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WHEN COWS HAVE WINGS: AN ANALYSIS OF THE OECD'S TAX HAVEN WORK AS IT RELATES TO GLOBALIZATION, SOVEREIGNTY AND PRIVACY¹

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Over the last twenty years, startling advances in technology and the telecommunications revolution have made it easier to access offshore facilities - so much so, that today's offshore industry has developed a major global business, spanning all quarters of the world, involving, in one way or another, approximately half of the world's financial transactions by value.²

More than 150,000 offshore corporations are formed each year.³ During the year 2000, around 80,000 offshore companies were incorporated in the Caribbean islands alone.⁴

1. See JAMES DALE DAVIDSON & LORD WILLIAM REES-MOGG, *THE SOVEREIGN INDIVIDUAL: MASTERING THE TRANSITION TO THE INFORMATION AGE* 24 (Touchstone Books 1999) (1997) (stating that "[t]he state has grown used to treating its taxpayers as a farmer treats his cows, keeping them in a field to be milked. Soon, the cows will have wings.").

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2. Finor Associates, Ltd., *Tax Havens of the World: A Summary*, at http://www.finor.org/en/tax_havens_history.htm (last visited Feb. 4, 2002). *But see New Lease on Life for the Swiss Banquier Prive*, INT'L MONEY MKTG., Aug. 6, 2001, at 21, available at 2001 WL 13947788 (disagreeing with the capital impact of offshore banking). The Article stated that

[f]actors such as increased international coordination to curb tax evasion and money laundering have created problems for these [offshore] centres, and some industry estimates suggest that the level of assets held offshore will halve by 2005. Some have gone so far as to suggest that the moves made by the OECD, FATF and tax authorities will close down offshore banking altogether.

Id.

3. See Finor Associates, Ltd., *supra* note 2, at http://www.finor.org/en/tax_havens_history.htm (defining offshore corporations as the "incorporation of offshore companies, opening of offshore bank accounts and other offshore financial and asset protection services").

4. *Id.* St. Vincent and the Grenadines host roughly thirty-six banks even though the population is only 120,000. Gregg Fields, *Offshore Banks Escape Sanctions*, MIAMI HERALD, June 29, 2001, at 1C. Just imagine thirty-six

This Article addresses the Organisation for Economic Co-Operation and Development's (OECD) efforts to eliminate competition from tax haven jurisdictions that offer multinationals an opportunity to minimize taxes.⁵ Part I provides a factual account of the OECD's work regarding tax havens. Part II addresses how the OECD's actions will impede globalization in a way which is inconsistent with the OECD's own statement in support of globalization. Part III discusses how the OECD interferes with the fiscal sovereignty rights of other nations by labeling them as tax havens. Part III also explains how the OECD

banks crowded into Naperville, Illinois . . . a suburb of Chicago boasting the same population. Ten out of the thirty-two listed havens are in the Caribbean. *Id.* The United States has owned the Caribbean financial tax havens since World War II. Werner Rügemer, *Finance Havens Protect USA*, DIE TAGESZEITUNG (Francis Thanjan trans.) (issue date June 30, 2000) available at <http://www.gcforum.net/doc22-e.htm> (last visited Feb. 15, 2002). Though former President Clinton backed the Organisation for Economic Co-Operation and Development's ("OECD") efforts to combat tax havens, President Bush exerted pressure on the OECD regarding its requirements for the Caribbean tax havens. Fields, *supra*. In response to American pressure, the OECD agreed to delay the deadline for havens to pledge cooperation from July 31, 2001 to November 30, 2001. *Id.* The OECD also agreed to delay any punitive measures against havens until the OECD Members enacted similar legislation regarding bank secrecy and exchange of information. *Id.* While governments in the Caribbean backed the fight against money laundering, "they balked at helping rich countries fight tax evasion." *Id.* One reason was because OECD Members, including the United States, contribute to tax evasion. *Id.* See also William C. Caccamise, Jr., Note, *U.S. Countermeasures Against Tax Haven Countries*, 26 COLUM. J. TRANSNAT'L L. 553, 556, 561 (1988) (stating that the United States lacked sufficient influence upon Caribbean nations and elsewhere to negotiate information-sharing treaties); Ernest R. Larkins, *Multinationals and Their Quest for the Good Tax Haven: Taxes are One, Albeit an Important, Consideration*, 25 INT'L LAW. 471, 478 -79 (1991) (examining the information exchange between the United States and the Caribbean).

5. The OECD promotes policies that encourage stable financial expansion of their member nations. See generally OECD, HARMFUL TAX COMPETITION - AN EMERGING GLOBAL ISSUE, at 2 (1998) [hereinafter OECD, HARMFUL TAX COMPETITION] (stating the purposes of the OECD). A multinational corporation is a corporation engaged in commercial activity "outside the country of origin" and is financially dependent upon such foreign operations. Jed Greer & Kavaljit Singh, A Brief History of TNC's (1995) (unpublished Article, on file with The John Marshall Law Review). Greer and Singh add that a transnational corporation generally manages their commercial activities based upon "regional or global" influences. *Id.* Although Greer and Singh's Article is clearly biased against corporations, they do provide references for their claims. *Id.* Domestic and international taxation can be understood with general background information written in simplified language. See, e.g., John Volpe, George Mason University, Tax Lecture (Nov. 9, 1998), at <http://mason.gmu.edu/~jvolpe/taxlecture.htm> (last visited Feb. 13, 2002) (discussing how multinational corporations are taxed). Volpe provides a general explanation of such concepts as foreign sales corporations, the alternative minimum tax, the foreign tax credit and transfer pricing. *Id.*

fails to consider the interests of these tax haven jurisdictions when the OECD makes recommendations and encourages other jurisdictions to coordinate defensive measures against such tax haven nations. Part IV discusses the need for investor privacy as weighed against the need to combat criminal actions. Part V proposes a global forum to best address tax haven issues so that developing nations maintain their sovereign independence.⁶

I. AN OVERVIEW OF THE OECD'S WORK TO COMBAT TAX COMPETITION

In 1998, the OECD published a report entitled *Harmful Tax Competition - An Emerging Global Issue*.⁷ The report establishes criteria to identify tax havens and recommends how to counteract these preferential regimes by focusing solely on "geographically mobile" capital in contrast to tax incentives to build factories.⁸

A tax haven is described as a country with no tax, or a low effective tax rate.⁹ Applying a subjective reputation test, a country is considered a tax haven if it offers itself as a place to be used by non-residents to escape taxes in their country of residence.¹⁰ Other factors that define a tax haven include a lack of regulatory or

6. See, e.g., DAVIDSON, ET AL., *supra* note 1, at 129-32 (anticipating that the information age will worsen the exploitation of undeveloped nations by more powerful nations such as the United States).

7. OECD, HARMFUL TAX COMPETITION, *supra* note 5. See also Sean D. Murphy, *OECD Listing of States for Unfair Tax Practices*, 94 AM. J. INT'L L. 677, 696-97 (2000) (describing the basis for the OECD's Harmful Tax Competition report). But see Karen B. Brown, *Harmful Tax Competition: The OECD View*, 32 GEO. WASH. J. INT'L L. & ECON. 311, 314 (1999) (criticizing key factors of the OECD report because it views a "multifaceted set of issues from a unilateral perspective").

8. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 8, (stating that "[t]ax incentives designed to attract investment in plant, building and equipment have been excluded at this stage"). See also THEODORE H. MORAN, FOREIGN DIRECT INVESTMENT AND DEVELOPMENT: THE NEW POLICY AGENDA FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION 95-96 (Inst. for Inst'l Econ. 1998) (observing that the countries are increasingly designing tax programs to attract foreign investment income); Yitzhak Hadari, *The Role of Tax Incentives in Attracting Foreign Investments in Selected Developing Countries and the Desirable Policy*, 24 INT'L L. 121, 122-23 (1990) (discussing tax incentives generally).

9. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 21. See also Larkins, *supra* note 4, at 483 (listing the "pure" no-tax countries as Andorra, Anguilla, the Bahamas, Bahrain, Bermuda, the Cayman Islands, Djibouti, Nauru, Nevis, the Turks and Caicos Islands and Vanuatu). Tax havens have gained popularity because of the information and technology explosion over the last two decades. Finor Associates, Ltd., *supra* note 2, at http://www.finor.org/en/tax_havens_history.htm.

10. *Id.* See also OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 21-24 (referring to the reputation criterion as one "without any objective basis"). OECD Member Luxembourg abstained from adopting this report due in part to application of the reputation test. *Id.* at 74-75.

administrative constraints and the limited exchange of information due to bank secrecy provisions.¹¹ The last factor considered is whether the tax haven country lacks a requirement for “substantial activity.”¹² The absence of a substantial activity requirement “suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven.”¹³ Though these criteria identified tax havens, the OECD did not intend to publish a list of tax havens until the year 2000.¹⁴

To defend against the harm that tax havens caused, the OECD proceeded to make three categories of recommendations.¹⁵

11. *Id.* at 21-24.

12. *See id.* at 22-24 (suggesting it is important that “the activity be substantial”). “Ring fencing” is another method that various nations use to protect their own economies. *Id.* at 26-27. Ring fencing occurs when the tax haven nation forbids an investor to enter their “domestic market” or forbids their own residents from benefiting from any economic investment in their nation. *Id.* Numerous multinational subsidiaries are merely a wall plaque and an address. *See* J.W. SMITH, *THE WORLD’S WASTED WEALTH* 2 138 (Inst. for Econ. Democracy 1994) (referring to the 11,000 corporations registered in the Cayman Islands which has a population of only 10,000). Some tax havens, by offering free trade zones, encourage a physical presence as well. *See* Finor Associates, Ltd., *supra* note 2, at http://www.finor.org/en/tax_havens_history.htm. Mauritius, for example, has in excess of 700 companies physically based in its Export Processing Zone. *See id.*, at http://www.finor.org/en/tax_havens_history.htm (referring to the Isle of Man and Madeira as well).

13. OECD, *HARMFUL TAX COMPETITION*, *supra* note 5, at 24. It is unrealistic to think that multinationals only consider taxes when making decisions. *See* Larkins, *supra* note 4, at 472-73 (1991) (listing the multiple “ingredients” that influence a corporation’s decision to invest with tax haven countries). There are numerous non-tax considerations when a multinational decides whether to make a foreign investment. *See, e.g.*, OXFAM POLICY PAPERS, *Tax Havens - Releasing the Hidden Billions For Poverty Eradication, The Impact of Financial Havens on Developing Countries-pt. 2*, at <http://www.oxfam.org.uk/policy/papers/taxhvn/tax3.htm> (June 2000) (listing examples of attractions for foreign investment including “large markets, natural resources, development infrastructure, a relatively cheap and efficient labour force, macro-economic stability and liberal trade regimes”); Hadari, *supra* note 8, at 122-23 (same). This is not to de-emphasize the powerful lure of a nominal tax rate. *See, e.g.*, JAMES R. HINES, JR., NATIONAL BUREAU OF ECONOMIC RESEARCH, *INTERNATIONAL TAXATION 2* (2000) (classifying non-tax considerations as secondary because “countries with lower tax rates receive much more foreign direct investment than do countries with higher tax rates.”).

14. *See* OECD, *TOWARDS GLOBAL TAX CO-OPERATION, REPORT TO THE 2000 MINISTERIAL COUNCIL MEETING AND RECOMMENDATIONS BY THE COMMITTEE ON FISCAL AFFAIRS: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES 17* (2000) [hereinafter OECD, *TOWARDS GLOBAL TAX CO-OPERATION*] (listing all thirty-five jurisdictions that the OECD identifies as tax havens).

15. OECD, *HARMFUL TAX COMPETITION*, *supra* note 5, at 39. Tax havens prefer nations to first apply their own defensive measures rather than the designated tax haven because the administrative burden will rest with the

The first set of recommendations concerns how to make current domestic defensive legislation more effective.¹⁶ The second set of recommendations concerns tax treaties and the third emphasizes the need for international cooperation and calls for nations to act collectively against tax competition.¹⁷

On the home front, countries are encouraged to apply their domestic laws concerning Controlled Foreign Corporations (CFCs) in a way that curbs harmful tax practices.¹⁸ Regarding exemptions

country that stands to benefit from increased tax revenue. See Regional Position Statement, Pacific Islands Forum, to the OECD, ¶ 2 (Apr. 28, 2002), available at <http://www.forumsec.org.fj/news/2001/apr13.htm> (last visited Feb. 18, 2002) [hereinafter Pacific Islands Forum] (encouraging nations to first apply defensive measures). Taiwan defends against tax haven abuse using complex but largely ineffective measures. See Connie Guang-Hwa Yang, Note, *Taiwan's Control of the Tax Sheltering Use of Tax Haven Base Companies: Substance Over Form Rule or Subpart F-Type Legislation?*, 31 COLUM. J. TRANSNAT'L L. 231, 251-58, 268 (1993) (analyzing the effectiveness of Taiwan's "substance over form" rule as compared to legislation that resembles I.R.C. §§ 951-64 (Subpart F) of the United States Tax Code).

16. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 39. See also Caccamise, Jr., *supra* note 4, at 554 (advocating "judicial sanctions to enforce compliance with discovery orders" because the United States can then obtain enhanced information about offshore accounts); Kurt A. Wagner, *U.S. Taxation of Foreign Income: The Use of Tax Havens in a Changing Tax Environment*, 18 S. ILL. U. L.J. 617, 633-34 (1994) (suggesting that the United States' recent tax haven proposals are complicated regulations but increase tax revenue).

17. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 39. The United States follows the "residence" principle. *Ninth meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters: Report of the Secretary-General*, U.N. ESCOR, 1999 Sess., 9th mtg., Agenda Item 13 (j), ¶ 34, n.3, U.N. Doc. E/1999/84 (1999) [hereinafter UN Ninth Meeting]. The "residence" or "worldwide" principle taxes corporations and persons on their income earned both domestically and outside their jurisdictional borders. *Id.*; JANICE C. SHIELDS, INTERHEMISPHERIC RES. CTR. AND INST. FOR POLICY STUDIES, 3 FOREIGN POLICY IN FOCUS 1, No. 1, TAXING OVERSEAS INVESTMENTS (Jan. 1998), available at <http://www.fpif.org/pdf/vol3/1iftax.pdf> (last visited Feb. 22, 2002). Other nations, such as Switzerland and Argentina, follow the "territorial" or "source" principle, which taxes all income earned from sources within its jurisdiction. See UN Ninth Meeting, *supra*, ¶ 34, n.2 (defining "source" principle); Shields, *supra* (referring to the same principle as the "territorial" principle). This causes multinationals to be taxed twice, which is unfair at times. Shields, *supra*. To combat this problem, the United States provides various credits and negotiates tax treaties with other countries. *Id.* The United States currently has such treaties with forty-seven countries. *Id.*

18. See OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 41-42 (indicating there are fourteen OECD Members with CFC legislation). A corporation is a CFC if "U.S. shareholders own more than 50 percent of its outstanding voting stock, or more than 50 percent of the value of all its outstanding stock . . . on any day during the foreign corporation's tax year." See SARAH E. NUTTER, IRS STATISTICS OF INCOME BULLETIN, CONTROLLED FOREIGN CORPORATIONS, 1996 134 (Spring 2001) available at <http://www.irs.gov/pub/irs-soi/96cfcart.pdf> (last visited Feb. 17, 2002) (providing an excellent explanation and statistical analysis of CFCs). See also

of foreign income, the OECD recommends eliminating exemptions based on the countries from which the foreign income is earned, the type of income, or the rate at which the income is taxed in the foreign jurisdiction.¹⁹

Tax authorities need information to effectively enforce the tax system.²⁰ Therefore, the OECD encourages countries to adopt foreign information reporting rules regarding the international transactions and foreign operations of resident taxpayers.²¹ The OECD recommends that countries publish their conditions for granting pre-tax administrative decisions for greater transparency to permit equal treatment among similarly situated taxpayers.²²

Eric T. Laity, *The United States' Response to Tax Havens: The Foreign Base Company Services Income of Controlled Foreign Corporations*, 18 NW. J. INT'L L. & BUS. 1, 3 (1997) (detailing a study of foreign base company service income); SARAH E. NUTTER, IRS STATISTICS OF INCOME BULLETIN, STATISTICS OF INCOME STUDIES OF INTERNATIONAL INCOME AND TAXES 151 (Winter 1998/1999) available at <http://www.irs.gov/pub/irs-soi/intstart.pdf> (last visited Feb. 17, 2002) (providing an overview of income statistic studies that used available international information); UNITED STATES GENERAL ACCOUNTING OFFICE, TAX ADMINISTRATION: FOREIGN- AND U.S.- CONTROLLED CORPORATIONS THAT DID NOT PAY U.S. INCOME TAXES, 1989-95 4, NO. GAO/GGD-99-39 (1999) (considering CFCs a defensive tactic because an owner must report as gross income his or her respective share of the CFC's income); Caccamise, Jr., *supra* note 4, at 558-59 (same).

19. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 43. To some extent, the United States already does this. See, e.g., Shields, *supra* note 17, at 3 (stating that "Congress has attempted to reduce tax avoidance benefits of shifting income to tax havens by establishing a list of types of income (such as interest revenue or shipping profits) that may not be deferred from U.S. taxation . . .").

20. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 43-44.

21. *Id.* See also OECD Model Tax Convention, Apr. 29, 2000, art. 26 (1997) (stating that the basis for information exchange is to benefit member nations). For example, some Canadian provinces are seeking to gain information. See Theresa Tedesco, *OSC Won't Lead Way in Offshore Crackdown: We Will Not Put Our Industry at a Disadvantage*, FIN. POST, Oct. 19, 2001, at 1, available at 2001 WL 28026552 (citing the three Canadian provinces of British Columbia, Alberta and Quebec that compelled their brokerage firms to list all open accounts in the OECD blacklisted tax havens and to ultimately determine the beneficial owners of these accounts).

22. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 44-45. See also OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS (1995) [hereinafter OECD, TRANSFER PRICING GUIDELINES] (providing the OECD's transfer pricing guidelines). To assist corporations in determining transfer pricing which will be considered acceptable by the tax authority, the IRS, among other nations' tax authorities, offers Advance Pricing Agreements (APAs). VOLPE, *supra* note 5. Some APAs take six to nine months to develop. *Id.* See also Senator Byron Dorgan, *How Corporations Operate Tax Free*, 32 WASHINGTON MONTHLY 34-35 (July/Aug. 2000) (viewing transfer pricing as a way for multinationals to negotiate their own tax bills). "An [APA] determines, in advance of controlled transactions, an appropriate set of indicators . . . , critical assumptions as to future events for the determination of the transfer pricing for those transactions over a fixed

“More than two-thirds of world trade involves at least one multinational, half of which occurs within the same multinational around the world.”²³ When trade occurs within a multinational, the corporation uses a concept called transfer pricing to allocate costs between the subdivisions.²⁴ To prevent shell paper-based

period of time.” UN Ninth Meeting, *supra* note 17, ¶ 26. This is not to be confused with safe harbors, a process whereby a multinational may follow a set of rules under which transfer prices would be acceptable. *Id.* ¶ 28. This method was discouraged because of the potential for “tax arbitrage” and “double taxation.” *Id.* In spite of funds diverted to promote the APA program, as of 1995, APAs were used infrequently and when they were used, the APAs often determined the transfer price by a pricing method not described in Section 482 of the Internal Revenue Code. See UNITED STATES GENERAL ACCOUNTING OFFICE, INTERNATIONAL TAXATION: TRANSFER PRICING AND INFORMATION ON NONPAYMENT OF TAX 3, No. GAO/GGD-95-101 (1995) [hereinafter GAO/GGD-95-101] (referring to uncontrolled price, cost plus and resale price as the three described in the Code); UNITED STATES GENERAL ACCOUNTING OFFICE, TAX ADMINISTRATION: INFORMATION ON IRS’ INTERNATIONAL TAX COMPLIANCE ACTIVITIES 1, No. GAO/GGD-94-96FS (1994) (reporting the IRS’ efforts to expand the APA program).

23. MYRIAM VANDER STICHELE, TRANSNATIONAL INST., TOWARDS A WORLD TRANSNATIONALS’ ORGANISATION?, (WTO Booklet Series No. 3, 1998), available at <http://www.tni.org/pubs/index.htm> (last visited Feb. 20, 2002). See also Greer & Singh, *supra* note 5 (stating that “[b]y the 1960’s an estimated one-third of world trade was intra-company in nature, a proportion which has remained steady to the present day . . . [but] [t]he absolute level and value of intra-company trade has increased considerably since that time.”).

24. OECD, TRANSFER PRICING GUIDELINES, *supra* note 22, at P-3. See also Robert S. McIntyre, *Taxing Multinational Corporations*, Citizens for Tax Justice, at <http://www.ctj.org/html/mnc.htm> (Mar. 1998) [hereinafter McIntyre, *Taxing Multinational Corporations*] (providing a simplified explanation of transfer pricing); Robert S. McIntyre, *The Hidden Entitlements, Tax Breaks for Multinational Corporations*, Citizens for Tax Justice, at http://www.ctj.org/hid_ent/part-2/part2-3.htm (last visited Feb. 10, 2002) [hereinafter McIntyre, *The Hidden Entitlements*] (explaining that multinationals “transfer prices” to shift income away from the United States and shift deductible expenses into the United States). Transfer pricing is a legal means by which multinationals decrease their tax liability. McIntyre, *The Hidden Entitlements*, at http://www.ctj.org/hid_ent/part-2/part2-3.htm. The goal of every multinational is to maximize shareholder value. See Michael Avramovich, *Intercompany Transfer Pricing Regulations Under Internal Revenue Code Section 482: The Noose Tightens on Multinational Corporations*, 28 J. MARSHALL L. REV. 915, 929 (1995) (explaining how multinationals legitimately use transfer pricing to maximize shareholder value). Multinationals do this by maximizing profits in low or no tax jurisdictions and minimizing profit or maximizing expenses in high tax jurisdictions such as the United States. *Id.* See also Dorgan, *supra* note 22, at 35 (stating that “[i]t takes the money out of one pocket—its operations in the U.S.—and puts it into another, which is its operations abroad.”). A corporation may purchase items from a subsidiary located in a tax haven. GAO/GGD-95-101, *supra* note 22, at 2. Transfer pricing not only relates to tangible goods but to services, such as royalty payments. *Id.* at 1. The corporation will not be taxed on the profits made in that country so the subsidiary could charge the United States-based

operations, the OECD recommends countries follow its 1995 Transfer Pricing Guidelines that only permit "arm's length" transactions.²⁵

The last recommendation involving domestic legislation involves bank secrecy.²⁶ Countries are encouraged to permit tax authorities to have access to banking information by eliminating impediments to such information.²⁷

The second set of recommendations relates to tax treaties.²⁸

parent corporation a high price and thus make a huge profit. *Id.* at 1-2. In some cases, prices are overly inflated. *Id.* For example, disposable plastic gloves sold for \$46.22 a piece, ballpoint pens for \$8,500, apple juice at \$2,052 per liter and, my personal favorite, wrist watch batteries were sold to the parent for the bargain price of \$8,252 each. Dorgan, *supra* note 22, at 33-35. This "overcharging" serves the parent well because having to purchase those products at such a high price leads to a loss (on paper) in the United States which prevents the corporation from having to pay taxes on any profit. *See, e.g.,* McIntyre, *Taxing Multinational Corporations*, *supra* note 24 (providing examples of corporations including IBM, Schering-Plough and Prime Computer which utilized tax havens such as Ireland and Puerto Rico to inflate their foreign taxes and minimize American taxes). This is not to say that all corporations participate in abusive transfer pricing schemes. GAO/GGD-95-101, *supra* note 22, at 3 (acknowledging that the differences in tax payment rates between foreign corporations and domestic operations was not convincing evidence of transfer pricing abuse).

25. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 45 (citing OECD, TRANSFER PRICING GUIDELINES). The arm's length principle provides that transfers between related companies must be made as if the companies were strangers to each other. *Id.* *See also* McIntyre, *Taxing Multinational Corporations*, *supra* note 24 (describing how multinationals evade United States taxes when they inform the IRS that they earned their taxable income overseas). This method is considered unrealistic because corporations set up subsidiaries to avoid having to deal at an arm's length. Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX REV. 89, 148 (1995). In theory, the effect is to make the price paid for products internally reflect a reasonable market price and not an inflated price. *Id.* at 94. In practice, however, the process of sifting through transactions to determine the arm's length price has been referred to as "trying to disentangle a vat of spaghetti with a toothpick." Dorgan, *supra* note 22, at 35. Developing countries find the arm's length principle especially hard to apply due to lack of similar goods and comparable prices. UN Ninth Meeting, *supra* note 17, ¶ 26.

26. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 45-46. *See* Caccamise, Jr., *supra* note 4, at 557 (discussing the United States Bank Secrecy Act).

27. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 45.

28. *Id.* at 46-52. Tax treaties are considered to solve double taxation problems and to promote orderly international tax relationships. UN Ninth Meeting, *supra* note 17, ¶ 33. Sometimes, however, income is not taxable anywhere due to tax treaties. *See* McIntyre, *The Hidden Entitlements*, *supra* note 24 (referring to a case which Intel Corporation won in United States Tax Court and was permitted to treat millions of dollars in profits as Japanese income). Intel's profits came from selling American-made chips, but a tax treaty required Japan to exempt these American profits from tax. *Id.*

The OECD recommendations encourage nations to “intensify exchange of relevant information concerning transactions in tax havens” and “restrict the entitlement to treaty benefits for entities and income covered by measures constituting harmful tax practices,” and to clarify “the status of domestic anti-abuse rules and doctrines in tax treaties.”²⁹ Furthermore, countries are encouraged to terminate their tax treaties with tax havens and to coordinate enforcement programs.³⁰ Finally, countries are encouraged to assist in the recovery of tax claims from other countries.³¹

In its final set of recommendations, the OECD emphasized the need for international cooperation in response to harmful tax competition.³² To assist in coordinated defense measures, the

29. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 46-49. To gain greater consistency in the use of exclusion provisions, the OECD committed itself to developing a list of exclusion provisions to be used when negotiating tax treaties. *Id.* at 49.

30. *Id.* at 49-51. The United States has done this. See, e.g., BALTIC BANKING GROUP, INTERNATIONAL FINANCE, FUNDAMENTALS OF ECONOMICS: TAX PLANNING, (1999), at http://www.balticbankinggroup.com/fundamentals/tax_planning.html (last visited Feb. 13, 2002) [hereinafter BALTIC BANKING GROUP] (commenting that the IRS recently disregarded several “international tax planning” treaties to crack down on tax-free tax planning). The article qualified the IRS action that threw out the treaties with the Netherlands, Antilles and the British Virgin Islands because the United States is re-negotiating treaties with these countries. *Id.* This makes “exchange of information” sections in unilateral tax treaties inapplicable to tax havens because the tax haven jurisdictions will continue to limit a state’s ability to obtain the desired information. Caccamise, Jr., *supra* note 4, at 556; UN Ninth Meeting, *supra* note 17, ¶ 14.

31. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 52. The UN commented:

[T]he effort to increase collaboration encounters several difficulties which perceptibly limit States’ ability to take action to meet the new challenges of globalization. First, many States are reluctant to relinquish part of the information obtained in the exercise of their administrative authority and powers within their territory, while some States decline to seek such information from their taxpayers. Second, there is a lack of mutual interest on the part of both States in gathering and providing information. It is considered that tax-planning schemes designed to reduce the tax burden in a State utilize the legal mechanisms provided for in another State (or other States) either unilaterally or in conjunction with the application of a double-taxation convention, so that it is unlikely that the other State will have an equal interest in providing the information.

UN Ninth Meeting, *supra* note 17, ¶ 14.

32. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 52. The challenge is to get all States to cooperate at the same time. See, e.g., OXFAM POLICY PAPERS, *supra* note 13 (emphasizing the need for a multilateral approach to prevent bad behavior from “shift[ing] to the next weakest link in the chain”). See also Tedesco, *supra* note 21, at 1 (indicating that Canadian investment dealers “could lose a substantial part of their \$20-billion a year in business from offshore accounts if they are forced to comply with the tougher client

OECD committed to developing a list of tax havens by the year 2000 that was based on their specified criteria.³³ Countries are encouraged to ensure that economic or political ties with the listed countries are not used to encourage harmful tax practices.³⁴ To promote voluntary compliance with the 1998 report recommendation, the OECD committed to having a dialogue with non-member countries.³⁵ It also committed to promoting principles of good tax administration regarding the enforcement of the Report's recommendations.³⁶

II. THE OECD'S EFFECT ON GLOBALIZATION

The issue is whether the OECD's attempt to combat tax havens supports globalization. The OECD is occasionally referred to as "tax haven haters," "überbureaucrats" or the "Parisian monstrosity," and thus, is not without its critics.³⁷ Deroy Murdock wrote for the *National Review Online*:

The OECD scheme would encourage the world's major economies to penalize 41 low-tax countries and territories for maintaining attractively low rates unless they essentially relinquish their fiscal sovereignty. It also would institutionalize the exchange of financial information across international borders to help tax authorities chase their citizens' assets around the globe.³⁸

This common criticism touches upon the concepts of globalization, sovereignty and privacy. Each concept will be addressed respectively.

Globalization is considered the "march of international capitalism."³⁹ A hallmark of capitalism is competition, and since a majority of the highest-taxing nations collaborated to stomp out lower tax alternatives, the OECD's work to combat tax havens is

identification policy and brokers elsewhere are not"). A Canadian industry official remarked, "[i]f it isn't the same everywhere, all that'll happen is that the business will leave Canada and go somewhere else." *Id.*

33. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 57.

34. *Id.* at 57-58.

35. *Id.* at 58.

36. *Id.*

37. See Michael Lynch, *Tax Haven Haters: The OECD's Hypocritical Campaign Against Low-Tax Countries*, REASON ONLINE, (May 3, 2001), at <http://reason.com/ml/ml050301.html> (last visited Feb. 1, 2002) (speaking of the OECD's campaign against tax havens as "blatant hypocrisy"); Ilana Mercer, *The War on Tax Havens*, at <http://www.ilanamerger.com/taxhaven.htm> (Sept. 10, 2001) (speaking of "überbureaucrats" at the OECD); Deroy Murdock, *Attack of the Global Tax Police*, NATIONAL REVIEW ONLINE, at <http://www.nationalreview.com/murdock/murdock042301.shtml> (Apr. 23, 2001) (speaking of the "Parisian monstrosity").

38. Murdock, *supra* note 37.

39. Udayan Roy, *A Survey of Globalisation: Globalisation and its Critics*, ECONOMIST, Sept. 29, 2001, at 3. Globalization has also been referred to as a "business driven phenomenon." Stichele, *supra* note 23.

against globalization.⁴⁰ After all, the OECD Members constitute twenty-nine countries, none of which are considered tax havens.⁴¹

The OECD addresses globalization in a way which sounds very positive:

The OECD believes that the progressive liberalisation of cross-border trade and investment has been the single most powerful driving force behind economic growth and rising living standards. The Organisation seeks to safeguard and promote an open, multilateral trading system and to encourage adjustments to that system to take into account the changing nature of international trade, including the interface between trade, investment and taxation. The Committee believes that the proposals set out in this Report, although not covering all aspects of tax competition, will further promote these objectives by reducing the distortionary influence on taxation on the location of mobile financial and service activities, thereby promoting fair competition for real economic activities. If governments can agree that these location decisions should be driven by economic considerations and not primarily by tax factors, this will help move towards the "level playing field" which is so essential to the continued expansion of global economic growth.⁴²

40. See Sarah Anderson & John Cavanagh, INSTITUTE FOR POLICY STUDIES, TOP 200: THE RISE OF CORPORATE GLOBAL POWER 7 (1996), available at http://www.ips-dc.org/downloads/Top_200.pdf (last visited Feb. 14, 2002) (commenting that "[a]s citizen movements the world over launch activities to counter aspects of economic globalization, the growing power of private corporations is becoming a central issue."). See also Stichele, *supra* note 23. Combating tax havens pleases anti-corporation groups who are against globalization for fear of increasing multinationals' power and influence. Dr. Michael Hudson, *Globalized Economy and Recapture of Rent*, THE PROGRESS REPORT, at <http://www.progress.org/cg/recapt00.htm> (last visited Feb. 14, 2002).

The task is not only to attack globalization, it is to show the way out, to propose a policy alternative, a counter-strategy. There is such a thing as market socialism. Governments can shape the market to encourage productive investment, and tax away what is parasitic . . . The kind of globalization we have seen since 1980 has been primarily parasitic. It is like a tumor, a tapeworm on the economic organism, not the organism itself.

Id.

41. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 3. In alphabetical order, the original Members of the OECD include 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. *Id.* at 2. Later joining nations include Australia, the Czech Republic, Finland, Hungary, Japan, Korea, Mexico, New Zealand and Poland. *Id.*

42. *Id.* at 8-9. See also UN Ninth Meeting, *supra* note 17, ¶ 3 (highlighting the integrated nature of this global problem). "It cannot be emphasised too strongly that tax haven problems cannot be divorced from the taxation of international transactions in general, or from non-tax policy concerns." BALTIC BANKING GROUP, *supra* note 30. The problem is made more

What could be “real economic activities”? “The Top 200 corporations’ sales are growing at a faster rate than overall global economic activity. Between 1983 and 1999, their combined sales grew from the equivalent of 25.0 % to 27.5 % of World GDP.”⁴³ That appears real to me. By using offshore centers, multinationals are able to maintain a competitive edge.⁴⁴ In fact, if the OECD were successful, it would not “promote fair competition” but rather hinder it.⁴⁵

The continuing existence of tax havens, however, may cause substantial repercussions. “If economic integration allows capital and skills to migrate to low-tax jurisdictions, the tax base will shrink. Governments will find themselves unable to finance social programmes, safety nets or redistribution of income.”⁴⁶ For this reason, tax policy is not just domestic, but rather considers the effects of foreign tax policies and how to counter those effects.⁴⁷ While there is an argument to be made for a level playing field, what exactly does that mean in terms of tax competition? Critic Paul Jacob says the following:

[The OECD wants] the countries of the world to join hands and tax everybody at the same rate, the same way. Form a kind of global tax cartel. It’s a blatant bid to eliminate tax competition between nations. If the goal were ever accomplished - or even roughly

complicated by the need to consider competing policy objectives such as maintaining the competitiveness of overseas business investments, taxing foreign investment fairly, promoting investment in the developed country or making sure the system is administratively efficient. *Id.*

43. Anderson & Cavanagh, *supra* note 40, at 3.

44. Finor Associates, Ltd., *supra* note 2 (commenting that “[s]tudies show that lower tax regimes allow multinational companies to offer their products in all nations at more competitive prices than would otherwise be possible if not for the ability of these companies to operate in lower tax environments.”). Those who do not trust corporations put it another way. See, e.g., OXFAM POLICY PAPERS, *supra* note 13 (describing the impact of financial havens on developing countries as “[t]hose TNCs willing to exploit the opportunities for international tax avoidance can gain a significant advantage of domestic competitors and small and medium sized enterprises.”).

45. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 9.

46. Roy, *supra* note 39, at 15. See also Fields, *supra* note 4 (quoting the director of financial, fiscal and enterprise at the OECD William Witherell: “[r]ampant tax evasion is a threat to the treasuries and democratic foundations of every nation”).

47. Hines, Jr., *supra* note 13, at 1.

The ability and evident willingness of taxpayers to relocate activity, to shift taxable income between jurisdictions, and to respond to incentives created by the interaction of domestic and foreign tax rules, mean that the tax policies of other countries obviously must be considered in the formulation of domestic policy. In the current environment, almost every U.S. tax provision influences foreign direct investment (FDI) or provides incentives for international tax avoidance.

Id.

approximated - it would be a disaster for the world's taxpayers.⁴⁸

The elimination of all tax competition would be harmful indeed. Competition denotes alternatives and alternatives give multinationals the opportunity to leave and take their investments with them.⁴⁹ This opportunity to leave prevents governments from being tyrants.⁵⁰ One must consider that the highest taxing governments in the world are trying to eliminate this competition.⁵¹

The OECD makes it clear that establishing a standard tax rate is not its intent. For example, one OECD report stated that “[t]he project is not primarily about collecting taxes and is not intended to promote the harmonization of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates.”⁵² The emphasis must be on the qualifier “primarily,” otherwise, collecting taxes and dictating an appropriate level of tax rates appears to be exactly what the OECD is attempting to accomplish.⁵³ For example, the recommendations on transparency

48. Paul Jacob, *Taxpayers Unite!* (U.S. Term Limits Daily Radio Commentary No. 389, June 25, 2001), available at http://www.termlimits.org/press/common_sense/cs389.html (last visited Feb. 14, 2002).

49. Roy, *supra* note 39, at 15. See also OXFAM POLICY PAPERS, *supra* note 13 (commenting that “[t]he internationally integrated nature of TNCs allows them to choose between locations according to the different tax regimes or other benefits on offer.”).

50. Roy, *supra* note 39, at 15. See also OECD, HARMFUL TAX COMPETITION (statement by Switzerland), *supra* note 5, at 76 (stating that “competition in tax matters has positive effects . . . it discourages governments from adopting confiscatory regimes, which hamper entrepreneurial spirit and hurt the economy, and it avoids alignment of tax burdens at the highest level.”). The effect of tax competition is explained:

Tax competition, like any competition, disciplines governments. The U.S.’ tax cuts of the 1980s kept taxes lower in Europe than they otherwise would have been, just as Virginia’s lower taxes puts pressure on neighboring Maryland and the District of Columbia. The United States is a giant free-trade zone in which states compete as tax jurisdictions; we’ve all benefited from it.

Lynch, *supra* note 37. If one country does something, other countries have to follow suit so as not to lose foreign direct investments. For example:

Since the US move to abolish the withholding tax on foreign residents earning interest income on portfolio investments in 1984, no other major economy has been able to maintain a withholding tax for fear of losing out on foreign investments . . . [i]n all countries the fear that money would shift elsewhere makes unilateral moves to tax interest income impossible.

OXFAM POLICY PAPERS, *supra* note 13. The United States’ action has led it to be called “the largest tax haven in the world.” Lynch, *supra* note 37.

51. Pacific Islands Forum, *supra* note 15, ¶ 2.

52. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 14, at 5.

53. *Id.*

are designed to ease the collection of taxes by tax authorities.⁵⁴ Consider also the criteria that identify a country as a tax haven primarily based on no tax rate or a very low effective tax rate. By encouraging defensive measures against these countries, the OECD is effectively dictating to tax havens that their tax rate levels are inappropriate.⁵⁵ The OECD continued:

Rather, the project is about ensuring that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation decisions. The project is focused on the concerns of OECD and non-OECD countries, which are exposed to significant revenue losses as a result of harmful tax competition.⁵⁶

The Economist, recognizing the mobility of capital and its effect of competition, states:

So far this competition has affected the structure of tax codes rather than overall tax burdens; total yields have been unaffected. In an effort to attract inflows of capital, and especially inflows of foreign direct investment, governments have been lowering their tax rates for corporate income and raising them for personal income, or relying more on a variety of indirect taxes, or both.⁵⁷

While *The Economists'* conclusion somewhat defeats the OECD's concern of "significant revenue losses" based upon tax rate, this conclusion may not be accurate.⁵⁸

In 1998, the congressional Joint Committee on Taxation estimated that the United States Treasury would lose ten billion dollars in revenue due to tax breaks offered to multinational corporations.⁵⁹ Foreign sales corporations would cause a loss of \$1.6 billion dollars and transfer pricing would add another twelve to fifty billion dollars to the significant revenue losses.⁶⁰ This

54. See OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 24 (explaining that information exchange would simplify tax calculation).

55. *Id.* at 77 (statement by Switzerland) (using tax rates as a criterion to identify tax havens "results in an unacceptable protection of countries with high levels of taxation").

56. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 14, at 5. This tax competition may be causing developing countries to forego tax revenues of at least \$50 billion per year. OXFAM POLICY PAPERS, *supra* note 13. See also *Evasion of Responsibilities and Dues*, Global Issues that Affect Europe, at <http://www.globalissues.org/TradeRelated/Corporations/Evasion.asp> (last visited Nov. 27, 2001) (recognizing the reality that poorer countries do not have any alternative but to lower or eliminate taxes for corporations threatening to leave).

57. Roy, *supra* note 39, at 16.

58. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 14, at 5.

59. Shields, *supra* note 17, at 2.

60. *Id.* By some estimates, transfer pricing cost the United States \$43 billion dollars in 1999 alone, more than \$117 million dollars a day. See Dorgan, *supra* note 22, at 35 (referring to Professors Simon Pak and John Zdanowicz who based their transfer pricing estimates upon examination of customs receipts). Offshore export companies cost the United States billions of

would only support the OECD's position if the United States suffered these losses as a result of harmful tax competition. After all, low or no tax jurisdictions are what make transfer pricing both possible and profitable.

However, these tax breaks appear to be offered more out of freewill than out of a forced response to maintain the United States' premiere competitive position.⁶¹ As stated in *The Economist*, the United States is merely lowering its tax rates for multinational corporations to stimulate foreign direct investment and raising them for personal income.⁶² This is supported by the fact that only twelve percent of income generated from taxes was from corporations, compared to a full forty-four percent which came from individual income taxes.⁶³

III. THE OECD'S VIOLATION OF SOVEREIGNTY

All globalization leads to a sacrifice of some sovereignty.⁶⁴

dollars annually:

In accordance with the Foreign Sales Corporation Act (FSC), US firms are free to carry out their export business via mailbox companies on the Cayman Islands, the Virgin Islands, Bermuda, Puerto Rico, Barbados, Guam and certain other centres. This results in a tax reduction of about 65 percent . . . According to EU information, currently half of all US exports in the order of some 125 billion US dollars enjoy rebates in this way. The US Federal Budget for 2001 envisages an indirect subvention of 4.1 billion dollars for this purpose.

Rügemer, *supra* note 4. Boeing, Microsoft and GM are cited as examples of multinationals which took advantage of the Foreign Sales Corporation status to get a tax exemption for exports generated offshore. Michael Paulson, *WTO Case File: Foreign Sales Corporations*, available at <http://seattlep-i.nwsourc.com/national/case4.shtml> (last visited Nov. 22, 2001). The WTO held the FSC to be an illegal export subsidy. *Id.*

61. The United States offers five ways for international investors to reduce taxes estimated to provide \$19,100 million dollars in benefits. Janice C. Shields, *Corporate Welfare and Foreign Policy*, THE PROGRESS REPORT, at <http://www.foreignpolicy-infocus.org/papers/cw/index-body.html> (last visited Nov. 27, 2001) (combining the following tax breaks: inventory property sales source rule exception, foreign sales corporations, tax deferral of income of controlled foreign corporations, transfer pricing, and lack of a minimum tax on foreign-owned businesses). The OECD has been criticized for not taking these tax competitive features into account. Brown, *supra* note 7, at 313.

62. Roy, *supra* note 39, at 9.

63. Shields, *supra* note 17, at 1. To the individual feeling the burden of taxes, this statistic considered alone seems unfair. However, consider the argument in *The Economist* which states that "heavy reliance on corporate taxes is bad policy . . ." Roy, *supra* note 39, at 16.

64. See UN Ninth Meeting, *supra* note 17, ¶ 4 (recognizing the likelihood that the increased need for international tax cooperation will risk fiscal sovereignty). The UN recognized that the "new economic situation requires a reappraisal of the State's position in the exercise of its powers of taxation, which in turn necessitates abandoning the concept of exercise of sovereignty, with attendant consequences." *Id.* ¶ 11.

Any sovereignty that is lost by signing worldwide trade agreements, however, is tolerable because it is only forfeited after an opportunity to negotiate.⁶⁵ By excluding non-OECD members in the analysis and by recommending coordinated defense measures, the OECD violates the sovereignty of those nations that it unilaterally deems tax havens.⁶⁶ “It is uncivil, not to mention coercive, for the OECD to force tax havens to prostrate their laws before those of the aggressor governments.”⁶⁷

Every nation has a right to operate its own tax regimes and should not need to put its economy, which is primarily based on the offshore investment market, at risk to ensure that taxing giants maintain their imprisoned tax base.⁶⁸ Even the OECD admits that a nation’s economy could be detrimentally affected if it reforms the OECD-way to get off the tax haven blacklist.⁶⁹ As an example, the economies of the Pacific Islands will be negatively affected by the OECD’s proposal because it maintains the current status quo.⁷⁰ The Pacific Islands Forum met with the OECD to express their concerns and to address this issue.⁷¹

65. See Pacific Islands Forum, *supra* note 15, ¶ 5 (arguing that affected nations should fully participate in more than mere “dialogue . . . to fully achieve multilateralisation” because it could “divide the concerted efforts of affected nations to achieve a consistent dialogue with the OECD”).

66. See, e.g., OXFAM POLICY PAPERS, *supra* note 13 (emphasizing the need for developing countries [tax havens] to be involved in discussions from the beginning). See also Brown, *supra* note 7, at 314 (5) (commenting that multinational corporations ultimately shape both tax laws and capital investments because they desire to minimize their tax rates when tax haven nations are not included in such tax law discussions).

67. Mercer, *supra* note 37.

68. Pacific Islands Forum, *supra* note 15, ¶ 3. Conversely, nations have a right to require information regarding investors using brokers within the state’s jurisdiction. See, e.g., Tedesco, *supra* note 21, at 1 (quoting a Canadian securities official who believed it unacceptable for entities to hide behind the secrecy laws of foreign countries). The Canadian securities official rationalized:

It is not illegal to deal with privacy jurisdictions. What you can’t say is that the rules won’t allow brokerages to ask important questions. Our view is that if they are operating in this jurisdiction, trading in stocks through a Canadian broker, on a Canadian stock exchange, the fact is they have to comply with the rules here.

Id.

69. OECD, TOWARD GLOBAL TAX CO-OPERATION, *supra* note 14, at 7. Because tax incentives attract foreign investment, some countries make legislative changes to intentionally become tax havens. See, e.g., Walid Nasser, *Transforming Lebanon into a Tax Haven*, 18 MIDDLE EAST EXEC. REP. 8, 15-16 (Aug. 1995) (describing the changes Lebanon made to its tax system to attract offshore companies).

70. Pacific Islands Forum, *supra* note 15, ¶ 2. The Pacific Islands Forum has seven nation members: Cook Islands, Nauru, Niue, Republic of Marshall Islands, Tonga and Vanuatu. *Id.*

71. See *id.* (stating that the GDP of Australia is \$300 billion dollars, compared to the Pacific Forum nations’ GDP of only \$1 billion dollars). Prior

The Pacific Islands feel powerless against the OECD.⁷² All seven of the listed Pacific Islands have a combined gross domestic product less than that of Australia.⁷³ As a result, they “do not have the resources of the OECD Members to address the issue of harmful tax competition.”⁷⁴ Income from offshore centers in these countries can amount to eight to ten percent of their GDP.⁷⁵ These factors contribute to one-sided negotiations, not the open “dialogue” that the OECD portrays.⁷⁶

The Pacific Islands detailed their concerns in a report to the OECD.⁷⁷ Emphasizing the sovereignty of all nations to compete in the international financial markets, the Pacific Islands Forum first observed that they are being forced to choose between two

to the 1998 Report, the OECD held three seminars to involve non-OECD countries in the analysis. OECD, TOWARD GLOBAL TAX CO-OPERATION, *supra* note 14, at 22. These seminars brought together over thirty non-member countries and were held in various nations throughout the world to permit maximum participation. *Id.* For example, the OECD held one seminar in Mexico to include the Latin American region and another in Turkey for the NIS region. *Id.* The Asian Development Bank also had an OECD seminar in Singapore to include the Asian region. *Id.* The OECD stated that these seminars have enlightened the committee regarding the concerns of non-member countries. *Id.* See also Press Statement 3601, Regional Talks on Harmful Tax Competition, Pacific Islands Forum, to the OECD (Apr. 28, 2002), available at <http://www.forumsec.org.fj/news/2001/apr13.htm> (last visited Feb. 18, 2002) [hereinafter Pacific Islands Forum Press Statement] (quoting Acting Secretary-General of the Pacific Islands Forum Secretariat Mr. Iosefa Maiava). Mr. Iosefa Maiava summarized the OECD visit when he said, “[t]he visit to the region by OECD representatives has improved their understanding of the vulnerable situation of these Pacific nations.” *Id.*

72. *Id.* (referring to its relationship with the OECD as a “David and Goliath standoff”).

73. *Id.* See also Brown, *supra* note 7, at 314 (criticizing the OECD’s Forum report). Brown argues that the OECD fails to recognize that the developed countries’ tax regimes have harmful effects on the economies of developing countries. *Id.* See also OXFAM POLICY PAPERS, *supra* note 13 (observing that developing countries can hardly compete with rich countries that can afford to offer massive subsidies and incentives).

74. Mary Swire, *Pacific Nations Present United Front Against OECD*, Tax-News.com, at <http://www.tax-news.com/asp/story/story.asp?storyname=3334> (May 1, 2001).

75. *Id.* Eliminating the attractiveness of these financial centers would seriously impact all sectors of their economy and their long-term economic growth. Pacific Islands Forum, *supra* note 15, ¶ 2; Murdock, *supra* note 37. Developing countries which seek to be tax havens believe the “benefits of attracting investment will offset the erosion in their tax base.” OXFAM POLICY PAPERS, *supra* note 13.

76. OECD, TOWARD GLOBAL TAX CO-OPERATION, *supra* note 14, at 20. This “dialogue” included the economic assistance that jurisdictions will need to transition in the absence of tax incentives. *Id.* Therefore, the OECD seeks to eliminate the ability of these economies to fairly compete because they prefer to dis-empower these economies and have them depend on OECD Member countries for economic support. *Id.*

77. See generally Pacific Islands Forum, *supra* note 15.

evils.⁷⁸ If they choose not to commit to the OECD's recommendations, they face coordinated defensive measures which will harm their economies and cause them to greatly rely upon welfare from OECD Members.⁷⁹ Conversely, if they choose to abide by the OECD's demands, their economies will suffer because these countries lack the ability to otherwise effectively compete for foreign direct investment.⁸⁰

In addition, the OECD treats its Members differently than those nations listed as tax havens.⁸¹ The Pacific Island Forum demands compensation for the business that will be lost.⁸² The Forum suggested that the OECD Members use domestic defensive measures rather than have the Pacific Islands forfeit their tax haven status.⁸³ For example, The Pacific Islands Forum suggested that OECD Members standing to benefit from a lack of tax haven competition should bear the burden of administrative costs.⁸⁴

Input from all parties likely to be affected is needed to respect each party's sovereign right to regulate its own fiscal policies.⁸⁵ The OECD, an exclusive membership of the leading industrialized nations, is not the appropriate forum for a worldwide discussion regarding global tax competition.⁸⁶ In my opinion, the United Nations' policy of recognizing the needs of developing countries is a better forum to discuss these important worldwide issues. The United Nations is also a better forum to create a solution which can positively affect both developed countries and especially the developing countries.⁸⁷

78. *Id.* ¶ 2.

79. *Id.*

80. *See id.* (stating that "the elements that make offshore tools attractive will be removed and so cause shrinkage or closure of this sector in listed nations.").

81. *Id.* ¶ 3. The Pacific Islands Forum concluded that:

Listed nations have been treated unfavourably, both in terms of the listing and in terms of the standards expected, compared with other offshore financial centres and OECD Members. The substance of the OECD-developed Memorandum of Understanding (November 2000) does not attract the support of listed nations. It offers one-sided benefits to OECD Members, while OECD nations with offshore financial centers are not required to make an identical commitment.

Id. ¶ 2.

82. Pacific Islands Forum, *supra* note 15, ¶ 4.

83. *Id.* ¶¶ 8-9.

84. *See id.* ¶ 8 (requesting the OECD Members bear the expenditures necessary to "rather than being borne by the so-called "tax havens").

85. *Id.* ¶ 9.

86. *Id.* ¶¶ 10, 12 (supporting the OECD's Global Tax forum which would involve multiple global organizations).

87. *See generally* UN Ninth Meeting, *supra* note 17, ¶¶ 2-4 (indicating that the UN's report was to recommend an "institutional framework" for modern-day globalized markets that would manage opportunistic tax base practices).

IV. THE NEED TO BALANCE INVESTOR PRIVACY WITH CRIMINAL DETERRENCE

Like globalization and sovereignty, privacy issues relate to situations where parties on either side of a pro-privacy or pro-information exchange stand to lose money.⁸⁸ If the tax authorities seeking the exchange of information have their way, economies which rely on the lucrative private banking business stand to lose millions of dollars in lost customers.⁸⁹ If the pro-privacy group maintains the status quo, however, criminals will continue to launder money or evade taxes, and countries such as the United States lose millions of dollars.⁹⁰ Since there are legitimate reasons to seek privacy and legitimate needs for information gathering, both sides are justified in their arguments. Therefore, a compromise must be found where damages are minimized.

The following Section addresses how two OECD Members viewed the OECD's work regarding information exchange. This Section acknowledges that there are legitimate reasons for seeking privacy and legitimate reasons to seek information. However, an international standard is necessary regarding when information gathering is appropriate and how much information can or should be sought.

Both Luxembourg and Switzerland abstained from the OECD's 1998 Report because the OECD advocated abolishing bank secrecy.⁹¹ Due to the value of these sectors to their

88. Pacific Islands Forum Press Statement, *supra* note 71 (exemplifying the discrepancy between what the Pacific Islands stand to lose as compared to OECD Member nations).

89. *Id.*

90. See GAO/GGD-95-101, *supra* note 22, at 4 (concluding that in 1993, "international examiners proposed adjustments to taxable income of . . . \$900 million for 247 FCCs and \$1.3 billion for 122 USCCs").

91. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 73-78 (Annex II). See also Caccamise, *supra* note 4, at 554-61 (discussing various Member comments on bank secrecy). Luxembourg did not share the OECD's view that bank secrecy was harmful. OECD, TOWARDS GLOBAL TAX CO-OPERATION, *supra* note 14, at 74. Furthermore, Luxembourg wanted the exchange of information to be subject to precise limits equivalent to those in criminal matters. *Id.* Switzerland similarly agreed that information limits are "legitimate and necessary to protect the confidentiality of personal data." *Id.* at 77. This is not surprising considering the impact Swiss private banks have on its economy. See *New Lease on Life for the Swiss Banquier Prive*, *supra* note 2, at 21 (describing Switzerland's private banking sector). Measured by assets, two of Switzerland's private banks are the largest in the world. *Id.* UBS is the largest bank with Credit Suisse coming in third. *Id.* The private banking sectors of these banks are highly profitable. *Id.* Both UBS and Credit Suisse "earn more than half of their entire profits from their private banking arms." *Id.* Regarding the OECD's efforts to combat tax havens, a Swiss banker stated:

Private banks operating in tax havens are under pressure to increase transparency and liaise better with global tax authorities. This can be

economies, their cause for concern is legitimate.⁹² These two countries, among others, believe “[t]he right to personal confidentiality is one of the keys to democracies” and they will seek to protect that right.⁹³

Not all offshore account holders are criminals.⁹⁴ A legitimate reason to seek privacy is a desire to protect assets from an unstable government’s confiscation or from frivolous alleged creditors.⁹⁵ Another legitimate reason to seek privacy may be to keep information from competitors or non-governmental organizations which feel that “too much profit is itself evidence of exploitation.”⁹⁶ In spite of these lawful reasons, multinationals as well as citizens must give up some of that privacy to protect their economies.⁹⁷

Freedoms are limited to protect society from harm.⁹⁸ For example, in the United States we are granted the right of free speech.⁹⁹ However, we are unable to use “fighting words” because some speech is harmful.¹⁰⁰ Similarly, we are free to enter into contracts for any subject matter . . . as long as that subject matter is legal. This limitation is designed to protect us from harmful contracts, such as contracts to kill. Is it not then appropriate to

seen as an opportunity and a threat. Clearly, account holders seeking privacy may well be discouraged, but, equally, higher standards and regulation will attract legitimate investors and make them feel more comfortable.

Id.

92. See Pacific Islands Forum Press Statement, *supra* note 71 (comparing the miniscule tax base losses that OECD Member nations suffer compared to what the Pacific Islands could potentially suffer to emphasize the value of offshore centers to the Pacific Islands).

93. See *New Lease on Life for the Swiss Banquier Prive*, *supra* note 2, at 21.

94. Terence Corcoran, *Know Your Regulators!: Offshore Account Probe is Another Twisted Venture*, FIN. POST: EDITORIAL, Oct. 18, 2001, at 15, available at 2001 WL 28026420.

95. Larkins, *supra* note 4, at 478-79. See also J. Alex Tarquinio, *Squirreling Your Money Abroad*, Forbes.com, at <http://forbes.com/2000/01/08/feat.html> (last modified Jan. 8, 2000) (citing asset protection as a reason to seek a private offshore account). For example, when a seller sells a corporation, the seller has to make numerous representations and warranties. *Id.* After the buyer has bankrupted the company within a year, the buyer wants his or her money back. *Id.* The seller’s profit from the sale would be protected if he or she had put it in an offshore trust. *Id.*

96. Larkins, *supra* note 4, at 478-79 (listing some tax havens which have confidentiality laws, including “Anguilla, the Bahamas, the Cayman Islands, Liechtenstein, Luxembourg, Panama and Vanuatu”).

97. See Dorgan, *supra* note 22, at 35 (concluding that transfer pricing drains the United States’ economy).

98. Pacific Islands Forum, *supra* note 15, ¶¶ 6, 12.

99. *R.A.V. v. City of St. Paul, Minn.*, 505 U.S. 377, 382 (1991).

100. See *id.* at 382 (citing *Chaplinsky v. New Hampshire*, 315 U.S. 568, 572 (1942)) (defining fighting words as “those which by their very utterance inflict injury or incite an immediate breach of the peace”).

limit privacy to prevent harm?¹⁰¹

As a child I was taught a test to determine if I was doing something right or wrong. If the whole world found out about what I contemplated doing, could I still be proud about it? This test kept me out of trouble numerous times, just as investigative journalism surely makes those who would otherwise deceive us hesitate, if only for a moment.

This glare of the public eye is used as a criminal deterrent in numerous situations. For example, consider the reporting requirements in the Foreign Corrupt Practices Act or many environmental treaties in which pollution levels are published for all to see.¹⁰² This is part of what the OECD is trying to accomplish when it publishes a list of tax havens. For example, the OECD's 1998 Report correctly states that "[b]ecause non-transparent administrative practices as well as an inability or unwillingness to provide information not only allow investors to avoid their taxes but also facilitate illegal activities, such as tax evasion and money laundering, these factors are particularly troublesome."¹⁰³

To facilitate information gathering to deter criminal activity, investment brokers are subject to a "know-your-client" rule.¹⁰⁴ "[T]he most fundamental obligation of brokers is to ensure they have sufficient knowledge of their clients' affairs in order to act in their best interests. Implicit in this basic tenet is that brokers are required to uphold the integrity of the capital markets."¹⁰⁵ The challenge is that no uniform regulations currently exist regarding just how much information an investment firm is expected to know about offshore clients in highly secretive jurisdictions.¹⁰⁶ Therefore, those seeking to maintain their privacy-related

101. *But see* Murdock, *supra* note 37 (quoting Heritage Foundation fiscal policy analyst Dan Mitchell: "[i]f you repealed the Fourth, Fifth and Eighth Amendments, you could reduce crime, but it wouldn't be worth the cost to individual liberty.").

102. *See, e.g.,* Kathleen A. Lacey, *Expansion of SEC Authority into Internal Corporate Governance: The Accounting Provisions of the Foreign Corrupt Practices Act (A Twentieth Anniversary Review)*, 7 J. TRANSNAT'L L. & POL'Y, 119, 120-21 (explaining that Congress included accounting provisions requiring accurate and clear representation of expenses in an attempt to combat bribery and other foreign corrupt practices).

103. OECD, HARMFUL TAX COMPETITION, *supra* note 5, at 24. The use of privacy to evade taxes is common. For example, privacy-bulletin.com's slogan says "Offshore Banking: Get your money out of the country before your country gets the money out of you." E-commerce Solutions, Privacy Bulletin – Categories, at <http://www.privacy-bulletin.com/ecommerce> (last visited Feb. 14, 2002).

104. Tedesco, *supra* note 21, at 1.

105. *Id.* *But see* Corcoran, *supra* note 94, at 15 (arguing that the "know-your-client" rule is to protect investors from incompetent and manipulative brokers"). If Mr. Corcoran's analysis of the "know-your-client" rule is correct, it seems that the title of the rule is a misnomer.

106. Tedesco, *supra* note 21, at 1.

business profits will likely be less inclined to interpret the rule broadly.

Numerous efforts are in progress to enable tax authorities to gain the information needed to enforce their laws.¹⁰⁷ Emphasis needs to be placed on the need to maintain sovereignty.¹⁰⁸ Courts are challenged by this as exhibited in the Seventh Circuit Court of Appeals case of *United States v. First National Bank of Chicago*.¹⁰⁹

In *First National*, the IRS requested information regarding records at their Greek branch regarding a Greek bank account.¹¹⁰ First National's bank employees in Greece could not comply because Greek bank secrecy laws subjected them to six months in prison for disclosing any personal information.¹¹¹ The issue was whether First National should be compelled to comply with the discovery order despite Greek laws subjecting bank employees to a jail term.¹¹² The court stated that "[t]he fact that foreign law may subject a person to criminal sanctions in the foreign country if he produces certain information does not automatically bar a domestic court from compelling production."¹¹³ Rather, Section 40 of the Restatement (Second) Foreign Relations Law entitled "Limitations on Exercise of Enforcement Jurisdiction" provides a guiding analysis:

Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in light of such factors as

(a) vital national interest of each of the states,

107. See Convention on Mutual Administrative Assistance in Tax Matters, opened for signature Jan. 25, 1988, Europ. T.S. No. 127, 1988 U.S.T. Lexis 193, 195 (explaining that the Treaty's purpose is to create an atmosphere of international cooperation while countries retain both sovereignty and self-determined legislation).

108. This is challenging. In St. Vincent, for example, the policy is to not provide information until someone is indicted. Fields, *supra* note 4, at 1C. Western authorities, however, must first get information on offshore accounts before they can indict someone. *Id.*

109. Caccamise, Jr., *supra* note 4, at 567-68 (citing *United States v. First Nat'l Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983)). In *First National*, the court concluded that "a foreign interest in bank secrecy laws is not superseded by the domestic interest in the enforcement of tax law" under Section 40 of the Restatement (Second) Foreign Relations Law. *Id.* at 568; *First Nat'l*, 699 F.2d at 345.

110. *First Nat'l*, 699 F.2d at 342.

111. See *id.* (commenting that First National's employees' prospective prison terms were not convertible into a fine).

112. *Id.* at 343.

113. *Id.* at 345 (citing *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 563 F.2d 992, 997 (10th Cir. 1977)).

(b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,

(c) the extent to which the required conduct is to take place in the territory of the other state,

(d) the nationality of the person, and

(e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.¹¹⁴

Applying these factors, the court held that both the IRS and Greece had interests that required remanding for further proceedings.¹¹⁵ The court suggested that First National attempt to obtain Greece's permission to provide the information requested.¹¹⁶ It reasoned that "[a]lthough the interest of the United States in collecting taxes is of importance to the financial integrity of the nation, the interest of Greece, served by its bank secrecy law is also important"¹¹⁷

A subsequent Seventh Circuit Court of Appeals case acknowledged the difficulty in balancing the interests of a foreign jurisdiction with domestic interests.¹¹⁸ "[T]he judiciary has little expertise, or perhaps even authority to evaluate the economic and social policies of a foreign country."¹¹⁹ However, in tax cases where the United States is a party, the national interest is compelling.¹²⁰ Even assuming the domestic interest is more compelling, one needs to consider the resources of the other state to assist with compliance.¹²¹ With concepts as difficult as transfer pricing, compliance efforts are very costly for both the corporation and the IRS.¹²²

114. *Id.* at 346.

115. *First Nat'l*, 699 F.2d at 346.

116. *Id.*

117. *Id.* Although there was a bilateral tax treaty between the United States and Greece, the court did not render an opinion regarding its effect on the case. *Id.*

118. *Reinsurance Co. of Am., Inc. v. Administratia Asigurarilor de Stat (Administration of State Ins.)*, 902 F.2d 1275, 1280 (7th Cir. 1990).

119. *Id.* (quoting Judge Marshall from *In re Uranium Antitrust Litig.*, 480 F.Supp. 1138, 1148 (N.D. Ill. 1979)).

120. *Id.*

121. *See UN Ninth Meeting*, *supra* note 17, ¶ 21. "[T]here are perceptible differences in the ability of developed and developing countries to obtain and provide required information to a treaty partner. The developed countries need to provide information and assistance to developing countries to enable them to carry out exchange of information procedures at an affordable cost." *Id.*

122. *See VOLPE*, *supra* note 5 (stating that "[l]arger US businesses pay \$1.33 on tax compliance for each dollar sent to the federal government."). *See also* GAO/GGD-94-96FS, *supra* note 22, at 3 (describing that the IRS increased

In summary, though privacy interests are important, the interest in deterring criminal behavior is equally important. The court in *First National* indicated that criminal matters were subject to a different standard than tax matters.¹²³ While there are more issues when personal liberty is involved, tax evasion is a crime and the same standard should be applied to the discovery of information due to its criminal nature.

V. PROPOSAL FOR A MORE GLOBAL FORUM

To avoid the sovereignty issues caused by a small group of industrialized nations applying peer pressure to a large group of very small developing countries, I propose a forum other than the OECD to address issues related to tax havens.¹²⁴ While the World Trade Organisation (WTO) has recently addressed a tax incentive, the WTO generally is not an appropriate body to address the issue because its focus is retroactive and case-specific. For example, the WTO found the Foreign Sales Corporation to be in violation of the WTO as an export subsidy. Also, its enforcement is limited to a limited number of members.

A better forum to address international tax matters proactively is the United Nations. Significantly, “nearly every nation in the world belongs to the UN.”¹²⁵ The United Nations emphasizes the sovereignty of its members and states that “all the Member States - large and small, rich and poor, with differing political views and social systems - have a voice and vote in this process.”¹²⁶ This global presence would encourage the cooperation necessary to effectively address international tax related issues while maintaining the sovereignty rights of all who would be affected.

The United Nations organ that addresses tax issues is the Economic and Social Council, which is headquartered in New York.¹²⁷ The Council has already begun work regarding the important area of international economic issues.¹²⁸ “As the central forum for discussing international economic and social issues and for formulating policy recommendations, the Council plays a key

their staff to enforce “international tax compliance” laws).

123. *First Nat'l*, 699 F.2d at 345.

124. OECD, *About OECD*, at <http://www.oecd.org/oecd/pages/home/displaygeneral> (last visited Feb. 15, 2002) (stating that “[d]ialogue, consensus and peer pressure are at the very heart of OECD.”) (emphasis added).

125. See U.N., *The UN in Brief: How the UN Works*, at <http://www.un.org/Overview/brief.html> (last visited Feb. 15, 2002) (declaring that 189 countries are Members). *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

role in fostering international cooperation for development.”¹²⁹ The Council has fifty-four members with leadership from Croatia, Guatemala, Finland, Bahrain and South Africa.¹³⁰ In the years 1998 and 1999, the United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters met to discuss issues such as transfer pricing, exchange of information and tax treaties.¹³¹

Like the OECD, the United Nations views tax havens as a “threat.”¹³² The United Nations also defines a tax haven similarly to the OECD.¹³³ According to the United Nations, a tax haven is a country with a “[l]ow or zero effective tax rate; [a]n unwillingness to share information; [a] lack of transparency; absence of real business activity; [and] a special regime clearly demarcated from the domestic economy.”¹³⁴

However, the United Nations differs from the OECD in some important areas. For example, the United Nations views the tax haven issue as a “cooperative effort between developed and developing countries and transitional economy countries.”¹³⁵ Also, the United Nations does not consider developing countries offering incentives leading to a low effective tax rate to be tax havens.¹³⁶ Regarding exchange of information, the United Nations has a more realistic viewpoint than the OECD:

[T]ax haven countries flourished primarily because of their insistence on non-disclosure of information to the countries of residence of taxpayers who used the facilities offered by tax havens. Such tax haven countries were not likely to enter into bilateral tax treaties with non-tax haven countries with provisions of exchange of information since their own existence as a tax haven would then be at stake. It was also noted that developed countries with their greater economic power and highly developed legal systems were in

129. U.N., *The UN in Brief: How the UN Works*, at <http://www.un.org/Overview/brief.html>.

130. U.N., United Nations Economic and Social Council, *Members*, at <http://www.un.org/esa/coordination/ecosoc/members.htm> (last visited Feb. 4, 2002) (listing the fifty-four Members); U.N., United Nations Economic and Social Council, *Welcome*, at <http://www.un.org/esa/coordination/ecosoc/> (last visited Feb. 4, 2002) (listing members of the UN’s leadership team).

131. See UN Ninth Meeting, *supra* note 17, ¶¶ 2-4, (stating that the purpose of their meeting was to “explore” methods to curtail “unfair tax competition”); *Eighth Meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters: Report of the Secretary General*, U.N. ESCOR, 1998 Sess., 8th mtg., Agenda Item 13 (d), ¶ 2-3, U.N. Doc. E/1998/100 (1998), available at <http://www.un.org/documents/esosoc/docs/1998/e1998-57.htm> [hereinafter UN Eighth Meeting] (stating that the purpose of the meeting was to resolve world wide tax evasion and double-taxation issues).

132. UN Eighth Meeting, *supra* note 131, ¶ 10.

133. *Id.* ¶ 12.

134. *Id.*

135. *Id.* ¶ 10.

136. *Id.* ¶ 13.

a better position, compared with the majority of developing countries, to deal with tax havens.¹³⁷

Rather than using coordinated defense measures against tax havens, the United Nations seeks to empower nations by offering training to tax administrators of transitional and developing economies.¹³⁸ This training includes “practical methods and strategies for combating tax evasion” and gives “tax administrators” the opportunity to discuss their own tax systems.¹³⁹

The United Nations’ proposed solution greatly resembles the OECD’s solution because it pressures tax havens to exchange more information for crime prevention.¹⁴⁰ However, the United Nations is approaching this with a more realistic point of view as a result of a true open dialogue with its expansive group of Members. Taxpayers can no longer be expected to stay within borders like cows to be milked. However, if enough people contribute to an open discussion, a fair allocation of the tax burden can be reached while still supporting globalization. National sovereignty can be maintained and the right to privacy can be balanced with the need to deter criminal conduct.

137. UN Eighth Meeting, *supra* note 131, ¶ 20.

138. *Id.* ¶ 43.

139. *Id.*

140. *Id.* ¶ 46.