that because of deeper economic integration among states, high tax jurisdictions have the right to intervene in the taxation choices of low tax jurisdictions in respect of income earned from financial and other service activities.[112]

That a low tax jurisdiction provides more favorable tax treatment of capital income than a high tax jurisdiction indicates that the former has and is pursuing opportunities to exploit tax competition that the latter cannot or is unwilling to compete with. But that is no different than any country having and pursuing opportunities to exploit competition in other areas, such as labour and environmental regulation, that many other countries cannot or are unwilling to compete with. Countries use their competitive advantages to attract investment all the time. These advantages might be natural resources, cheap labour, lax environmental laws or low or no taxes for capital or even other bases. To single out increased competition in a particular area (such as taxation) as a reason to launch an internationally coordinated campaign to stop such competition is inadequate to say the least.

Thus far, the only time taxation matters fall into the international arena (i.e., are subject to international law) is through the conclusion of bilateral tax treaties regarding double taxation. Despite the fact that most of these treaties (numbering over 1000 in

nations. But Rosembuj argues that Vogel's theory lacks effectiveness because it is "closely linked to an infringement of a contracted obligation between states" and "if it is not expressly stated in the agreement … hard to accept that this – the general principle – may give rise to an orientation contrary to the adopted agreements…" Rosembuj posits that a general principle of state tax evasion should be admitted despite noting that admittance of such a general principle is not unanimously accepted, citing Levine, *La lutte contre l'evasion fiscale de caractére international en l'absence et en presence de convetions internationals* (Paris, 1988) at 142: "In the conditions of international society and international law there is no general principle that forces sovereign states to provide reciprocal assistance to combat international tax evasion."

[112] See Tanzi, "Taxation", *supra* note 76 at 67 where the author discusses the lack of solutions for dealing with problems of capital taxation as deep integration intensifies, concluding that "[i]n any case, a first best solution is unlikely to be achievable as long as the tax systems remain the exclusive responsibility of particular countries and these countries continue to have conflicting objectives."

existence) are based on the OECD Model Treaty[113], it cannot be said that the OECD's work in this area has created international standards such that the OECD would be considered an authority of some sort with respect to international principles of taxation. The diverse and particular nature of the clauses included in each of the treaties, as well as the fact that most of these treaties are concluded between developed countries, does not reflect homogeneity and sufficient similarity for the principles found therein to be transposed into the international legal realm.[114] While the OECD's publication of the Model Treaty and its Commentaries may be influential in the negotiation and interpretation of the bilateral tax treaties of its Member States, they do not carry the weight of international law, nor do they establish international standards, as the tax treaties concluded by the Member States themselves do not strictly follow the Model Treaty.[115]

Thus, while a recommendation, such as the HTC Initiative or the Model Treaty, by the OECD may be influential on the policy decisions of the Member States, it is does not establish international standards or legal principles. The HTC Initiative expresses the views of the OECD regarding the taxation of capital income - it is not a statement of international principles of taxation. The HTC Initiative may be an attempt by the OECD

[113] OECD, The Draft Double Taxation Convention on Income and Capital (Paris: OECD, 1963), and The Model Double Taxation Convention on Income and on Capital (Paris: OECD, 1977) and The Model Convention on Income and on Capital (Paris: OECD, loose leaf). The current Model Treaty is the 2005 version of the loose leaf. The OECD Model Treaty and the accompanying Commentaries are considered "the benchmarks against which income tax treaties between developed countries are negotiated". See American Law Institute, Federal Income Tax Project, International Aspects of United States Taxation II Proposals of the American Law Institute on United States Income Tax Treaties (1992) American Law Institute [American Law Institute, "Federal Income Tax Project"] at 54. Some bilateral tax treaties are based on the UN Model Double Taxation Conventions, UN ECOSOC, United Nations Model Double Taxation Convention between Developed and Developing Countries (1980) U.N. Doc. ST/ESA/102 and (2001) U.N. Doc. ST/ESA/PAD/SER.E21. The UN Model takes into account the special situation of developing countries. See Tanzi, "Taxation", *supra* note 76 at 83.

[114] Rosembuj, "Harmful Tax Competition", *supra* note 89 at 317.

[115] The question as to whether the OECD Model Treaty and the Commentaries, which provide explanations of the suggested interpretations of the various articles of the Model Treaty, have become part of customary international law has been considered in the international tax literature. For a full discussion see David A. Ward et al., *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model* (The Netherlands: IBFD Publications BV, 2005); at 42 the authors conclude that the Commentaries "... cannot pass the test of having become customary law because they change constantly, there is no proof of their widespread adoption in state practice and, most importantly, because they fail to be supported by the requisite *opinio juris.*" The conclusion reached by most is that "... the OECD materials undoubtedly do not rise to the level of customary international law", see American Law Institute, *supra* note 113 at 54.

"to define international standards for capital taxation as a means to control tax competition,"[116] but it is not some sort of objective review and report with respect to the description of pre-existing principles of international taxation grounded in a sufficient basis of support among the members of the international community.

(ii) The limited scope of the 1998 Report

An obvious criticism of the OECD's HTC Initiative is its limited scope as the 1998 Report focuses on geographically mobile activities. The decision of the OECD to focus solely only on the issue of capital taxation in respect of financial and other service activities raises the following issues: first, it does not take into account the other areas of taxation that countries compete in, such as manufacturing, which may contribute to harmful tax competition as defined by the OECD; second, it glosses over the fact that countries compete against each other for economic investment in many different ways, such as labour wages and regulatory laws, like lax environmental policies; and third, it conveniently focuses on the most mobile of economic activities while ignoring increased mobility of other factors in the international economy that have also heightened competition among nations. The OECD's request for an internationally coordinated effort through its HTC Initiative loses strength as one examines each of these objections.

Other aspects of tax competition

Focusing only on capital taxation ignores the fact that taxes are a policy tool choice of governments. Special tax regimes or favorable tax rates targeted to business interests are common budget items in most developed nations, especially the OECD Member States.[117] Governments use the tax expenditure tool to encourage the behaviour of taxpayers by deferring, reducing or eliminating a tax obligation (despite the fact that

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[116] Eckhard Janeba and Michael Smart, "Is Targeted Tax Competition Less Harmful than its Remedies?" (2003) 10 *International Tax and Public Finance* 259 [Janeba & Smart, "Targeted Tax Competition"] at 259.

[117] For example, where governments want to encourage the modernization of manufacturing tax expenditure items allow for corporations to accelerate depreciation of machinery and equipment. Tax expenditures are also used to meet social policy objectives; for example, governments seek to encourage employers to offer health insurance by allowing them to deduct the cost of doing so. See Howard, "Tax Expenditures", *supra* note 95.

such measures constitute a revenue loss) much in the same way that countries provide favorable tax regimes and rates to attract geographically mobile activities.

In choosing to focus solely on capital taxation, the OECD does not examine how differences in the taxation of manufacturing, consumption, labor, or property may lead to "harmful" tax consequences. By its own admission, the 1998 Report does not cover all aspects of tax competition,[118] specifically noting that tax incentives designed to attract real investment (e.g., plant, building and equipment) have been excluded despite the fact that such policies may also have the harmful effects as described in relation to geographically mobile activities. In other words, the OECD decided to disregard tax regimes directed at manufacturing and similar activities, sometimes referred to as production tax havens,[119] "in the interest of creating a manageable work plan."[120]

In fact, in the case of manufacturing, one might argue that the negative effects of tax competition are most pronounced. Production tax haven jurisdictions offer tax incentives and tax holidays to non-resident investors to attract direct investment in various industries, much in the same way that jurisdictions compete for capital investment. However, production tax havens may arguably have a worse effect on the economies of other jurisdictions. As previously discussed, tax competition for capital investment (i.e., portfolio investment) does not affect the ultimate location of the investment, as does tax competition for foreign direct investment. It is estimated that at least 103 countries offer special tax concessions to foreign corporations that set up production or administrative facilities within their borders.[121]

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[118] *Ibid.*, para. 8.

[119] See Avi-Yonah, "Fiscal Crisis", *supra* note 91 at 1588: "A production tax haven is a jurisdiction that grants a tax holiday to foreign production facilities located therein, but still levies an income tax on domestic corporations and individual residents. This type of haven differs from the traditional offshore tax haven, which has no corporate income tax (and sometimes no significant tax at all). This distinction is crucial because it means that a foreign investor in a production tax haven can enjoy the benefits of government services which the government finances by taxing relatively immobile factors of production such as labor and land, while the investor itself pays little or no corporate income tax."

[120] Joann M. Weiner and Hugh J. Ault, "The OECD's Report on Harmful Tax Competition" (1998) 51 *National Tax Journal* 601 [Weiner & Ault, "The OECD's Report"] at 602.

[121] Avi-Yonah, "Fiscal Crisis", *supra* note 91 at 1588. Countries considered to be production tax havens include: Argentina, Brazil, China, Hong Kong, India, Indonesia, Ireland, Israel, Malaysia, Philippines, Poland, Puerto Rico, Singapore, South Korea, Taiwan and Thailand.

Focusing solely on geographically mobile activities makes it easy to target the offshore financial services industry, which is made up of small, mainly island, states that carry little political and economic clout internationally and are not members of the OECD. Moreover, in limiting the scope of the 1998 Report to geographically mobile activities, the OECD easily shielded itself from the international backlash that might have resulted had they chosen to include competition for foreign direct investment within the scope of the HTC Initiative as many of those countries hold far greater weight, both economically and politically, on the international scene than the small island states the OECD instead decided to attack.

Other aspects of competition

Tax competition occurs much in the same way as any other form of competition between countries and this point should not be muted simply because the OECD decided it was more workable to deal with only one aspect of competition, taxation, and only one aspect of tax competition at that – capital income taxation. As previously noted, countries compete on labour costs with low wages, as well as environmental laws. In both circumstances, jurisdictions with lax labour and environmental laws are criticized for, among other things, creating an unleveled playing field with regard to business costs because nations that have highly developed labour and environmental laws create increased business and compliance costs, thus making it more expensive to invest and carry on business in such jurisdictions. Yet, the OECD has not embarked on a mission to eradicate the use of cheap wages and lenient environmental laws so as to make competition "fair".

In addition, financial services activities are not the only activities that are sensitive to competition. Business-process outsourcing has emerged as one of globalization's biggest threats to the Western economies.[122] Colloquially referred to as "the global back office", India and China (and other jurisdictions) have emerged as new

[122] Business-process outsourcing ("BPO") is the contracting of a specific business task, such as payroll, to a third-party service provider. Usually, BPO is implemented as a cost-saving measure for tasks that a company requires but does not depend upon to maintain their position in the marketplace. BPO is often divided into two categories: back office outsourcing which includes internal business functions such as billing or purchasing, and front office outsourcing which includes customer-related services such as marketing or tech support.

centres for such activities (and the corresponding jobs) because of the decreased costs to business.[123] In China, an entry-level processor employee is paid $300USD a month which is one-tenth of the comparable American wage.[124] While cheap labour costs are one factor to the booming outsourcing business in India and China, low rental costs and generous tax breaks are also important factors that provide for an overall lower cost of doing business. Coupled with reasonably good infrastructure, an educated workforce both in highly and low skilled labour and strong state support for such international investment, countries such as China and India are competing with the Western economies much in the same way that tax havens and jurisdictions operating preferential tax regimes are competing in the financial services sector. Instead of incurring high labour and rental costs in the US, companies are opting to move their business-process operations to cheaper jurisdictions like India and China.

In the same way, rather than use investment vehicles (often taxable), lawyers and accountants in one of the high tax jurisdictions in the OECD Member States, investors have the option of using one of the jurisdictions operating offshore financial centres that provide not only a more beneficial tax regime, but also cheaper transaction costs with the same level of skill and infrastructure. The financial and other services offered by tax havens and preferential tax regimes provide the full range of support but at a lower cost, just as China and India provide cheaper costs for business processes.

Thus, to attack jurisdictions engaged in competition for financial and other service activities, while ignoring other aspects competition is patently unfair when the OECD claims that competition on the basis of tax incentives creates negative effects on the international economy, specifically the tax bases of its Member States. Do other forms of competition not have negative effects on the economies of the Member States? Clearly, when a taxpayer can move its investment to a jurisdiction with a more hospitable tax system, this creates competition between governments to attract such investment, but much in the same way that a free labour market leads to competition between employers

[123] "Outsourcing in China" *The Economist* (6 May 2006) 69 at 70. Although India was at the helm of such outsourcing, it is now facing competition from China, which can also offer millions of low-cost workers for business-process outsourcing at prices that are cheaper than India, which has seen a rise in salary for graduates, engineers and programmers.

[124] *Ibid.*

to attract employees.[125] The fact that the OECD decided to downplay other aspects of tax competition, and to ignore altogether other aspects of competition among states, does little to advance the OECD's calls for multilateral action. If these other types of competition do not warrant multilateral action, then why is tax competition in respect of the taxation of capital income any different? To suggest that it is unfair when jurisdictions compete in a manner such as designing their tax systems according to their own competitive advantage, while ignoring the fact that countries compete in various other manners all the time, is not credible.

The highly mobile nature of capital income

The OECD would argue that its decision to focus on capital taxation is based on the highly mobile nature of capital investment. The 1998 Report discusses that the increased mobility of capital is, in large part, to blame for what it considers harmful tax competition and justifies the need for multilateral action since any attempts to unilaterally deal with the issue result in the activity being moved to other jurisdictions that are not part of the HTC Initiative.

Although capital is highly mobile, it is not the only mobile factor in the international economy today, as people and manufacturing have also become more mobile than in the past. Immigration laws have been loosened, or completely removed, as is the case within the European Union, which permits the mobility of labourers. Manufacturing businesses are also more mobile than in the past due to changes in technology, which have provided cheaper and faster communications and transportation channels, and also have made it easier for production facilities to be relocated. Thus, while tax havens and jurisdictions with preferential tax regimes are attracting financial and other service activities because of low (or no) tax rates on geographically mobile activity, other countries such as Singapore and Ireland are attracting full-scale investments where offices and plants are built and staffed on account of low corporate tax rates.[126]

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[125] Teather, "Harmful Tax Competition", *supra* note 82 at 59.

[126] "American Ingenuity, Irish Residence", Editorial, *The New York Times* (17 November 2005) which reports how Microsoft trimmed more than United StatesD$500 million from its annual tax bill by setting up an Irish subsidiary to hold its intellectual property assets so that profits from licensing fees from software

In addition, the threat of capital flight due to low levels of taxation on capital income is not new. In 1984, when the United States introduced the portfolio interest exemption, which eliminated its withholding tax of 30 per cent on portfolio interest earned by non-residents, it is estimated that about $300 billion fled from Latin American countries to the United States.[127] Not surprisingly, after the United States unilaterally abolished its withholding tax on interest, many of the other major economies (i.e., the OECD Member States) followed suit and removed their withholding tax on similar payments for fear of losing mobile capital to the United States. Of course, there were no calls at the time by the OECD to halt such harmful tax competition. In fact, the reaction was quite the opposite as the OECD admits to the benefits of such tax competition:

> The more open and competitive environment of the last decades has had many positive effects on tax systems, including the reduction of tax rates and broadening of tax bases which have characterized tax reforms over the last 15 years. In part these developments can be seen as a result of competitive forces which have encouraged countries to make their tax systems more attractive to investors. In addition to lowering overall tax rates, a competitive environment can promote greater efficiency in government expenditure programs.[128]

Against that background, it seems rather hypocritical of the OECD to promote and embrace deregulation of financial markets and trade liberalism, while at the same time attacking only certain jurisdictions that are taking advantage of such changes in the international economy, just as its Member States have in the past.[129] It does not follow that because financial and other service activities are highly mobile and unilateral action

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created and designed in Redmond, Washington are taxed in Ireland, and not the United States. The subsidiary's address is a "Dublin law firm that advertises its smarts in turning Ireland into a tax shelter."

[127] Avi-Yonah, "Fiscal Crisis", *supra* note 91 at 1584-1585 where the author reports that estimates of capital flight from all developing countries to the United States in the 1980s range as high as $148 billion in a single year.

[128] OECD, "The OECD's Project on Harmful Tax Practices: The 2001 Progress Report" (Paris: OECD, 2001) [OECD, "2001 Report"] at para. 1.

[129] "Of course, the OECD argument comes after many of its member states have reached a high level of industrial development precisely because of tax competition in which they lured foreign investment into their countries by tax breaks. In fact, many of them still do. In the United States, for instance, institutions, both banks and non-banks, held more than $1.8 trillion in deposits from foreign persons at the end of 2000. That money is there because the US exempted the holders of those accounts from taxes on their interest income. The US banking system, particularly in Florida and New York, would face collapse if these trillions of dollars were to be withdrawn and taken elsewhere ...", H. E. Sir Ronald Sanders, "The Fight Against Fiscal Colonialism: The OECD and Small Jurisdictions" (2002) Issue 365 *The Round Table: The Commonwealth Journal of International Affairs* 1 [Sanders, "Fiscal Colonialism"] at 13.

risks capital flight, that harmful tax competition necessarily requires coordinated multilateral action through the HTC Initiative.

(iii) Subjective determination of harm

In today's globalized world, and with the proliferation of international organizations, the international community is more frequently called upon to collectively engage in actions to promote universal goods. However, such multilateral efforts typically entail an objective determination that a problem is global, thus necessitating internationally coordinated action. An objective determination in the international arena is usually achieved through a general consensus of a majority of states. In this respect, the HTC Initiative fails as the principles upon which it is founded are neither objective, nor do they consist of a general consensus of international opinion.

In the first place, the OECD does not have consensus within its own organization, evidenced by the abstentions in respect of the 1998 Report of Luxembourg and Switzerland.[130] In its statement to the Council, Luxembourg described the OECD's decision to limit the report to financial activities as "partial and unbalanced", noting that it has taken "an almost unilateral approach with respect to the prescribed measures", and its reliance on the criterion of "reputation" lacks an objective basis.[131] Similarly finding the 1998 Report "partial and unbalanced", Switzerland describes the OECD's approach as "selective and repressive", while finding that its focus on the fact that tax rates are lower in one country than in another "results in unacceptable protection of countries with high levels of taxation."[132]

Consensus within the organization broke down further in 2001 when the United States reevaluated its participation in the HTC Initiative, issuing a statement that discussed some serious concerns about the direction the OECD was taking, specifically referring to the "potentially unfair treatment of some non-OECD countries" because of "the underlying premise that low tax rates are somehow suspect", and clearly denounced

[130] It should be recalled that the Council approved the 1998 Report as a recommendation, therefore it is not legally binding on the Member States. Despite having veto powers, dissenting Member States usually abstain so that they do not prevent other Members from proceeding as desired.

[131] OECD, "1998 Report", *supra* note 1, Annex II, Statement by Luxembourg at 73-75.

[132] *Ibid.,* Statement by Switzerland at 76-78.

any attempts at tax harmonization.[133] In light of such harsh criticism from its own Members, it is unacceptable for the OECD to adopt the posture that the 1998 Report accurately reflects international opinion on the issue of tax competition and therefore requires international attention.

In any event, even if there were consensus within the organization, it would not be sufficient to establish the general consensus of the international community on the issue of harmful tax competition. In fact, it would not be accurate to say that the OECD's opinion represents a worldview on any of the issues it deals with. The OECD is a members only (and by invitation only) club that consists of 30 of the 192 nations in existence, and whose membership is dominated by the most developed nations in the world. The common thread that binds these nations is not universal since admittance into the club is reserved to those countries that accept the principles upon which the organization was built, particularly the belief in a market economy and the expansion of world trade. While the objectives of the OECD may be global in nature (i.e., worldwide trade liberalism), it does not follow that it is a global organization whose opinions and objectives are shared by the international community, either as a whole or by a majority of states. Moreover, although the OECD likes to point out that non-member states were included in the process of concluding the 1998 Report through three separate regional seminars, conveniently none of those states invited to partake in the discussions were subsequently targeted jurisdictions.[134]

The ideas set out in the 1998 Report lack any objective basis; rather, they emphasize the innate subjectivity involved in any attempt to ultimately define "harmful" tax competition. The report explicitly states that while one country may view a tax

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[133] The United States Department of the Treasury, *Treasury Secretary O'Neill Statement on OECD Tax Havens* (10 May 2001) PO-366 online <http://www.ustreas.gov/press/releases/po366.htm> [US Department of the Treasury, "O'Neill Statement"]: "The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments – like businesses – to create efficiencies."

[134] OECD, "1998 Report", *supra* note 1 at para. 14; the list of non-member countries included in the OECD's "extensive outreach programme" include the following countries who participated in three separate regional seminars: Argentina, Bolivia, Brazil, Chile, Colombia, Jamaica, Peru, Venezuela; Albania, Azerbadjian, Estonia, F.Y.R.O.M., Georgia, Latvia, Lithuania, Moldovia, Mongolia, Romania, Slovak Republic, Ukraine; China, India, Indonesia, Malaysia, Philippines, Singapore, Sri Lanka, Chinese Taipei, Thailand.

practice as harmful, another country may not.[135] It is clearly noted that although more attractive tax regimes and tax incentives serve legitimate purposes as government policy instruments to stimulate investment, other countries may see such tax incentives as diverting investment from one country to another. These assertions, made by the OECD itself, reinforce the inherent subjectivity involved in making a determination of harmful tax competition.[136]

However, despite admitting that the question of whether tax policies are harmful involves a subjective determination, the OECD decided to provide key factors to be used to identify jurisdictions engaged in harmful tax practices, as though this could be accomplished in some general manner. These key factors call attention to policies that are designed to deliberately divert investment or serve principally to erode the tax base of other jurisdictions, namely through no or low taxes on capital investment. According to the OECD, based on its own conclusions, such practices are appropriately labeled as harmful because they do not reflect different judgments about the appropriate level of taxes and public outlays or the appropriate mix of taxes in a particular economy, and are tailored to attract investment or savings originating elsewhere or to facilitate the avoidance of other countries' taxes.[137]

Thus, while acknowledging that the determination of harm is in the eye of the harmed, the OECD reaches its own conclusion regarding the tax policy rationale of national governments, suggesting that such behaviour is harmful because its sole purpose is to divert investment income from the jurisdictions of its Member States to the targeted jurisdictions. In this regard the OECD is at least consistent – it seems that it considers tax competition to be harmful when it perceives that it is the interests of its Member States that are being harmed.

An examination of the 1998 Report shows that the OECD's accusations are rather self-serving and hardly capable of providing any objective basis for a determination of harmful tax practices, such that harmful tax competition may be considered a universal good to be pursued by the international community through multilateral efforts. How is it

[135] *Ibid.*, at para. 27.

[136] *Ibid.*

[137] *Ibid.*, at para. 29.

that the OECD is in a position to determine whether tax incentives in foreign jurisdictions are being used as legitimate policy instruments when it did not even invite such jurisdictions to the table to discuss the issue? An international campaign should not be based on a subjective determination of harm. In today's globalized economy, any time a nation decides to create an incentive for a particular industry, it may affect that same industry (and other industries) in other nations. As one commentator succinctly put it, "in some settings tax competition seems likely to be harmful, in others beneficial, and in still others the assessment depends on one's other tax policy views."[138]

In spite of the inherent difficulty involved in objectively defining harmful tax competition, had the OECD taken a more inclusive approach in putting together the 1998 Report by not only consulting with, but actively including, the jurisdictions that were subsequently targeted by the HTC Initiative (and not merely those that would fall outside its scope), then that might have given the 1998 Report more credibility by demonstrating to some extent that it was not a report that was published on the basis of completely biased and self-serving views of the most developed countries in the world. Instead, the OECD unilaterally established its own idea of harmful tax competition with the expectation that the international community would support its initiative.

The absence of international law in support of the OECD's position, the limited scope of the 1998 Report and the subjective determination of "harmful" tax competition reflects a political compromise within its own group that does not warrant the call for multilateral action. The world has changed in certain ways, and some observers would predict that Western economies may in the coming decades ultimately lose a great deal more than just the tax revenues from economic activities within their jurisdictions – they may lose out on having those economic activities located within their jurisdictions in the first place.[139] In this respect, the HTC Initiative may simply reflect the wrong priorities.

[138] Shaviro, "Multi-Jurisdictional Tax Competition", *supra* note 86 at 9.

[139] See Thomas Friedman, *The World is Flat* (New York: Farrar, Straus and Giroux, 2005) where the author discusses how cheap and ever-present telecommunications have eliminated all barriers to international competition. Friedman focuses on technological and social shifts (what he calls "flatteners") that have occurred which have effectively leveled the economic world, "…around the year 2000, all ten of the flatteners … started to converge and work together in ways that created a new, flatter, global playing field" at 175-76.

III. THE OECD'S CONDUCT IN LAUNCHING THE HTC INITIATIVE

In order to fully assess the international legal implications of the OECD's HTC Initiative, consideration must be given not only to the justifications upon which such action is taken, but also the conduct of the OECD in pursuing the initiative. The OECD did not merely announce that it was concerned about or was studying the implications of jurisdictions engaging in harmful tax competition; it also provided a detailed method by which identification of such jurisdictions would occur, recommended measures to combat harmful tax practices, published a list of offending jurisdictions, and demanded commitment of such jurisdictions under the threat of further naming and shaming and coordinated defensive measures. This section of the analysis will consider each of these acts of the OECD.

(a) The 1998 Report

As discussed above, the 1998 Report sets out the principles underlying the OECD's plan to combat harmful tax practices, but it also provides the analytical framework for identifying jurisdictions engaged in harmful tax practices. Although the 1998 Report sets out the criteria for identifying harmful tax practices, it does not identify specific tax regimes that the OECD considers to be harmful. Rather, it provides various factors to be used to identify tax practices that are considered to constitute harmful tax competition.

(i) Tax Havens vs. Preferential Tax Regimes

Before providing the factors used to identify harmful tax practices, the OECD makes an important distinction between tax havens and preferential tax regimes. In the 1998 Report, the OECD concludes that if jurisdictions have "no or nominal income taxes", and "offer themselves as places to be used by non-residents to escape tax in their country of residence", then they are considered to be "tax havens".[140] On the other hand, if jurisdictions have features in their tax system "constituting harmful tax competition",

[140] OECD, "1998 Report", *supra* note 1 at para. 42; see also para. 46.

but otherwise "raise significant revenues" from income tax, then such jurisdictions are considered as offering "preferential tax regimes" but are not deemed tax havens.[141]

The OECD claims that such a division of harmful tax practices is valid because jurisdictions that raise significant revenues through their income tax are more interested in curbing harmful tax competition, whereas tax havens are not likely to cooperate since they do not raise significant revenues and therefore do not share the same concerns of revenue loss and base erosion. In this respect, the OECD asserts that tax haven jurisdictions have "no interest in trying to curb the 'race to the bottom' with respect to income tax" and are "actively contributing to the erosion of income tax revenues in other countries" and thus "unlikely to co-operate in curbing harmful tax competition".[142] Unlike the situation with tax havens, a jurisdiction with a preferential tax regime is considered to have an interest in curbing harmful tax competition because of the significant revenues it otherwise collects, "which are at risk from the spread of harmful tax competition and it is therefore more likely to agree on concerted action."[143]

In establishing this distinction between tax havens and preferential tax regimes, it is submitted that the OECD's line of reasoning is flawed. The OECD has separated harmful tax competition into these two categories as a function of whether a particular jurisdiction raises significant revenues and the underlying intention of its fiscal regime, not as a function of any difference in the particular conduct engaged in or in its harmful effects on other countries. If the OECD is really complaining about the conduct of such jurisdictions, then why has it defined those jurisdictions differently on the basis of whether their fiscal regimes are designed to raise significant revenues or not? The distinction provided by the OECD is not based on a qualitative difference, since the conduct of the jurisdictions is not really any different – in both cases the jurisdictions are engaged in the use of harmful tax practices: why is a preferential tax regime in the United Kingdom any different than one in Barbados?

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[141] *Ibid.*, at para. 42.

[142] *Ibid.*, at para. 43.

[143] *Ibid.*

According to the justifications outlined in the 1998 Report, both jurisdictions have tax regimes that skew international trade and investment flows[144], and both jurisdictions employ tax practices that lead to revenue loss and base erosion in other jurisdictions. The only difference, in keeping with the OECD's rationale, is that one country raises more income taxes (and, presumably, spends more with a big budget). The distinction is simply not logical because the conduct either is appropriate or it is not; it should not make a difference which jurisdiction, one that raises significant revenues through income tax as opposed to one that does not, is engaging in harmful conduct when the effect of engaging in such conduct is purportedly the same.

That the OECD focuses on the characteristics of the tax systems of jurisdictions engaged in harmful tax practices, as opposed to their conduct, is further emphasized by the characterization of preferential tax regimes as "potentially harmful", whereas the effects of tax havens are immediately deemed harmful. An overview of the key factors used to identify harmful tax practices further elucidates this underlying bias. Coincidentally, only non-member states are jurisdictions identified as tax havens, while only the Member States qualify for the designation of jurisdictions with preferential tax regimes, and never as tax havens.

(ii) The Key Factors to Identify Tax Havens and Preferential Tax Regimes

Having divided harmful tax practices into two separate categories, the OECD provides the key factors to be used in detecting jurisdictions that are either tax havens or have harmful preferential tax regimes. Pursuant to the criteria listed in the 1998 Report, a tax haven may be identified as a jurisdiction with no or only nominal taxes, no effective exchange of information, a lack of transparency and the absence of a requirement that

[144] This would depend on the degree to which the tax cost to a non-resident investor exceeds the perceived value to the non-resident of public or other goods and services provided by that jurisdiction. If a non-resident investor perceives that the tax cost of investing in a particular developed country is equal to the value to the non-resident of public or other goods and services provided by that jurisdiction and enjoyed directly or indirectly by the non-resident, then the non-resident should in theory perceive the true tax cost to it of investing in that jurisdiction as being equivalent to the tax cost to it of investing in a developing jurisdiction that neither imposes substantial taxes nor provides substantial public or other goods and services. By extension, it would seem that a preferential tax regime offered by a developed jurisdiction, that otherwise provides substantial public or other goods and services, would be even more attractive to a non-resident investor than an equivalent preferential tax regime offered by a developing jurisdiction that does not provides substantial public or other goods and services. Thus, it would seem that preferential tax regimes might be of greater concern to proponents of a "level playing field" than tax havens.

substantial activities be carried on in the jurisdiction. With respect to preferential tax regimes, the factors provided to assist in determining whether such regimes are harmful include no or low effective tax rates on the relevant income, the regime being "ring fenced", no effective exchange of information, and the operation of the regime being nontransparent.[145]

No or Only Nominal Taxes vs No or Low Effective Tax Rates

According to the 1998 Report, "the necessary starting point" in identifying a tax haven is whether the jurisdiction imposes no or only nominal taxes, either across the board or in specific circumstances.[146] Although the report indicates that a number of factors must be evaluated to confirm the existence of a tax haven, no or nominal taxation is a necessary condition to identify a tax haven. In addition, the report declares that if a jurisdiction "offers itself, or is perceived to offer itself, as a place to be used by non-residents to escape tax in their country of residence", that may be sufficient to identify a tax haven.[147] In the case of preferential tax regimes, the OECD advises that the necessary starting point is no or low effective tax rate but only in respect of the relevant income, geographically mobile activities.[148] Unlike the situation with tax havens, a no or low effective tax rate is not a sufficient condition to identify a preferential regime as harmful and all the relevant factors must be considered.

Despite noting that all the factors must be considered in identifying a tax haven, the OECD submits that it is sufficient to determine whether a jurisdiction is a tax haven on the basis of whether it is perceived as being one. What is the purpose of providing

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[145] With respect to preferential tax regimes, the 1998 Report describes eight additional criteria that may assist the identification of such regimes: (i) an artificial definition of the tax base; (ii) failure to adhere to international transfer pricing principles; (iii) foreign source income exempt from residence country tax; (iv) negotiable tax rate or tax base; (v) existence of secrecy provisions; (vi) access to a wide network of tax treaties; (vii) regimes which are promoted as tax minimization vehicles; (viii) the regime encourages purely tax-driven operations or arrangements. These additional factors are to be considered in conjunction with the four key criteria as they permit a reduction in the tax burden on the relevant income than would otherwise be the case. OECD, "1998 Report", *supra* note 1 at paras. 68 to 79.

[146] *Ibid.*, at para. 52.

[147] *Ibid.*

[148] *Ibid.*, at para. 61. Consideration must be given to whether a zero rate is applied to the regime, or a positive rate is applied but the way in which the tax base is defined has narrowed such that the effective rate is lower than the statutory rate.

"identifying factors" of a jurisdiction if the OECD is just going to rely on a purely subjective "reputation test"?[149] Clearly, the first question that arises is whose subjective perception is being relied upon, both in determining whether a jurisdiction is offering itself as a tax haven, or the view that it is perceived as one? Is it enough that one country perceives a jurisdiction to be a tax haven? Alternatively, should it be enough that one country does not perceive a jurisdiction to be a tax haven?

The OECD itself has admitted that the concept of a tax haven has no precise technical meaning and that it has had difficulties pinning down an objective definition in the past.[150] In 1987, the OECD Committee on Fiscal Affairs emphasized the difficulty of devising an objective definition and the inevitable failure of attempts to do so.[151] In spite of that, the OECD concluded then, as it does now, "that a good indicator that a country is playing the role of a tax haven is where the country or territory offers itself or is generally recognized as a tax haven".[152] The OECD's reliance on a reputation test is highly subjective, which is insufficient when it is attempting to establish international standards to be used to identify harmful tax practices. The emphasis that the OECD is placing on the reputations of jurisdictions confuses the issue since the target of the HTC Initiative is supposed to be the conduct of jurisdictions, alleged to be harmful, not what other countries may think of them.

No Effective Exchange of Information & Lack of Transparency

Other key factors that characterize a tax haven are the lack of transparency in the operation of a jurisdiction's administrative tax practices and the existence of provisions that prevent the effective exchange of information. The OECD considers the failure to effectively exchange information particularly harmful since non-transparent practices and the unwillingness by a tax haven to share information allows investors to avoid their taxes and facilitates illegal activities, such as tax evasion and money laundering.[153]

[149] *Ibid.* at para. 51.

[150] *Ibid.*, at paras. 42 and 51.

[151] OECD, International Tax Avoidance and Evasion, Four Related Studies No.1 (Paris: OECD, 1987) at 22.

[152] OECD, "1998 Report", *supra* note 1 at para. 51.

[153] *Ibid.*, at para. 53.

The 1998 Report cites lack of effective exchange of information and lack of transparency by a jurisdiction operating a preferential tax regime as key factors in determining whether the preferential regime has the potential to cause harmful effects. In this respect, the report focuses on the unwillingness or inability, due to administrative policies, limited access to banking information, or other practices that prevent tax authorities in the residence jurisdiction from obtaining relevant financial information on taxpayers benefiting from the preferential tax regime.[154] The OECD argues that such practices hamper efforts by tax authorities interested in preventing tax evasion and avoidance, while also providing taxpayers leeway in negotiating favorable reductions in the tax burden of certain income that may result in harmful tax competition.

The main problem with the OECD's allegations regarding information matters is the divergent conclusions reached in the 1998 Report depending on whether a jurisdiction is a tax haven or one that operates a preferential tax regime. Concerning tax havens, lack of effective exchange of information and transparency are *particularly* harmful, while the same conduct by jurisdictions with preferential tax regimes may only suggest the *potential* to cause harm. It is submitted that either the conduct of not providing information is harmful, or it is not. Again, the OECD is referring to the whether the jurisdiction raises significant revenues (or not) in ascribing blame and in characterizing harmfulness, rather than the conduct engaged in by those jurisdictions.

The OECD also arrives at different conclusions regarding the harmful effects relating to such practices depending on what type of jurisdiction it is. In respect of tax havens, the conclusions have a much more negative connotation, alleging that such practices "facilitate illegal activities, such as tax evasion and money laundering". However, in the context of preferential tax regimes, the OECD complains of "the inequality of treatment of taxpayers in similar circumstances" and that such practices encourage "corruption and discriminatory treatment", taking issue really with the fact that "such behaviour may give these taxpayers a competitive advantage".

If the OECD contends that the lack of effective exchange of information and transparency are key factors in identifying both tax havens and potentially harmful preferential tax regimes, then why diverge on the conclusions that result from such

[154] *Ibid.*, at paras. 63-64.

behaviour? It does not follow that money laundering and illegal activities only occur in tax havens and not in jurisdictions operating preferential tax regimes; either it occurs as a result of lack of effective exchange of information and nontransparent practices, or it does not. Is the OECD implying that tax evasion and money laundering do not occur in jurisdictions that are transparent in the operation of their tax regimes and effectively exchange information with other jurisdictions? The approach used by the OECD creates a misconception that low tax regimes thrive on tax evasion and other illegal activities, attempting to further demonize jurisdictions that have no or low taxes.

In addition, the OECD appears to be preoccupied with detecting the activities of taxpayers for the purpose of determining their foreign source incomes from the source jurisdiction, which does not directly relate to the conduct of the jurisdictions targeted by the HTC Initiative - it relates to the conduct of taxpayers in the resident jurisdiction.

No Substantial Activities

The 1998 Report lists no substantial activities as the final characteristic to be used to identify a tax haven. The OECD alleges that the absence of a requirement that an activity be substantial suggests that a tax haven is attracting foreign capital investment solely for tax-driven purposes, thus contributing to harmful tax competition. [155] It is further asserted that this may indicate that a jurisdiction has neither the infrastructure (legal or commercial), nor the ability to offer any economic advantages to attract substantial activities in the absence of the tax minimizing opportunities it provides. The suggestion is that tax havens do not encourage genuine economic activities which promotes unfair competition.

The OECD is essentially targeting the use of "paper companies" which are foreign entities that it considers to have no economic function except to permit transactions to flow through them without the requirement of adding value (i.e, the use of financing companies by MNEs). Again, the assumption is that the use of such companies is harmful. However such companies are typically used by MNEs to reduce the amount

[155] *Ibid.*, at para. 55.

of taxes otherwise payable in foreign countries, not in their countries of residence, and not to evade taxes.[156]

Moreover, the determination of when and whether an activity is substantial is difficult in and of itself. At what point does an activity become "substantial"? The OECD itself admits that such a determination is problematic, explicitly noting that in some cases financial and management services involve substantial activities while at the same time noting that they may be found to lack substance.[157] Furthermore, using such a criterion encourages subjective determinations and only adds to the prejudicial treatment of tax havens evident throughout the 1998 Report.

Regime Ring Fencing

Regime ring fencing is the final criterion used in identifying and assessing harmful preferential tax regimes. This factor involves the discriminatory treatment of resident and non-resident investors. A preferential tax regime is ring fenced when the residents of the jurisdiction are prevented from taking advantage of the benefits of the regime or when non-residents, which benefit from the regime, are prevented from accessing the domestic market. The OECD finds such regimes as harmful because the jurisdiction offering the regime is protecting its revenue base by limiting the tax benefits to certain areas or certain investors, which effectively insulates the domestic economy from the harmful effects of the incentive regime. It is asserted that in doing so jurisdictions are engaged in harmful tax practices since the adverse impact of ring fenced regimes will be felt only on foreign tax bases.[158]

The trouble with using ring fencing as a criterion to characterize harmful tax practices is that it is common for jurisdictions to discriminate between residents and non-residents in the application of their tax laws, providing different benefits to each group. In addition, the policy rationale for implementing such regimes is particular to each

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[156] In addition, this charge of the OECD would appear to be somewhat self-serving, in that the targeted activities, involving dealings in highly mobile financial instruments, are by their nature not activities that require very much physical presence in the host jurisdiction and do not distort capital flows. See discussion on page 35.

[157] OECD, "1998 Report", *supra* note 1 at para. 55.

[158] *Ibid.*, at para. 62.

jurisdiction. By not permitting a non-resident investor to operate in the domestic market, a jurisdiction may be protecting domestic industry. Also, in providing benefits to non-resident investors only, a jurisdiction may be attempting to attract further investment that does not require such incentives domestically. In most circumstances, it is much harder for a jurisdiction to attract foreign investors, than domestic investors. Moreover, domestic investors may be benefiting from other aspects of the taxation laws by virtue of being resident in the jurisdiction so that they may not need to benefit from the ring fenced regime.

(iii) 19 Recommendations for Action: Domestic Legislation, Tax Treaties & International Cooperation

Having established these criteria to characterize harmful tax practices, the 1998 Report then outlines the measures to be used to combat harmful tax competition. These measures are revealed in the form of 19 Recommendations that cover three areas: domestic legislation, tax treaties, and international cooperation.

The Recommendations regarding domestic legislation focus on unilateral efforts that the Member States should take to change and strengthen their laws to eliminate preferential tax regimes that are designed to attract investments solely for tax minimization purposes.[159] These recommendations are aimed at shutting down the relocation of geographically mobile activities to Member State jurisdictions that provide tax incentives designed to reduce the tax burden on those activities. Member States are advised to refrain from adopting harmful tax practices and to scale back any tax benefits available through preferential tax regimes.

In the area of tax treaties, the OECD focuses on bilateral efforts that countries can undertake to counteract harmful tax competition. For the most part, these recommendations build on existing bilateral agreements between countries with a focus on limiting the use of treaty benefits so that they do not facilitate the use of harmful tax practices or the improper use of the tax treaties themselves. In order to achieve this

[159] *Ibid.*, at paras. 94 and 97-112.

objective, the OECD recommends the restriction and exclusion of tax treaty benefits for entities and income covered by measures constituting harmful tax competition.[160]

In an effort to curb tax evasion, the OECD advocates greater and more efficient use of exchange of information through tax treaties by intensifying exchange of relevant information concerning transactions in tax havens and harmful preferential tax regimes.[161] Finally, the OECD recommends that Member States terminate any existing tax treaties with tax havens and consider not entering into tax treaties with such countries in the future.[162] Although these recommendations are addressed to the Member States, they also affect non-member states that risk losing tax treaties with Member States if they are identified as tax havens.

The final group of recommendations deal with intensifying international cooperation. The key components of the OECD's plan for a multilateral attack on harmful tax competition involve the adoption of a set of "Guidelines for dealing with harmful preferential tax regimes in Member countries" (the "Guidelines") and the establishment of a "Forum on Harmful Tax Practices" (the "Forum"). The focus of these recommendations is to encourage all countries, whether OECD Member States or not, to work together to curb the spread of harmful tax practices.

The Guidelines provide that Member States should: refrain from adopting new, or extending the scope, of existing, measures; review their existing measures; and remove the harmful features of their preferential tax regimes.[163] The Forum would be responsible for monitoring and implementing the Guidelines and the Recommendations, and to engage in dialogue with non-member states regarding harmful tax practices, though pursuant to the procedures governed by the OECD Convention. More significantly, within one year of its first meeting, the Forum was charged with composing a list of

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[160] An example of this would be that the normally reduced rates of withholding would not apply to situations where harmful tax practices are present. See *ibid.*, Recommendations #9 at 47 and #11 at 49.

[161] *Ibid.*, Recommendation #8 at 46-47.

[162] *Ibid.*, Recommendation #12 at 49-50.

[163] See, *ibid.*, paras. 143-145. The 1998 Report provided for a review period of two years and a removal period of five years, which commenced April 9, 1998, the date on which the OECD Council approved the Report. An additional two years was permitted for removing benefits to taxpayers that were at the time subject to the preferential regime.

countries that meet the tax haven criteria set out in the 1998 Report.[164] These recommendations clearly affect both Member and non-member states, specifically those that will be identified as tax havens or as having preferential tax regimes.

Although the OECD believes that the Recommendations provide a useful starting point for improving international cooperation to counter harmful tax competition, one might argue that the case is quite the opposite.[165] International cooperation may not be as necessary as the OECD claims. The recommendations regarding domestic legislation illustrate that harmful tax competition issues can be addressed at home, which weakens the OECD's claim that multilateral action is necessary.

For example, one of the recommendations urges the Member States that have not already done so to adopt Controlled Foreign Corporation ("CFC") rules and to consider applying their CFC rules to income and entities covered by tax practices considered to constitute harmful tax competition. Generally speaking, CFC rules are designed to tax currently the indirect passive income of residents of the relevant jurisdiction, income that is most likely to be shifted to entities established in low tax jurisdictions. If any particular Member State is concerned about its residents earning indirect passive income (or any other type of income) through such entities, it would of course be open to such Member State to adopt CFC rules that are as broad as it desires, coupled with corresponding penalties for non-disclosure and such.

The difficulty with adopting a common approach to defining what types of income should be caught by such CFC rules lies in the different priorities of the Member States, and the fact that any one of them alone is capable of adopting an effective CFC regime of its own. Canada, for example, does not need the cooperation or consent of the OECD or of any other country in order to implement a very robust CFC regime,[166] that is designed to meet Canada's priorities and interests in the context of outbound cross-border investments by its residents.

The reality is that there are many loopholes available to international investors to avoid paying taxes in the OECD countries, and as one commentator noted: "A very

[164] *Ibid.*, Recommendation #16 at 57.

[165] *Ibid.*, at para. 139.

[166] These rules are referred to as the Foreign Accrual Passive Income ("FAPI") rules.

important point and one that is often misunderstood is that it is *not* the existence of tax havens that tends to lower the world tax rate on capital income, but the tax treatment of incomes earned elsewhere and channeled to the tax havens [emphasis original]."[167]

That the OECD believes the Recommendations are a useful starting point for improving international cooperation is also particularly troublesome when one considers the proposal to create a blacklist of jurisdictions it deems to be tax havens. The purpose of the list is to allow Member States to coordinate their policies toward jurisdictions identified as tax havens. For example, the Member States would use the list to comply with the recommendation regarding the termination of tax treaties with tax haven jurisdictions. It is difficult to accept that the OECD believed that international cooperation would be improved with the unveiling of a blacklist including those same countries it wishes to improve relations with on harmful tax competition issues. Especially when one considers that the tax haven jurisdictions were in no way involved in establishing the basis upon which they would be judged. The OECD never consulted these jurisdictions, nor did they involve them in any discussion prior to the publishing of the 1998 Report. The OECD decidedly took a very offensive approach which inevitably put tax haven jurisdictions on the defensive.

Strictly speaking, the Recommendations and Guidelines included in the 1998 Report, though nonbinding in nature, were intended to be pursued by the OECD Member States. However, non-member states soon found themselves being pressured to comply with the HTC Initiative as the promise to develop a list of tax havens by the Forum was delivered in the 2000 Report, wherein the targeted jurisdictions found themselves faced with the choice of providing commitment letters or risk being labeled "uncooperative tax havens" and the targets of coordinated defensive measures.

(b) The 2000 Report

In the 2000 Report, the OECD lived up to its promise to develop a list of tax havens, identifying 35 jurisdictions that it found met the tax haven criteria outlined in the 1998 Report.[168] The OECD demanded that those jurisdictions identified as tax havens

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[167] Tanzi, "Taxation", *supra* note 76 at 80.

[168] *Ibid.*, at para. 7.

commit to the HTC Initiative and were given one year to provide such commitments. The jurisdictions identified were also advised that if such commitments were not made, then the tax havens would be placed on a list as "uncooperative tax havens" and the OECD Member States on a coordinated basis might take defensive actions against them.[169] In the report the OECD also identified 47 preferential tax regimes as "potentially harmful" in the OECD Member States.[170]

Once again, the OECD displayed its bias with respect to identifying harmful tax practices depending on whether it was dealing with the Member States or non-member states. The 2000 Report identifies the preferential tax regimes in Member States as "potentially harmful", while identifying tax havens as intrinsically harmful, despite the fact that the features of the regimes in both jurisdictions may contribute equally to harmful tax competition. Moreover, the OECD conveniently chose to exclude holding company regimes and similar preferential tax regimes of its Member States "although such regimes may constitute harmful tax competition."[171]

A similar bias is noticed in the manner in which tax havens and potentially harmful preferential tax regimes were identified. Member States were permitted to engage in a self-review of preferential tax regimes in their tax systems, which was followed by a peer review of those flagged in the self-review process. This is in stark contrast to the arbitrary manner used by the OECD in identifying tax haven jurisdictions that the organization itself deemed were engaged in harmful tax competition to the detriment of the Member States without any consultations with the jurisdictions subsequently targeted.

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[169] *Ibid.*, at paras. 18-23.

[170] OECD, "2000 Report" *supra* note 3 at para. 11. For a full listing of those regimes see Appendix III.

[171] *Ibid.*, at para. 12. Holding company regimes are used by MNEs to reduce the overall tax liability of their operations in the same way financing companies are used (see discussion on page 35) except that the parent company uses equity rather than debt to inject funds into its operating company. Rather than the parent company (in a high tax jurisdiction) buying the shares of the operating company directly, it establishes a holding company in a low or no tax jurisdiction which then buys shares of the operating company. The objective is to reduce the withholding tax on dividends paid out by the operating company, therefore the holding company must be placed in a low or no tax jurisdiction with a good underlying treaty network so that the dividends paid out by the operating company are not taxable whether paid, earned or received by a non-resident (i.e, the holding company). If the parent company held the shares directly, then such dividends would likely be taxable at a high rate.

One notable exception to the tax haven list is Hong Kong, which meets all of the OECD's tax haven criteria. Such an omission was perhaps a political move on the part of the OECD, as one observer commentated: "Was Hong Kong's omission an indication that the OECD did not want to offend the Peoples Republic of China?"[172] As well, because of the limited scope of the HTC Initiative the OECD ignores major manufacturing jurisdictions that grant tax holidays to foreign investors that arguably contribute to harmful tax competition, including China, and many other countries.[173]

The blacklisting of jurisdictions through the publication of the list of tax havens is evidence of the OECD's reliance on political and economic coercion as a method to secure international support and cooperation for its HTC Initiative. In the past, the term tax haven was used to describe low tax regimes in a neutral way, however the OECD HTC Initiative has attached a negative connotation to it.[174] As a consequence, this list damages their reputations which could have repercussion on their economies. The countries identified on the list are all small countries with a population of less than half a million who carry little political and economic weight in the international order.[175] Furthermore, the Member States play an important role in the economies of these tax havens since much of the investment in the financial and capital markets of these jurisdictions originates from taxpayers resident in the Member States.

The OECD's demand for commitments, failure to do so carrying the risk of further naming and shaming as "uncooperative tax havens" and coordinated defensive measures, places enormous political and economic pressure on these jurisdictions to comply. These tax haven jurisdictions are faced with the choice of committing to the preordained principles of the HTC Initiative or risk facing coordinated or unilateral defensive measures by some of the most powerful nations in the world that could devastate their economies and the livelihood of their populations.

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[172] Sanders, "Fiscal Colonialism", *supra* note 129 at 5.

[173] Such other countries include: Argentina, India, Israel, Puerto Rico, South Korea and Singapore to name a few. See Avi-Yonah, "Fiscal Crisis", *supra* note 91 at 1589.

[174] Bishnodat Persaud, "The OECD Harmful Tax Competition Policy: A Major Issue for Small States" in Rajiv Biswas, ed., *International Tax Competition: Globalisation and Fiscal Sovereignty* (London: Commonwealth House, 2002) 17 [Persaud, "Major Issue for Small States"] at 18.

[175] *Ibid.* The exceptions are Bahrain, which has just over that, and Liberia, which has less than three million.

Furthermore, the OECD is dictating excessive demands through coercion on a group of small and less powerful states. In the context of exchange of information and transparency, the OECD is simply adding pressure to jurisdictions that are already complying with such matters pursuant to the demands of other institutions. The 2000 Report makes explicit note that "other institutions, such as the FATF and the UN Commission on money laundering, are addressing serious international criminal activities and money laundering in particular."[176]

The FATF, the Financial Action Task Force, was established by the G7 summit held in Paris in 1989, in association with the OECD. The FATF has developed a set of 40 recommendations (originally produced in a report in April 1990) that requires a comprehensive review of laws, regulations and practices to ensure adherence to international best practice including rules for reporting and investigating suspicious activities, the requirement to know beneficial owners of bank accounts and international business corporations, and to share information on criminal matters. In June 2000, the FATF released a money laundering blacklist that names 15 countries as non-cooperative in the fight against money laundering. Interestingly, of the 41 jurisdictions that the OECD has targeted as tax havens, very few are on the FATF's money laundering blacklist.[177] Thus, the demands under the HTC Initiative might be interpreted as excessive and unnecessary in light of initiative by the FATF which the OECD is directly involved with. Arguably it should be enough for the targeted jurisdictions to meet the FATF requirements since the OECD is part of that particular initiative and the proposals of both organizations have the same objectives.

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[176] OECD, "2000 Report", *supra* note 3 at 7.

[177] See Sanders, "Fiscal Colonialism", *supra* 129 at 14, footnote xxii, where the author notes: "In January 2002 Of the twelve Independent Commonwealth Caribbean countries, only four Dominica, St Vincent and The Grenadines, St Kitts-Nevis and Grenada were still on the FATF black list as "non co-operative" jurisdictions is relation to money laundering. The Bahamas was taken off in September 2001. None of the non-independent Caribbean territories were on the list; the Cayman Islands which was originally on the list was also taken off in September 2001." See also Howard J. Kellough, "World Tax Hegemony: The Thrust for a World Tax System" in *Report of Proceedings of Fifty-Third Tax Conference, 2001 Tax Conference* (Toronto: Canadian Tax Foundation, 2002) 7:1 at 19, footnote 48, where the author lists the following repeat offenders: Cook Islands, Dominica, Israel, Lebanon, the Martial Islands, Niue, St. Kitts-Nevis, and St. Vincent and the Grenadines.

(c) Modifications to the HTC Initiative – the 2001 Report

Following the publication of the OECD's blacklist identifying tax haven jurisdictions, many of the affected jurisdictions began to voice their opposition to the HTC Initiative and requested that various elements of the 1998 Report be reexamined in consultation with the jurisdictions targeted.[178] However, most of the pressure came from the United States which had reservations about the OECD policy, specifically the issue of sovereignty over tax rates, the erosion of bank secrecy and ring fencing. Comments made by the United States Secretary of the Treasury Paul O'Neill made clear that any international initiatives should focus on the core objective of exchange of information and that it did not support efforts to dictate what the tax rates and systems of other countries should be.[179]

Following discussions between the jurisdictions identified as tax havens and strong lobbying from the United States, the OECD's modified HTC Initiative was published in *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* issued in November 2001.[180] As a result of the lack of international support, the HTC Initiative has been scaled back since the 1998 Report and now matters focus squarely on exchange of information and transparency. The OECD removed the application of the no substantial activities criterion in determining whether a jurisdiction was uncooperative.[181] In light of this, the OECD declared that commitments being sought from tax havens to

[178] In January 2001, the OECD and the Commonwealth countries met in Barbados for a consultation that established a 13 member Working Group on Global Cooperation against Harmful Tax Practices. The group is comprised of six OECD Member States and seven developing countries, six of which were offshore financial centres. Meetings of the Joint Working Group took place in London in January 2001 and in Paris in March 2001. A conference for the Pacific Region was convened in Japan in February 2001. In April 2001, a joint OECD-Pacific Islands Forum meeting was held in Fiji. See, OECD, "2001 Report", *supra* note 128 at paras. 19 and 20 .

[179] US Department of the Treasury, "O'Neill Statement", *supra* note 133: "The work of this particular OECD initiative, however, must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities."

[180] OECD, "2001 Report", *supra* note 128. It should be noted that Belgium and Portugal, in addition to Luxembourg and Switzerland, abstained from the 2001 Report.

[181] *Ibid.*, at para 24. See also Sanders, "Fiscal Colonialism", *supra* note 129 at 21: "It was well known by this time that the new United States government had insisted on the removal of this criterion as a condition of continued support for the harmful tax competition initiative, no doubt to protect the activities of places, such as Delaware and Montana, which were well known centres for registering companies with no substantial activities in those States and which enjoyed a "ring-fenced" regime."

ensure that they were not included on the list of uncooperative jurisdictions would now be accepted only in respect of the effective exchange of information and transparency criteria.[182]

In effect, the OECD has altered the HTC Initiative to the point where tax competition in geographically mobile financial and service activities is permitted provided there is adequate exchange of information, despite being contributing to harmful tax competition. So, the activities that were once portrayed as "harmful" and worthy of multilateral coordinated defensive measures are now substantively permitted, provided that procedural disclosure criteria are satisfied.[183] It is important to note that while the HTC Initiative now focuses on principles of transparency and effective exchange of information, the OECD never made an argument for improved information sharing as an independent good as it is now trying to do. In an effort to save the HTC Initiative from complete failure, the OECD is focusing on information matters but this issue was only one part of the larger issue of harmful tax competition. The OECD did not promote improved transparency and exchange of information as important independent values in and of themselves; these matters formed one aspect of its crusade against harmful tax competition as a whole. However, rather than admit defeat it appears that the OECD is attempting push through its agenda in a disguised manner.

[182] OECD, "2001 Report", *supra* note 128 at para. 28. In addition, the one year deadline imposed by the 2000 Report for tax havens to provide such commitments was postponed to February 28, 2002.

[183] The 2001 Report also addressed the issue of the timing of the potential application of a framework of coordinated defensive measures against the tax havens and Member States with potentially harmful preferential tax regimes. The concern was that defensive measures would be applied to tax havens before the Member States with harmful preferential regimes. Although the 1998 Report indicated the potential use of such measures it did not specify a time frame. However, in the 2000 Report, the OECD stated that coordinated defensive measures against tax havens would not be implemented prior to July 31, 2001. The OECD acknowledged that the lack of symmetry in the timing of the application of the defensive measures raised concerns regarding a level playing field between Member States and tax havens. Thus, it was decided that defensive measures would not apply to uncooperative tax havens any earlier than they would apply to OECD Member States. The OECD did however note that each Member state "… retains the sovereign right to apply or not apply any defensive measures as appropriate, either within or outside a framework of coordinated defensive measures." See OECD, "2001 Report", *supra* note 128 at para. 32.

PART THREE THE INTERNATIONAL LEGAL IMPLICATIONS OF THE HTC INITIATIVE

Having thus examined the HTC Initiative, what can be said of the OECD's conduct in issuing the recommendations outlined in the 1998 Report and the publication of the 2000 blacklist of tax havens with the accompanying demands to commit to their project and threats of further naming and shaming and coordinated defensive measures for failure to do so? In other words, is the OECD justified in launching the HTC Initiative under public international law? This question may be answered by reference to the international obligations, if any, owed to the OECD or the Member States by the targeted jurisdictions pursuant to international law.

It has already been determined that in the context of international taxation there are no international laws that govern the conduct of nations. Although the OECD speaks of "internationally accepted standards", there are no international tax standards universally agreed upon by the subjects of public international law that could arguably justify the HTC Initiative. Moreover, while international responsibility involves the consideration of principles that exist outside the scope of taxation matters, which involve general obligations of international actors under international law, there are no such obligations that were violated by the targeted jurisdictions by engaging in harmful tax practices as described in the 1998 Report.

The OECD did not even provide any evidence of actual harm resulting from "harmful" tax competition. Therefore, it cannot be said that the targeted jurisdictions have violated any international principle such that the OECD is justified in taking action against them through the HTC Initiative. Since the targeted jurisdictions have not violated any international legal obligations owed to the OECD or the Member States, the issue that arises is what, if any, are the international legal implications of the HTC Initiative? This section will consider the HTC Initiative in the context of general principles of international law.

I. INTERNATIONAL RESPONSIBILITY OF INTERNATIONAL ACTORS

The determination of the international legal implications of the OECD's conduct through the HTC Initiative involves the consideration of international responsibility. At the outset of this paper it was concluded that the OECD is an international actor that possesses separate legal personality and is responsible for its own acts. Where an international organization commits an internationally wrongful act this entails the international responsibility of the organization.[184] However, this does not resolve the issue of whether the Member States themselves can be held responsible on a primary or secondary basis for the OECD's conduct through the HTC Initiative if it were found that such conduct constituted an internationally wrongful act. Thus, a preliminary issue that arises is whether the conduct of the OECD can be attributed to the Member States.

The general rule on the responsibility of states is derived from the decision of the Permanent Court of International Justice in *Phosphates in Morocco*, where it was found that once a state acted wrongfully against another on the international plane, then international responsibility would be established immediately as between the two states.[185] This principle has been codified in Article 1 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts (the "ILC's Articles on State Responsibility"), which provides: "Every internationally wrongful act of a State entails the international responsibility of that State".[186] However, Article 57 of the ILC's Articles on State Responsibility provides that any questions involving the responsibility of international organizations or the responsibility of states for the conduct of an international organization are not considered.[187] Nonetheless, the responsibility of a state for its own conduct is not excluded from the scope of the ILC's Articles on State Responsibility.[188]

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[184] Giorgio Gaja, Special Rapporteur, *First Report on Responsibility of International Organizations*, A/CN.4/532, International Law Commission 55th Session 2003, at para. 35. The International Law Commission has suggested the following text for draft articles on the responsibility of international organizations: "Article 3 General principles 1. Every internationally wrongful act of an international organization entails the international responsibility of the international organization." See para.39.

[185] Sienho Yee, "The Responsibility of States Members of an International Organization for its Conduct as a Result of Membership or their Normal Conduct Associated with Membership" in Maurizio Ragazzi, ed., *International Responsibility Today: essays in memory of Oscar Schachter* (The Netherlands: Koninklijke Brill NV, 2005) 435 [Yee, "Responsibility of States"] at 436-37.

[186] *Report of the International Law Commission on the work of its fifty-third session*, Gen. Ass. Recs. Fifty-sixth Session, Supp. No. 10, U.N. Doc. A/56/10 [ILC, "Articles on State Responsibility"].

[187] Article 57 reads: "These articles are without prejudice to any question of the responsibility under international law of an international organization, or of any State for the conduct of an international organization."

[188] See *Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries* adopted by the International Law Commission, Fifty-third Session (2001) II *YILC* Part ii 59 [ILC, "Commentary"] at pp 361-363. See also Yee, "Responsibility of States", *supra* note 185 at 437 "While

Where an international organization makes a decision that does not bind a member state, in that it may have an express right to opt-out of, or make reservations to, the application of a specific decision to it, then it is not the act of the organization as such that binds the state. Rather, it is the state's subsequent acceptance of the decision at the international level that confers binding force on the organization's decision, which amounts to the state's own conduct.[189] Therefore, in such cases a state may be held responsible for an internationally wrongful act of an international organization that flows from the state's own acts or omissions and not from its relationship with the organization.[190] Pursuant to Article 1 of the ILC's Articles on State Responsibility, if a state chooses to participate in, or implement domestically, an internationally wrongful act committed by an international organization, then primary responsibility of a state may be found for its own commission of an internationally wrongful act.[191]

Another situation in which the primary responsibility of a state may be engaged is where a state aids or assists the organization in the commission of an internationally wrongful act.[192] In this circumstance, the responsibility flows from the application of Article 16 of the ILC's Articles on State Responsibility, which provides for such

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Article 57 would, by fiat of the Commission, exclude the responsibility of States for acts of an international organization from the scope of application of the Draft Articles, the general rule codified in Article 1 would seem to have application outside the sphere where the Commission reigns, and would lead to the conclusion that States may be responsible for the acts of international organizations if the normal conditions for the application of this general rule are met."

[189] Dan Sarooshi, *International Organizations and Their Exercise of Sovereign Powers* (Oxford: Oxford University Press, 2005) [Sarooshi, "International Organizations"] at 59-60. The author assesses the responsibility of states for internationally wrongful acts of international organizations in three different contexts that depend on the characterization of the conferral by states of powers on international organizations. The author considers three different types of conferrals of powers: agency relationships, delegations and transfers. In the case of the OECD, the powers conferred to the organization by the Member States would fall into the category of delegations because such powers are revocable under the instrument of conferral at the discretion of the Member States (e.g., Article 17 of the Convention permits the unilateral withdrawal from the OECD) and the fact that none of the OECD's decisions are in and of themselves binding (e.g., While Article 5 of the Convention permits the organization to take decisions that are binding on the Member States, Article 6 allows for Member States to abstain from a decision in which case the decision is not applicable to the abstaining state). See generally pp 54-64. Note that in all three categories of conferrals of powers the responsibility of a state for an internationally wrongful act of an international organization is found to exist on the basis of the ILC's Articles on State Responsibility and general principles of international law.

[190] *Ibid.*, at 63.

[191] *Ibid.*

[192] *Ibid.*

responsibility if the following conditions are met: first, that the state does so with knowledge of the circumstances of the internationally wrongful act; and second, that the act would be internationally wrongful if committed by that state.[193] Since the decision of the organization is non-binding, any aid or assistance given by a state is voluntary which falls within the scope of Article 16.[194]

Also, secondary responsibility arguably arises where "states actively pursue or support within the international organization the decision that causes the commission of the internationally wrongful act."[195] The determination of secondary responsibility, equally applicable to the issue of primary responsibility, rests on the notion that states cannot escape international responsibility for their own acts by hiding behind essentially non-binding decisions of an organization. Moreover, such a rule is needed to ensure the integrity of the international system: "It is illogical to suppose that a group of States can manufacture immunity from responsibility toward third States by the creation of an international legal personality."[196]

In the absence of such responsibility, states would be able to avoid their obligations under international law by creating international organizations with various powers and then denying responsibility for the way in which those powers are exercised.[197] Fundamentally, states cannot evade international responsibility for their own conduct, whether it is exercised directly or indirectly through an international organization to which they belong.

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193 ILC, ""'Articles on State Responsibility", *supra* note 186: "A State which aids or assists another State in the commission of an internationally wrongful act by the latter is internationally responsible for doing so if: (a) That State does so with knowledge of the circumstances of the internationally wrongful act; and (b) The act would be internationally wrongful if committed by that State."

194 See ILC, "Commentary", *supra* note 188 at 155.

195 Sarooshi, "International Organizations", *supra* note 189 at 64. See specifically footnote 46 where the author cites support for this type of approach in the United States Supreme Court decision in *First National City Bank v Banco Para El Comercio Exterior De Cuba*, which found that governments cannot "avoid the requirements of international law simply by creating juridical entities whenever the need arises."

196 Ian Brownlie, "The Responsibility of States for the Acts of International Organizations" in Maurizio Ragazzi, ed., *International Responsibility Today: essays in memory of Oscar Schachter* (The Netherlands: Koninklijke Brill NV, 2005) 355 [Brownlie, "Responsibility of States"] at 362.

197 Sarooshi, "International Organizations", *supra* note 189 at 64.

II. INTERNATIONALLY WRONGFUL ACTS

Since every internationally wrongful act of an international actor entails the international responsibility of that actor, it must be determined whether the conduct of the OECD and the Member States amount to an internationally wrongful act.[198] An internationally wrongful act of an international actor is defined as conduct consisting of an action or omission that is attributable to the international person under international law, and which constitutes a breach of an international obligation of the international actor.[199]

In the context of the HTC Initiative, the particular conduct that will be examined includes the following:

> (i) the publication of the 1998 Report which sets out the key factors to be used to identify tax haven jurisdictions and provides recommendations targeted against such jurisdictions;
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> (ii) the publication of the 2000 Report which blacklists 35 jurisdictions as tax havens and threatens further naming and shaming of tax havens as "uncooperative" if such jurisdictions do not commit to the HTC Initiative; and
>
> (iii) the threat of coordinated defensive measures by the Member States against those jurisdictions that do not comply with the HTC Initiative.[200]

The acts listed above as items (i) and (ii) essentially amount to the use of political and economic coercion by the OECD and the Member States in an attempt to force the targeted jurisdictions to comply with principles of the HTC Initiative. Such actions against the targeted jurisdictions may constitute interference in the sovereign right of

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[198] "International actor" is used to describe both the OECD and the Member States since the conduct of the OECD through the HTC Initiative may engage the international responsibility of both.

[199] ILC, "Articles on State Responsibility", *supra* note 186 at Article 2 of the ILC's Articles on State Responsibility. I have replaced the term "State" with "international actor. The ILC has suggested the same definition for the draft articles on the responsibility of international organizations.

[200] The conduct of the OECD in relation to the Member States, i.e., the publication of criteria identifying preferential tax regimes, the publication of a list of potentially harmful preferential tax regimes and the threat of coordinated defensive measures against those jurisdictions, will not be considered as they do not raise issues of international responsibility since they are actions against their own members who are party to the Convention pursuant to which the OECD is permitted to make such recommendations. The issue of international responsibility arises as against non-member states since the HTC Initiative is an imposition of obligations on third parties who are not party to the Convention and consequently do not fall within the scope of permitted OECD actions. Therefore any actions taken against them occur on the international plane, which may entail the international responsibility of the OECD and the Member States.

nations to determine their own tax regimes, which is prohibited by the duty not to intervene. Accordingly, these acts will be considered together.

The last act, the threat of defensive measures, will be considered separately, as this involves a consideration of the use of countermeasures pursuant to international law. Although the OECD has stated that the individual Member States would be responsible for implementing the defensive measures, this does not necessarily absolve the OECD of any international responsibility that might arise.[201] Just as a state may find itself responsible for the unlawful conduct of an international organization, the same may also be true in the reciprocal case of an international organization being responsible in relation to the unlawful conduct of a state.

As in the case of state responsibility, an international organization which aids or assists a state in the commission of an internationally wrongful act by the state is internationally responsible for doing so if that organization does so with knowledge of the circumstances of the internationally wrongful act and the act would be internationally wrongful if committed by that organization.[202] Thus, while the OECD itself does not have the power to impose defensive measures, it will provide the framework for the coordinated defensive measures and therefore could be considered as aiding and assisting the Member States if such conduct constitutes internationally wrongful acts.

(a) Political and Economic Coercion & the Imposition of Obligations on Non-Member States

Through the publication of the 1998 Report, the OECD initiated a process for determining which jurisdictions were to be characterized as tax havens and issued recommendations regarding measures to be taken through, *inter alia*, bilateral tax treaties against such jurisdictions. It may be recalled that these recommendations included the

[201] "Whether or not to impose defensive measures is a matter within the individual sovereignty of each country. The OECD is merely a forum in which member countries can share experience and, if they think it appropriate, seek the co-operation of other OECD countries. The OECD itself has no power to impose defensive measures." See OECD, *The OECD's Project On Harmful Tax Practices: A Briefing Note for Journalists* (Paris: OECD, 2004).

[202] See Giorgio Gaja, Special Rapporteur, *Third Report on Responsibility of International Organizations,* A/CN.4/553, International Law Commission 57th Session 2005 suggested Article 12 at para .44. The suggested text mirrors Article 16 of the ILC's Articles on State Responsibility.

following: the restriction and exclusion of tax treaty benefits to entities and income covered by measures constituting harmful tax competition; the termination of existing tax treaties with tax havens; and the consideration of not entering into tax treaties with such jurisdictions in the future. In the 2000 Report, the OECD published a blacklist of tax havens and threatened further naming and shaming of those jurisdictions as "uncooperative tax havens" if they did not make public political commitments to join the HTC Initiative. These actions of the OECD have been construed as violating the absolute sovereignty of nations over their domestic affairs. In particular, it has been suggested that such an intrusion into the domestic jurisdiction of sovereign states contravenes the duty of non-intervention, a principal corollary of the sovereignty and equality of states.[203]

State sovereignty is the fundamental principle upon which the international legal system has been built. Classical definitions of sovereignty involve three characteristics: (1) the state's exclusive jurisdiction over its territory and citizens; (2) a duty of non-intervention in the area of exclusive jurisdiction of other states; and (3) the state's supreme authority to guide its internal and external affairs without foreign interference.[204]

While the notion of absolute sovereignty is increasingly at odds with the realities of the international arena,[205] limitations upon the sovereignty of states cannot be presumed. As noted, a consequence of the independence and equality of states is the duty of states to refrain from intervening in the internal or external affairs of other states; a duty that binds international organizations as well.[206] This duty is particularly pronounced with respect to matters in the reserved domain of domestic jurisdiction, that is, the area of state activities where the jurisdiction of the state is not bound by

[203] Persaud, "Major Issue for Small States", *supra* note 174 at 25. See also, Simmons, "Legal Issues of the OECD Reports", *supra* note 4.

[204] Persaud, *ibid.* See also Magdalena Martin Martinez, *National Sovereignty and International Organizations* (The Hague and Boston: Kluwer Law International, 1996) at 64; and Daniel Philpott, "Ideas and the Evolution of Sovereignty" in Sohail H. Hashmi, ed., *State Sovereignty: Change and Persistence in International Relations* (Pennsylvania: The Pennsylvania State University Press, 1997) at 15.

[205] In *Corfu Channel (U.K. v. Albania)* [1949] I.C.J. Reports 39 at 43, the Court stated: "We can no longer regard sovereignty as an absolute and individual right of every State, as used to be done under the old law founded on the individualist regime, according to which, States were only bound by the rules they had accepted." See also Mary C. Tsai, "Globalization and Conditionality: Two Sides of the Sovereignty Coin" (2000) 31 *Law and Policy in International Business* 1317 [Tsai, "Globalization and Conditionality"] at 1318 where the author discusses recent developments in international law that support the notion that sovereignty is no longer absolute.

[206] Brownlie, "Public International Law", *supra* note 10 at 290.

international law.[207] Therefore, although sovereignty may no longer be considered absolute, there is a presumption against restrictions on the domestic jurisdiction of states.

Due to the significance of such unfettered jurisdiction, the customary rule of nonintervention has been expressly provided for in international conventions. The *Convention on the Rights and Duties of States*,[208] provides that "...the State has the right to ... organize itself as it sees fit, to legislate upon its interests, [and to] administer its services..."[209] and more explicitly that "[n]o state has the right to intervene in the internal or external affairs of another."[210] The *Charter of the UN* similarly espouses the duty of nonintervention, emphasizing that "[n]othing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matters to settlement under the present Charter."[211]

Taxation is a matter that falls within the reserved domain of domestic jurisdiction. In fact, the power to tax has traditionally been regarded as an exercise of sovereign power.[212] Any income connected with a source or person within the territory of a state may be subject to tax in that territory.[213] While jurisdiction is not based on the principle of exclusiveness, taxation is not a subject matter that permits restrictions in the area of

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[207] *Ibid.*, at 291: "...if a matter is prima facie within the reserved domain because of its nature and the issue presented in the normal case, then certain presumptions against any restriction on that domain may be created."

[208] Also known as the *Montevideo Convention*, 26 December 1933, 49 Stat. 3097, 165 L.N.T.S. 19. (entered into force 26 December 1934). Online at http://www.yale.edu/lawweb/avalon/intdip/interam/intam03.htm (The Avalon Project, 1998).

[209] *Ibid.*, Article 3.

[210] *Ibid.*, Article 8

[211] (New York: UN, 1945) at Article 2(7).

[212] Dale Pinto, "Governance in a Globalised World: Is it the End of the Nation State?" in Rajiv Biswas, ed., *International Tax Competition: Globalisation and Fiscal Sovereignty* (London: the Commonwealth Secretariat, 2002) 66 [Pinto, "End of the Nation State"] at 78.

[213] The jurisdiction to tax is asserted by states on the basis of source, residence and citizenship. Source, residence and citizenship taxation provide the framework within which each country legislates its domestic rules of the taxation of international income. Citizenship taxation is unique to the United States. See Nancy H. Kaufman, "Fairness and the Taxation of International Income" (1998) 29 *Law and Policy in International Business* 145 at 146-156.

domestic jurisdiction.[214] Also, the extra-territorial application of the jurisdiction to tax has never been accepted by states.[215] In *Government of India v. Taylor*, the House of Lords considered the enforcement of the taxation laws of one country by another country as an extension of the sovereign power that imposes the taxes.[216] It was held that such an assertion of sovereign authority by one state within the territory of another would be contrary to all concepts of independent sovereignties.

It is in this context that the HTC Initiative is perceived as violating the sovereignty of the exclusive jurisdiction to tax of the targeted jurisdictions. The publication of the 1998 Report is tantamount to the extra-territorial application of taxation laws by the OECD and its Member States on the targeted jurisdictions. The OECD has unilaterally composed a set of taxation principles that it demands the targeted jurisdictions accept by implementing the necessary changes in their domestic laws. These changes involve removing the features of their tax systems that the OECD has identified as "harmful". The Recommendations creating the Forum to establish a blacklist and directing Member States to terminate tax treaties and not consider entering into such treaties with jurisdictions deemed to be tax havens is regarded by some as a blatant interference in the fiscal affairs of the targeted jurisdictions.

Clearly, neither the OECD, nor the Member States have any lawful authority to impose such obligations on the targeted jurisdictions, as tax policy is a matter that falls within the exclusive sovereign authority of those jurisdictions. These demands, coupled with the subsequent publication of the list of tax havens and threat of further blacklisting if their cooperation is not secured, would seem to amount to the use of political and economic coercion by the OECD and the Member States that voted in favour of the HTC

[214] For example, crimes against international law, such as war crimes and genocide, permit restrictions against the reserved domain of domestic jurisdiction. See Brownlie, "Public International Law", *supra* note 10 at 297-318 on Jurisdictional Competence.

[215] See Brownlie, *ibid.*, at 306-308 on Extra-territorial Enforcement Measures: "The governing principle is that a state cannot take measures on the territory of another state by way of enforcement of national laws without the consent of the latter."

[216] *Supra* note 106 at 511. Unless countries agree by treaty such an extension of sovereign power is impermissible.

Initiative.[217] Therefore, the issue that arises is whether the use of political and economic coercion violates international law.

Political and economic coercion are means employed by states to influence each other's policies.[218] The use of such coercive diplomacy, i.e., disguised threats, is prevalent throughout international relations but its legitimacy, or otherwise, is still under debate. At present, there does not appear to be any international consensus as to the existence of a general limitation on the right of a state to use economic and political pressure as an instrument of state policy.[219] However, support for the proposition that political and economic coercion can be a violation of international law is found in the general international law principle of non-intervention.

It is argued that customary international law prohibits intervention in the form of forcible interference and therefore it is unclear whether nonforcible measures, such as political and economic coercion, fall within the meaning of the nonintervention norm.[220] While the rule of nonintervention had its origins in the practice of states, its inclusion in international conventions arguably expanded the scope of nonintervention to include nonforcible measures. For instance, the *Charter of the Organization of American States* provides as follows:

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[217] It should be recalled that Luxembourg and Switzerland abstained from the 1998 Report and the 2000 Report.

[218] Tom J. Farer, "Political and Economic Coercion in Contemporary International Law" (1985) 79 *The American Journal of International Law* 405 [Farer, "Political and Economic Coercion] at 405.

[219] William Gilmore, "The OECD, Harmful Tax Competition and Tax Havens: Towards an Understanding of the International Legal Context" in Rajiv Biswas, ed., *International Tax Competition: Globalisation and Fiscal Sovereignty* (London: the Commonwealth Secretariat, 2002) 289 [Gilmore, "International Legal Context"] at 312-313. It is argued that customary international law prohibits intervention in the form of forcible interference; therefore it is unclear whether nonforcible measures, such as political and economic coercion, fall within the meaning of the nonintervention norm. See also Farer, *ibid.*, at 406-411 where the author asserts that the use of coercive diplomacy has always been common state practice and its legitimacy has rarely (if ever) been questioned. But see also Sarah H. Cleveland, "Norm Internationalization and U.S. Economic Sanctions" (2000) 26 *Yale Journal of International Law* 1 [Cleveland, "Norm Internationalization" at 7 where the author states that "economic sanctions must also be consistent with broader principles of the international community, such as principles of international jurisdictions, nonintervention, and free trade…".

[220] Cleveland, *ibid.*, at 53. "Forcible" and "nonforcible" measures are terms of art: "forcible" measures generally refer to the use of armed forced, while "nonforcible" measures generally refer to economic sanctions (e.g., trade restrictions, blockades and embargoes) and the curtailing of diplomatic relations. However, it should be noted that there is no international consensus on whether these categories are precise; some academics consider forcible measures to include economic measures or political pressure.

Article 19
No State or group of States has the right to intervene, directly or indirectly, for any reason whatever, in the internal or external affairs of any other State. The foregoing principle prohibits not only armed force but also any other form of interference or attempted threat against the personality of the State or against its political, economic, and cultural elements.

Article 20
No state may use or encourage the use of coercive measures of an economic or political character in order to force the sovereign will of another State and obtain from it advantages or any kind. [221]

The UN has also recognized the legal significance of this principle as it has found expression in the *Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in accordance with the Charter of the United Nations*, which states:

> No State or group of States has the right to intervene, directly or indirectly, for any reason whatever, in the internal or external affairs of any other State. Consequently, armed intervention and all other forms of interference or attempted threats against the personality of the State or against its political, economic and cultural elements, are in violation of international law.
>
> No State may use or encourage the use of economic, political or any other type of measures to coerce another State in order to obtain from it the subordination of the exercise of its sovereign rights and to secure form it advantages of any kind.
>
> ... Every State has an inalienable right to choose its political, economic, social and cultural systems, without interference in any form by any other States.[222]

In the *Case Concerning Military and Paramilitary Activities in and Against Nicaragua* (the "Nicaragua Case"), the Court affirmed the principle of nonintervention and elucidated the content of the principle, specifically the importance of the notion of coercion. In this respect, the Court stated that:

> A prohibited intervention must accordingly be one bearing on matters in which each State is permitted, by the principle of State sovereignty, to decide freely. One of these is the choice of political, economic, social and cultural system, and the formulation of foreign policy. Intervention is wrongful when it uses methods of coercion in regard to such choices, which must remain free ones. The element of coercion, which defines, and indeed forms the very essence of, prohibited intervention, is particularly obvious in the case of an intervention which uses

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[221]Signed in Bogota, 1948, (Washington D. C.: Organization of American States, 1997) online http://www.oas.org/juridico/English/charter.html>.

[222] UN GA Res. 2625 (XXV), 25th Sess., (24 October 1970).

> force, either in the direct form of military action, or in the indirect form of support for the subversive or terrorist armed activities within another State. [223]

Still, the Court was cautious about establishing a general definition of the principle of nonintervention, "primarily because of the difficulty of striking a balance between permissible and impermissible intervention in an interdependent world."[224] This explains the lack of international consensus, among states and academics alike, as to use of nonforcible measures, specifically coercive economic measures. In the *Nicaragua Case* the Court had to consider a pleading by Nicaragua that there had been a violation of the principle of nonintervention due to certain economic measures taken against it by the United States. The Court held that the facts particular to that case did not constitute a violation of the principle.[225] For this reason, some commentators have concluded that customary international law does not prohibit economic coercion. Others have found that the conclusion of the Court does not have that absolute a character, and that "it simply held that the above facts did not constitute a violation of the principle."[226]

Although the debate will undoubtedly continue, the better view, to this commentator at least, is that economic and political measures could well be considered to amount to impermissible intervention in certain cases. Indeed, that the Court considered the application of the principle of nonintervention at all in the context of nonforcible measures, in this case economic force, indicates that the Court acknowledged that such a principle does exist and might be applied in some cases.[227] Also, the Court stated that prohibited intervention was particularly obvious when forcible measures are used, which does not preclude a finding that nonforcible measures might constitute prohibited intervention. What remains to be determined, however, is whether the OECD's conduct in this particular case would be regarded as impermissible intervention.

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[223] [1986] I.C.J. Rep. 14. On affirming the principle of nonintervention as a rule of customary law see para. 202.

[224] R. St. J. Macdonald, "The Nicaragua Case: New Answers to Old Questions?"(1986) *Canadian Yearbook of International Law* 127 [Macdonald, "The Nicaragua Case"] at 137.

[225] *Nicaragua Case, supra* note 223 at paras. 244-245.

[226] Macdonald, "The Nicaragua Case", *supra* note 224 at 138. See also Gilmore, "International Legal Context", *supra* note 219 at 315-316.

[227] Macdonald, "The Nicaragua Case", *supra* note 224 at 138.

On the basis of the foregoing, it is submitted that the consequences at international law of the HTC Initiative would involve a violation of the duty of nonintervention in the domestic affairs of the targeted jurisdictions by the OECD and the Member States. The HTC Initiative deals with matters of taxation, which fall within a domain that is under the exclusive jurisdiction of the state, and thus may breach the principle of nonintervention. The blacklisting and fear of further naming and shaming are clear threats against the personality of the targeted jurisdictions, as well as against the political and economic elements of the targeted jurisdictions. It is submitted that these actions are in violation of international law, as reflected by the UN General Assembly Resolution discussed above and reaffirmed by the Court in the ` *Case.* The Court held that prohibited intervention is that which interferes on matters which each state has the sovereignty to decide freely, which clearly includes the choice of taxation policy. The HTC Initiative attempts to restrict the ability of the targeted jurisdictions to decide for themselves the type of taxation regime to establish within their jurisdictions, which would appear to be in violation of their sovereign rights and the general principle of nonintervention.

It is important to note that the Member States are themselves free to exercise their sovereign right to establish taxation policies, such as having blacklists, which many Member States have, as well as deciding whether to enter into tax treaties with particular jurisdictions, or abolish existing treaties. These policies may offend the targeted jurisdictions, much in the same way that the policies of the targeted jurisdictions seemingly offend the Member States. Thus, one might argue that such conduct does not violate the principle of nonintervention since the Member States are merely exercising their own sovereign rights, and that the targeted jurisdictions are so affected is simply a consequence of the fiscal policy choices of the Member States. However, when such actions are viewed in the context of the HTC Initiative, an argument can be made that the Member States are no longer acting on their own free will and using their own discretion in exercising their sovereign rights, nor are they merely pursuing domestic policy choices.

While the Member States have the ability to decide whether, or not, to support the OECD's HTC Initiative and implement its recommendations, they are voluntarily participating in conduct that is coordinated by another international actor with strict instructions as to compliance that may constitute an internationally wrongful act. It should be recalled that, although the OECD is an international actor with legal personality, it does not have the same bundle of rights that attach to sovereign states. Specifically, the OECD does not have the sovereign right to tax. Therefore, while the Member States may be permitted to exercise their free will to establish tax policies, the OECD has no such right and any attempt to do, as discussed above, may violate the principle of nonintervention.

Therefore, it is not the case that one cannot find a violation in the conduct of the OECD if similar conduct would not be a violation by the Member States. It is the fact that the HTC Initiative is a concerted effort for coordinated multilateral action by one group of international actors conducted in the international arena against another group of international actors that removes the actions of the Member States from the domestic sphere and transfers them to the international sphere engaging the international legal consequences described above with respect to the principle of nonintervention.

It is perhaps one thing to adopt taxation policies for the purpose of advancing a nation's fiscal interests, even at the inevitable expense of another nation's fiscal or other economic interests, and perhaps quite another thing to adopt coordinated policies for the purpose of coercing another weaker nation into not advancing its fiscal and other interests, or for the purposes of damaging its industry. In the jargon of commercial "antitrust" law, the former is described as "competition", and the latter as "conspiracy".

On its own, developing a blacklist and including it in domestic legislation may not violate the nonintervention norm; however, when an international organization produces a blacklist, on the basis of criteria identified in a report that is published to the international community at large, and then proceeds to make public this list with the expectation that its Member States who have supported the report will adhere to the list, the conduct goes beyond any unilateral action by a state.

By conforming their policies to the recommendations of the organization, the states are no longer merely exercising their own sovereign rights with respect to domestic jurisdiction; rather, they are affirming the actions of the organization and giving legal effect to otherwise non-binding recommendations. In doing so, they may be participating in conduct that in the particular context constitutes an impermissible exercise of jurisdiction as it violates the duty not to intervene. It cannot be said that the Member States, after participating in the conduct of the OECD, can escape any international responsibility simply because they are doing something that might not have constituted an internationally wrongful act if it had been carried out in different circumstances.

The violation of the principle of nonintervention by the OECD arguably constitutes a breach of an international obligation owed to the targeted jurisdictions and represents an internationally wrongful act that would entail the international responsibility of the OECD. Since the Member States, except Luxembourg and Switzerland, voted in favour of the HTC Initiative, it could be argued that they may also be internationally responsible for the actions of the OECD. The international responsibility of the Member States may be engaged on the basis that they chose to participate in an internationally wrongful act committed by the OECD. In addition, secondary responsibility of the Member States may arise, since such members actively pursued or supported within the OECD the decision that caused the commission of an internationally wrongful act.

(b) Coordinated Defensive Measures

The effect at international law of the OECD's threat to use coordinated defensive measures, and the subsequent implementation of such measures by the Member States, against the targeted jurisdictions that do not comply with the HTC Initiative involves the consideration of the doctrine of countermeasures. The threat by the OECD of the use of coordinated defensive measures may be properly characterized as the use of political and economic coercion, and thus falls into the preceding analysis and it may be similarly concluded that such threat violates the principle of nonintervention. However, this examination goes beyond the threat of coordinated defensive measures to consider the ability of the Member States to actually implement such measures, as the OECD has indicated that such actions would be taken by the Member States themselves, citing its own lack of authority to do so.

At this point, it is useful to note that the use of language in the 1998 and 2000 Reports with respect to coordinated defensive measures has been imprecise, which makes it difficult to determine what exactly the OECD intends. For example, the various terminology used to described such action includes: "coordinated defensive measures", "counter measures", "enforcement measures", "defensive measures", "coordinated countermeasures" and "counteracting measures".[228] As a consequence of the use of such vague language it is not clear whether the OECD is invoking the legal concept of countermeasures.

In any event, the problem inherent in the ability of the Member States to use coordinated defensive measures is that countermeasures may only be taken in response to a violation of an international obligation, which the offending state (i.e., a targeted jurisdiction) owes to the injured state (i.e. a Member State).[229] It has already been determined that the targeted jurisdictions have not violated any international obligation owed to the Member States. There is no international treaty in existence that establishes international standards that must be adhered to by states in the design of domestic or international taxation regimes. Moreover, there is no customary international law relating to taxation, or imposing any limitations on the taxation measures that sovereign states may adopt.

Sovereignty over taxation matters has been closely guarded by states as it concerns issues within the reserved domain of domestic jurisdiction. As explained above, the extra-territoriality of measures relating to taxation has always been resisted, and courts of a particular jurisdiction will normally not recognize or enforce revenue judgments or orders made by courts of other jurisdictions.[230] In brief, there is no

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[228] "Coordinated defensive measures" – 2000 Report at paragraphs 17 and 33; also in the Recommendation of the Council on Implementing the Proposals Contained in the 1998 Report on Harmful Tax Competition at page 129; "counter measures" – 1998 Report at paragraphs 87, 95 and 171; "enforcement measures" – 1998 Report at paragraph 154; "defensive measures" – 1998 Report at paragraphs 63, 88 and 138 and the 2000 Report at pages 6, 7 and 8, and paragraphs 16, 20, 33, 34, 35, and 36; "coordinated countermeasures" – 1998 Report at paragraph 96; and "counteracting measures" – 1998 Report at paragraphs 86, 90, 92, 96, 114, 136 and 142. 1

[229] ILC, "Articles on State Responsibility", *supra* note 186, Part III, Chapter II deals with Countermeasures. On the object and limits of countermeasures Article 19 states: "1. An injured State may only take countermeasures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations under part two. 2. Countermeasures are limited to the non-performance for the time being of international obligations of the State taking the measures towards the responsible State. 3. Countermeasures shall, as far as possible, be taken in such a way as to permit the resumption of performance of the obligations in question."

[230] *Government of India v Taylor, supra* note 106. See also Pinto, "End of the Nation State", *supra* note 212 at 78 who cites the decision of the Privy Council in *Sirdar Gurdyal Singh v Rajah of Faridkote* [1894]

principle of international law that in any way implies an obligation on the part of states to cooperate in matters of taxation, or to not compete in this domain.

Accordingly, in the absence of the commission by a targeted jurisdiction of an internationally wrongful act, the Member States do not have the right to resort to the use of countermeasures. Countermeasures are unilateral measures which are in themselves illegal, but are justified as a response to an internationally wrongful act of another state. For this reason, the International Law Commission advises that countermeasures be seen as "a form of self-help, which responds to the position of the injured State in an international system in which the impartial settlement of disputes through due process of law is not yet guaranteed."[231] The use of countermeasures by the Member States cannot be justified unless there has been a violation of an international obligation by the targeted jurisdictions.

The international legal implications of the use of coordinated defensive measures also raises the issue of whether the use of such measures will violate the international obligations of the Member States. This issue has been considered in relation to the Member States' WTO obligations, since all of the OECD Member States are members of the WTO, and ten of the targeted jurisdictions are also members of the WTO. The coordinated defensive measures target the sector of trade in services, focusing on the area of taxation and financial services, which falls within the scope of the General Agreement on Trade in Services (the "GATS"). Though it is beyond the scope of this paper to examine the Member States' WTO obligations in connection with the use of coordinated defensive measures, it is interesting to note that a few commentators have found that such measures may result in a violation of WTO obligations and may lead to claims of WTO inconsistency.[232]

AC 679 in support of this proposition; and Brownlie, "Public International Law", *supra* note 10 at 306 who discusses the issue in the context of extra-territorial enforcement measures stating that tax investigations may not be mounted except under the terms of a treaty or other prior consent.

[231] ILC, "Commentary", *supra* note 188 at 346.

[232] See Roman Grynberg and Bridget Chilala, "WTO Compatibility of the OECD 'Defensive Measures' against Harmful Tax Competition" (September 2001) *The Journal of World Investment* 1; Stephen J. Orava, "Potential WTO Claims in Response to Countermeasures under the OECD's Recommendations Applicable to Alleged Tax Havens" in Rajiv Biswas, ed., *International Tax Competition: Globalisation and Fiscal Sovereignty* (London: the Commonwealth Secretariat, 2002) 177; Simmons, "Legal Issues of the OECD Report", *supra* note 4 at 285-286; and Gross, "Legality under the WTO", *supra* note 5.

Therefore, if the Member States decided to implement the coordinated defensive measures established by the OECD against the targeted jurisdictions, then they may be engaging in illegal conduct under international law since anticipatory countermeasures are not permitted and countermeasures cannot be taken to enforce policy. It may be that some of the unilateral measures may fall outside the doctrine of countermeasures because they are legal actions in and of themselves, but the Member States would have to ensure that this were true before pursuing any action as it might be considered that such actions constitute offensive, rather than defensive, measures.

CONCLUSION

The purpose of this thesis was to demonstrate that the actions of the OECD in the context of its campaign against certain forms of tax competition may have implications at international law, and could engage the international legal responsibility of both the organization and certain of its Members toward the targeted jurisdictions. The OECD is an international actor with legal personality; therefore, its conduct may give rise to implications in the international arena. Similarly, the Member States must take care to ensure that in supporting the actions of the OECD they are aware of any consequences that may arise as a result of such support. The international responsibility of the Member States is not negated by virtue of the fact that the OECD is itself a separate legal actor in the international arena. As members of the international community, the OECD and each individual Member State must ensure that their conduct complies with their international obligations and does not violate any principles of international law. When the OECD and the Member States do not act in accordance with international law, they may be held accountable for such action.

The HTC Initiative is arguably a thinly veiled effort to restrain tax competition in the area of capital taxation between countries. This was an attempt by the OECD to protect the tax bases of the Member States without regard to the effects of the HTC Initiative on the economies of the targeted jurisdictions. By offering competitive capital taxation regimes, the targeted jurisdictions are seeking to fund their own economic growth and development, often when they have few alternatives other than tourism. The HTC Initiative is an attempt to dictate tax policy to a collection of small, yet sovereign states. This behaviour by the OECD should not be permitted and should not go unnoticed – nor has it.

Indeed, the fact that the OECD abandoned the HTC Initiative, evidenced by the 2001 Report, illustrates that such behaviour was met with great resistance both by the targeted jurisdictions and the international community more generally; most notably, a few of the Member States themselves. Having deserted its crusade against harmful tax competition, the OECD's work currently focuses on addressing "harmful" tax practices by improving transparency and establishing effective exchange of information through its Global Forum on Taxation.

Despite this retreat by the OECD, the changes made to the HTC Initiative merely modified the content of the demands, but the conduct remains the same. The targeted jurisdictions were permitted to participate in the Global Forum on Taxation only after they accepted the OECD's terms of publicly committing to the pre-established standards of effective exchange of information and transparency or risk further naming and shaming as "uncooperative tax havens", and being the target of coordinated defensive measures.[233] The OECD is still dictating the terms of establishing international standards through political and economic coercion, and this should not be overlooked simply because it has permitted the targeted jurisdictions to participate in a forum under their auspices – on non-negotiable terms. The OECD purports to be interested in establishing a global level playing field that is "fundamentally about fairness", yet its approach remains biased and heavy handed.[234]

Overall, the HTC Initiative was shortsighted. By focusing solely on tax competition with respect to capital taxation, it failed to take into account the larger scheme of what has been occurring in the international economy over the past fifteen years or so. Globalization has made it increasingly easier for taxpayers to shift their

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[233] On April 18, 2002, the following tax haven jurisdictions which had not yet made commitments to transparency and effective exchange of information were identified by the OECD's Committee on Fiscal Affairs as uncooperative tax havens: Andorra; The Principality of Liechtenstein; Liberia; The Principality of Monaco; The Republic of the Marshall Islands; The Republic of Nauru; and The Republic of Vanuatu. After providing commitment letters, the following jurisdictions were removed from the list of uncooperative tax havens: Vanuatu (May 20, 2003); and Nauru, (December 23, 2003).

[234] The global level playing field concept is discussed in OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (Paris: OECD, 2004).

activities to lower tax jurisdictions, while simultaneously making it harder for governments to tax certain types of income excessively. The sheer speed and borderless mobility of transactions in the globalized economy has created challenges for governments who continue to rely on outdated regimes of taxation, designed with respect to certain more traditional types of transactions.[235]

In some respects, tax systems have not kept pace with the developments of the international economy. The control over capital outflows was dismantled through trade liberalization policies that were promoted by the OECD; in effect, the OECD helped take the lid off capital mobility and now it wants to use the HTC Initiative to put it back on because the Member States are not prepared to handle the consequences of doing so and the challenges that have emerged. In reality, the OECD must come to terms with the fact that the international economy has become so deeply integrated that, coupled with the improvements in technology, this accelerated process of globalization is not going to slow down, or reverse.

There has been a fundamental change to the international economy akin to the changes brought by the industrial revolution, but in this case it was a technological revolution which produced this intense age of globalization, and the evolution of the multinational enterprise and associated developments in transportation and communications technologies are fundamental aspects of this vast global web.[236]

The OECD has reacted inappropriately to this process of globalization and the HTC Initiative seems to indicate that the Member States simply cannot keep up with the changes that are required of their tax policies. Tax systems may be outdated and the Member State governments appear to be reluctant to modernize and change them, especially when it is much easier to attack a collection of small, less powerful states that have decided to adapt to this phenomenon. The targeted jurisdictions are not alone since

[235] An obvious example is e-commerce, which puts pressure on tax laws as certain types of internet sales are difficult to classify when dealing with intangible goods and services. The issue that arises in some cases is the characterization of income, for example, the sale of software over the internet that is provided online and immediately downloaded; is it a sale of a good or a provision of a service? Another example is the "permanent establishment" concept in most tax treaties which relies on the existence of a physical presence for the taxation of business income; however, globalization and new technologies have permitted companies to manage without the need for a physical presence. See Pinto, "End of the Nation State, *supra* note 212 at 78-82 for a discussion on the challenges to tax laws as a result of globalization.

[236] *Ibid.* at 69.

even some of the Member States have embraced the challenges of globalization; those jurisdictions offering preferential tax regimes are rationally seeking to build upon their comparative advantages by developing a global competitive advantage in providing international financial services.[237]

The challenge faced by all nations in today's globalized economy comes down to competitiveness and this tide cannot be reversed. Hence the inevitable failure of the HTC Initiative: nations are being challenged on every front, beyond taxation, to provide a competitive environment that attracts investment, while at the same time ensuring the competitiveness of domestic enterprises. Although it may be true that there are some undesirable effects of tax competition, international due process remains important, and to the extent that the international community believes they should be addressed, they should be considered and addressed on the basis of a truly international consensus and not by the OECD alone. Tax competition may be a truly multilateral issue that warrants a truly multilateral forum, however, the OECD's Global Forum on Taxation fails to provide this. The OECD's work continues to reflect predetermined principles established from its own biased perspective, while also continuing to coerce the commitment of small, politically powerless states by forcing acceptance of its agenda as a condition of participation. If international standards are being sought, then a truly international forum should be organized, characterized by truly voluntary participation, and not by the heavy hand of the OECD.

[237] Recall that the OECD determined that 47 preferential tax regimes in the Member State jurisdictions were considered "potentially harmful".

<u>APPENDIX I</u>
<u>CONVENTION ON THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT</u>

PARIS 14th December 1960

THE GOVERNMENTS of the Republic of Austria, the Kingdom of Belgium, Canada, the Kingdom of Denmark, the French Republic, the Federal Republic of Germany, the Kingdom of Greece, the Republic of Iceland, Ireland, the Italian Republic, the Grand Duchy of Luxembourg, the Kingdom of the Netherlands, the Kingdom of Norway, the Portuguese Republic, Spain, the Kingdom of Sweden, the Swiss Confederation, the Turkish Republic, the United Kingdom of Great Britain and Northern Ireland, and the United States of America;

CONSIDERING that economic strength and prosperity are essential for the attainment of the purposes of the United Nations, the preservation of individual liberty and the increase of general well-being;

BELIEVING that they can further these aims most effectively by strengthening the tradition of co-operation which has evolved among them;

RECOGNISING that the economic recovery and progress of Europe to which their participation in the Organisation for European Economic Co-operation has made a major contribution, have opened new perspectives for strengthening that tradition and applying it to new tasks and broader objectives;

CONVINCED that broader co-operation will make a vital contribution to peaceful and harmonious relations among the peoples of the world;

RECOGNISING the increasing interdependence of their economies;

DETERMINED by consultation and co-operation to use more effectively their capacities and potentialities so as to promote the highest sustainable growth of their economies and improve the economic and social well-being of their peoples;

BELIEVING that the economically more advanced nations should co-operate in assisting to the best of their ability the countries in process of economic development;

RECOGNISING that the further expansion of world trade is one of the most important factors favouring the economic development of countries and the improvement of international economic relations; and

DETERMINED to pursue these purposes in a manner consistent with their obligations in other international organisations or institutions in which they participate or under agreements to which they are a party;

HAVE THEREFORE AGREED on the following provisions for the reconstitution of the Organisation for European Economic Co-operation as the Organisation for Economic Co-operation and Development:

Article 1

The aims of the Organisation for Economic Co-operation and Development (hereinafter called the "Organisation") shall be to promote policies designed:

(a) to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;

(b) to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and

(c) to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

Article 2

In the pursuit of these aims, the Members agree that they will, both individually and jointly:

(a) promote the efficient use of their economic resources;

(b) in the scientific and technological field, promote the development of their resources, encourage research and promote vocational training;

(c) pursue policies designed to achieve economic growth and internal and external financial stability and to avoid developments which might endanger their economies or those of other countries;

(d) pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalisation of capital movements; and

(e) contribute to the economic development of both Member and non-member countries in the process of economic development by appropriate means and, in particular, by the flow of capital to those countries, having regard to the importance to their economies of receiving technical assistance and of securing expanding export markets.

Article 3

With a view to achieving the aims set out in Article 1 and to fulfilling the undertakings contained in Article 2, the Members agree that they will:

(a) keep each other informed and furnish the Organisation with the information necessary for the accomplishment of its tasks;

(b) consult together on a continuing basis, carry out studies and participate in agreed projects; and

(c) co-operate closely and where appropriate take co-ordinated action.

Article 4

The Contracting Parties to this Convention shall be Members of the Organisation.

Article 5

In order to achieve its aims, the Organisation may:

(a) take decisions which, except as otherwise provided, shall be binding on all the Members;

(b) make recommendations to Members; and

(c) enter into agreements with Members, non-member States and international organisations.

Article 6

1 . Unless the Organisation otherwise agrees unanimously for special cases, decisions shall be taken and recommendations shall be made by mutual agreement of all the Members.

2. Each Member shall have one vote. If a Member abstains from voting on a decision or recommendation, such abstention shall not invalidate the decision or recommendation, which shall be applicable to the other Members but not to the abstaining Member.

3. No decision shall be binding on any Member until it has complied with the requirements of its own constitutional procedures. The other Members may agree that such a decision shall apply provisionally to them.

Article 7

A Council composed of all the Members shall be the body from which all acts of the Organisation derive. The Council may meet in sessions of Ministers or of Permanent Representatives.

Article 8

The Council shall designate each year a Chairman, who shall preside at its ministerial sessions, and two Vice-Chairmen. The Chairman may be designated to serve one additional consecutive term.

Article 9

The Council may establish an Executive Committee and such subsidiary bodies as may be required for the achievement of the aims of the Organisation.

Article 10

1. A Secretary-General responsable to the Council shall be appointed by the Council for a terra of five years. He shall be assisted by one or more Deputy Secretaries-General or Assistant Secretaries-General appointed by the Council on the recommendation of the Secretary-General.

2. The Secretary-General shall serve as Chairman of the Council meeting at sessions of Permanent Representatives. He shall assist the Council in all appropriate ways and may submit proposals to the Council or to any other body of the Organisation.

Article 11

1. The Secretary-General shall appoint such staff as the Organisation may require in accordance with plans of organisation approved by the Council. Staff regulations shall be subject to approval by the Council.

2. Having regard to the international character of the Organisation, the Secretary-General, the Deputy or Assistant Secretaries-General and the staff shall neither seek nor receive instructions from any of the Members or from any Government or authority external to the Organisation.

Article 12

Upon such terms and conditions as the Council may determine, the Organisation may:

(a) address communications to non-member States or organisations;

(b) establish and maintain relations with non-member States or organisations; and

(c) invite non-member Governments or organisations to participate in activities of the Organisation.

Article 13

Representation in the Organisation of the European Communities established by the Treaties of Paris and Rome of 18th April, 1951, and 25th March, 1957, shall be as defined in Supplementary Protocol No. 1 to this Convention.

Article 14

1 . This Convention shall be ratified or accepted by the Signatories in accordance with their respective constitutional requirements.

2. Instruments of ratification or acceptance shall be deposited with the Government of the French Republic, hereby designated as depositary Government.

3. This Convention shall come into force:

(a) before 30th September, 1961, upon the deposit of instruments of ratification or acceptance by all the Signatories; or

(b) on 30th September, 1961, if by that date fifteen Signatories or more have deposited such instruments as regards those Signatories; and thereafter as regards any other Signatory upon the deposit of its instrument of ratification or acceptance;

(c) after 30th September, 1961, but not later than two years from the signature of this Convention, upon the deposit of such instruments by fifteen Signatories, as regards those Signatories; and thereafter as regards any other Signatory upon the deposit of its instrument of ratification or acceptance.

4. Any Signatory which has not deposited its instrument of ratification or acceptance when the Convention comes into force may take part in the activities of the Organisation upon conditions to be determined by agreement between the Organisation and such Signatory.

Article 15

When this Convention comes into force the reconstitution of the Organisation for European Economic Co-operation shall take effect, and its aims, organs, powers and name shall thereupon be as provided herein. The legal personality possessed by the Organisation for European Economic Co-operation shall continue in the Organisation, but decisions, recommendations and resolutions of the Organisation for European Economic Co-operation shall require approval of the Council to be effective after the coming into force of this Convention.

Article 16

The Council may decide to invite any Government prepared to assume the obligations of membership to accede to this Convention. Such decisions shall be unanimous, provided that for any particular case the Council may unanimously decide to permit abstention, in which case, notwithstanding the provisions of Article 6, the decision shall be applicable to all the Members. Accession shall take effect upon the deposit of an instrument of accession with the depositary Government.

Article 17

Any Contracting Party may terminate the application of this Convention to itself by giving twelve months' notice to that effect to the depositary Government.

Article 18

The Headquarters of the Organisation shall be in Paris, unless the Council agrees otherwise.

Article 19

The legal capacity of the Organisation and the privileges, exemptions, and immunities of the Organisation, its officials and representatives to it of the Members shall be as provided in Supplementary Protocol No. 2 to this Convention.

Article 20

1. Each year, in accordance with Financial Regulations adopted by the Council, the Secretary-General shall present to the Council for approval an annual budget, accounts, and such subsidiary budgets as the Council shall request.

2. General expenses of the Organisation, as agreed by the Council, shall be apportioned in accordance with a scale to be decided upon by the Council. Other expenditure shall be financed on such basis as the Council may decide.

Article 21

Upon the receipt of any instrument of ratification, acceptance or accession, or of any notice of termination, the depositary Government shall give notice thereof to all the Contracting Parties and to the Secretary-General of the Organisation.

IN WITNESS WHEREOF, the undersigned Plenipotentiaries, duly empowered, have appended their signatures to this Convention.

DONE in Paris, this fourteenth day of December, Nineteen Hundred and Sixty, in the English and French languages, both texts being equally authentic, in a single copy which shall be deposited with the depositary Government, by whom certified copies will be communicated to all the Signatories.

APPENDIX II
SUPPLEMENTARY PROTOCOL NO. 2 TO THE CONVENTION ON THE OECD

Paris, 14 December 1960

THE SIGNATORIES of the Convention on the Organisation for Economic Co-operation and Development (hereinafter called the "Organisation");

HAVE AGREED as follows:

The Organisation shall have legal capacity and the Organisation, its officials, and representatives to it of the Members shall be entitled to privileges, exemptions, and immunities as follows:

(a) in the territory of the Contracting Parties to the Convention for European Economic Co-operation of 16th April, 1948, the legal capacity, privileges, exemptions, and immunities provided for in Supplementary Protocol No. 1 to that Convention;

(b) in Canada, the legal capacity, privileges, exemptions, and immunities provided for in any agreement or arrangement on legal capacity, privileges, exemptions, and immunities entered into between the Government of Canada and the Organisation;

(c) in the United States, the legal capacity, privileges, exemptions, and immunities under the International Organisations Immunities Act provided for in Executive Order No. 10133 of 27th June, 1950; and

(d) elsewhere, the legal capacity, privileges, exemptions, and immunities provided for in any agreement or arrangement on legal capacity, privileges, exemptions, and immunities entered into between the Government concerned and the Organisation.

IN WITNESS WHEREOF, the undersigned Plenipotentiaries, duly empowered, have appended their signatures to this Protocol.

DONE in Paris, this fourteenth day of December, Nineteen Hundred and Sixty, in the English and French languages, both texts being equally authentic, in a single copy which shall be deposited with the Government of the French Republic, by whom certified copies will be communicated to all the Signatories.

Appendix III

Potentially Harmful Preferential Tax Regimes Identified in the OECD's 2000 Report *Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices*

Country Regimes[1]

Insurance

Australia Offshore Banking Units
Belgium Co-ordination Centres
Finland Åland Captive Insurance Regime
Italy Trieste Financial Services and Insurance Centre[2]
Ireland International Financial Services Centre
Portugal Madeira International Business Centre
Luxembourg Provisions for Fluctuations in Re-Insurance Companies
Sweden Foreign Non-life Insurance Companies

Financing and Leasing

Belgium Co-ordination Centres
Hungary Venture Capital Companies
Hungary Preferential Regime for Companies Operating Abroad
Iceland International Trading Companies
Ireland International Financial Services Centre
Ireland Shannon Airport Zone
Italy Trieste Financial Services and Insurance Centre[3]
Luxembourg Finance Branch
Netherlands Risk Reserves for International Group Financing
Netherlands Intra-group Finance Activities
Netherlands Finance Branch
Spain Basque Country and Navarra Co-ordination Centres
Switzerland Administrative Companies

Fund Managers[4]

Greece Mutual Funds/Portfolio Investment Companies [Taxation of Fund Managers]
Ireland International Financial Services Centre [Taxation of Fund Managers]
Luxembourg Management companies [Taxation of management companies that manage only one mutual fund (1929 holdings)]
Portugal Madeira International Business Centre [Taxation of Fund Managers]

Banking

Australia Offshore Banking Units
Canada International Banking Centres
Ireland International Financial Services Centre
Italy Trieste Financial Services and Insurance Centre[3]
Korea Offshore Activities of Foreign Exchange Banks
Portugal External Branches in the Madeira International Business Centre
Turkey Istanbul Offshore Banking Regime

Headquarters regimes

Belgium Co-ordination Centres
France Headquarters Centres
Germany Monitoring and Co-ordinating Offices
Greece Offices of Foreign Companies
Netherlands Cost-plus Ruling
Portugal Madeira International Business Centre
Spain Basque Country and Navarra Co-ordination Centres
Switzerland Administrative Companies
Switzerland Service Companies

Distribution Centre Regimes

Belgium Distribution Centres
France Logistics Centres
Netherlands Cost-plus/Resale Minus Ruling
Turkey Turkish Free Zones

Service Centre Regimes

Belgium Service Centres
Netherlands Cost-plus Ruling

Shipping[5]

Canada International Shipping
Germany International Shipping
Greece Shipping Offices
Greece Shipping Regime (Law 27/75)
Italy International Shipping
Netherlands International Shipping
Norway International Shipping
Portugal International Shipping Register of Madeira

Miscellaneous Activities

Belgium Ruling on Informal Capital
Belgium Ruling on Foreign Sales Corporation Activities
Canada Non-resident Owned Investment Corporations
Netherlands Ruling on Informal Capital
Netherlands Ruling on Foreign Sales Corporation Activities
United States Foreign Sales Corporations[6]

1. The preferential tax regimes are listed category-by-category. Certain regimes allow investors to carry out many different types of activities. Forty-seven preferential regimes are identified, but some are included in more than one category of the listing.
2. Non-operational.
3. Non-operational.
4. The taxation of fund managers is complex, given the various legal forms that can be used to structure fund management advice. These issues will be studied further in connection with the development of the application notes described in paragraph 13 in order to ensure that all similar regimes are treated the same.
5. The analysis of shipping is complex given the particularities of the activity. The criteria must be developed so as to take into account and be consistent with those particularities and will be considered further in connection with the development of application notes as regards shipping. Also, such further consideration shall compare tax equivalence of alternative regimes and should aim to establish similar standards for all comparable regimes.
6. As is the case with all regimes, the foreign sales corporation regime is only within the scope of the Report to the extent that it applies to mobile financial and other service activities. It should be noted that the treatment of the foreign sales corporation regime or any other regime for purposes of this Report has no bearing on its classification or treatment in connection with trade disciplines.

APPENDIX IV

JURISDICTIONS IDENTIFIED AS TAX HAVENS IN THE OECD'S 2000 REPORT *TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES*

Andorra
Anguilla – Overseas Territory of the United Kingdom
Antigua and Barbuda
Aruba – Kingdom of the Netherlands[a]
Commonwealth of the Bahamas
Bahrain
Barbados
Belize
British Virgin Islands – OverseasTerritory of the United Kingdom
Cook Islands – New Zealand[b]
The Commonwealth of Dominica
Gibraltar – Overseas Territory of the United Kingdom
Grenada
Guernsey/Sark/Alderney – Dependency of the British Crown
Isle of Man – Dependency of the British Crown
Jersey – Dependency of the British Crown
Liberia
The Principality of Liechtenstein
The Republic of the Maldives
The Republic of the Marshall Islands
The Principality of Monaco
Montserrat – Overseas Territory of the United Kingdom
The Republic of Nauru
Netherlands Antilles – Kingdom of the Netherlands[a]
Niue – New Zealand[b]
Panama
Samoa
The Republic of the Seychelles
St Lucia
The Federation of St. Christopher & Nevis
St. Vincent and the Grenadines
Tonga
Turks & Caicos – Overseas Territory of the United Kingdom
US Virgin Islands – External Territory of the United States
The Republic of Vanuatu

a) The Netherlands, the Netherlands Antilles, and Aruba are the three countries of the Kingdom of the Netherlands.
b) Fully self-governing country in free association with New Zealand.

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