The unfortunate genesis of an international tax organisation

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The Paris-based Organisation for Economic Co-operation and Development (OECD) was once known only for gathering statistics and publishing innocuous studies. But bureaucracies rarely turn down opportunities for bigger budgets and more powers, so the OECD was happy to do the bidding of high-tax nations and enter the realm of policy-making with an anti-tax competition project. The campaign against low-tax jurisdictions began in the mid-1990s and entered the public realm with the publishing of a 1998 report entitled, "Harmful Tax Competition: An Emerging Global Issue."

The report highlighted the degree to which the OECD was beholden to the radical theory of capital export neutrality (CEN), which presupposes that all differences in tax rates should be eliminated and that taxpayers should have no ability to protect themselves by shifting economic activity to jurisdictions with better tax law. Unfortunately, it was also just the opening salvo in what has become a lengthy campaign for higher taxes, more spending, and tax harmonisation.

The 1998 report has continued to serve as a framework for the OECD's Centre for Tax Policy and Administration, and eventually led to the formation of the Global Forum on Transparency and Exchange of Information for Tax Purposes. The Global Forum has become the preferred vehicle for the OECD's efforts to punish low-tax jurisdictions for attracting jobs and investment away from high-tax nations. The bureaucrats in Paris want to turn the organisation into an OPEC for politicians, protecting high-tax nations from the natural economic consequences of their anti-competitive policies.

More often than not, Global Forum meetings are boring affairs where tax bureaucrats go about the quiet business of rewriting international tax practices so that governments can extract the maximum amount of tax money with the least amount of resistance possible.

A couple of the recent meetings, however, have been rather remarkable in demonstrating the radical views of the OECD and high-tax nations. The 2009 meeting in Mexico City turned out well for taxpayers, but the 2011 meeting in Bermuda had a very unfortunate outcome.

OECD skulduggery in Mexico City

At the Mexico City Global Forum meeting in 2009, the OECD attempted a power grab by unilaterally asserting that it had the ability to impose rules to restrict tax avoidance and other forms of legal tax planning. This sounds absurd, particularly since the OECD claims that its effort is focused on trying to stop tax evasion, but it stems from the CEN theory. According to this ideological view, tax avoidance is just as bad as tax evasion.

But what was particularly noteworthy in Mexico City was how they attempted to spring the effort unannounced on attendees.

During the first day of the two-day conference, there was no mention of any campaign against tax avoidance and legal tax planning. The OECD even circulated a draft "summary of outcomes" after the dinner that evening, and the document began, "The main objectives of the meeting are…"

Yet by the next morning, the version that was used as the working document included a dramatic change. Delegates from low-tax jurisdictions were shocked to see a significant new clause, and the summary now read, "In the context of the broader effort to fight tax evasion and avoidance and to remove harmful tax practices that facilitate such activities, the main objectives of the meeting are…" Many of the low-tax jurisdictions understandably objected to the underhanded addition.

Despite the efforts of high-tax jurisdictions to stall or move on to other topics, opponents kept up the fight long enough to force removal of the new language. Most remarkable, the nation that was instrumental in stopping the OECD was China.

Yes, you read correctly. A nation governed by a nominal communist party played a key role in blocking a statist tax scheme pushed by supposedly capitalist nations.

But this would not be the last time the OECD targeted legal tax planning.

The Obama effect gives the OECD a victory in Bermuda

The OECD may have suffered a setback in Mexico City, but the bureaucrats have been somewhat successful over the past couple of years in their battle against tax competition. The election of Barack Obama was the key factor. Just as OPEC could not succeed without Saudi Arabia, the OECD's tax cartel is ineffective without support from the United States.

Looking back in history, the OECD launched its anti-tax competition project during the 1990s with the full support of the Clinton Administration. But then the OECD's campaign was stymied during the Bush years. Not because the Republican administration did anything to stop the OECD, but mostly because it didn't do anything to push the project forward. In the absence of active US support, the bureaucrats at the OECD didn't have the wherewithal to coerce the so-called tax havens.

Obama's election put America firmly back in the camp of anti-tax competition nations. Indeed, it probably explains why the OECD pulled the aforementioned stunt in Mexico City.

More importantly, it meant that the OECD and high-tax nations were able to bully even Switzerland into acquiescing to the notion that financial privacy laws no longer protect the human rights of non-resident investors. The various financial centres were forced to commit to signing a minimum number of tax information exchange agreements (TIEAs).

It seemed like the OECD had settled on a path that would enable high-tax nations to get the power to track – and tax – flight capital slowly but surely. But the bureaucracy used the 2011 Bermuda Global Forum as an opportunity to resuscitate the goal of undermining tax avoidance and tax planning. The vehicle for this renewed effort was the Multilateral Convention on Administrative Assistance in Tax Matters.

An emerging international tax organisation

The Multilateral Convention isn't actually new, but was radically altered in 2010 and unveiled again to OECD members in Bermuda. The Convention would obligate signatories to become deputy tax collectors for every other nation that joins. Even worse, it puts the OECD in charge of the "co-ordinating body," granting it enormous powers to interpret the agreement and resolve disputes. They are essentially granting themselves the ability to serve as judge, jury and executioner.

Under the guidance of OECD bureaucrats, the scheme would result in the creation of something akin to a World Tax Organisation. As a new potential blow to tax competition, the Multilateral Convention would likely lead to higher tax burdens. This is why nations such as France have been pushing the scheme, and why left-wing academics have long dreamed of just such an arrangement. It would furthermore undermine sovereignty by effectively outlawing certain pro-growth tax policies, and creating a system allowing foreign tax collectors to cross borders.

It would also increase the risk to human rights by undermining the financial privacy laws that protect individuals living under repressive regimes or in countries with high levels of crime and corruption. Already, the thuggish dictatorship of Azerbaijan has signed up, as well as the unstable nation of Moldova and the corrupt government of Mexico. And just like the Mexico City Surprise, the Multilateral Convention contains another attempt at "combating tax avoidance." This shouldn't come as much surprise given that CEN theory is based on the notion that taxpayers should never be allowed to benefit from better tax policy in other jurisdictions.

What comes next?

At this stage, it's only speculation to say how the Multilateral Convention will evolve. But it helps to look at the incentives of some of the main parties in the world of international taxation. And if you support tax competition and fiscal sovereignty, this does not lead to optimism. There are three reasons that the fear of an international tax organisation is warranted.

The high-tax nations that control the OECD want an aggressive, multilateral approach, and the Convention creates a tool that presumably can be used to bully low-tax jurisdictions into acting as deputy tax collectors.

The OECD doubtlessly welcomes the Convention since it expands the power and budget of the Paris-based bureaucracy. As noted above, the OECD will staff this new entity, giving the bureaucracy new authority and prestige.

The ideological advocates of bigger government have long wanted some sort of international tax organisation, and the left-wing law professors and statist NGOs doubtlessly will use the Convention as a starting point for even further demands.

The one unknown in the process is the degree to which other nations will sign on to the pact. The Convention currently has two dozen signatories, mostly OECD countries. No so-called "tax haven" is on the list.

But given the OECD's pressure for TIEAs, the Convention may be a tempting option. For all intents and purposes, signing the Convention could be seen as a one-stop way of dealing with demands and getting on the OECD's so-called white list of compliant jurisdictions.

Strategies for low-tax jurisdictions

The problem with the Convention is that it basically obliges signatories to enforce the bad tax laws of other nations. And that's just the beginning. With the OECD having the power to interpret the Convention, what seems like the worst-case scenario today almost surely will be the best-case scenario in the future.

So how should jurisdictions deal with this latest threat? The obvious answer is simply to say no. Signing up to the Convention is a no-win situation, particularly with the OECD having the unilateral power to decide what it means.

So long as the Obama Administration is in charge, low-tax countries and territories will be on the defensive. The OECD will continue to move the goalposts with endlessly expanding demands. The Global Forum will be a vehicle for advancing the agenda of high-tax governments, and the Convention undoubtedly will be part of that process.

The good news is that the Convention is currently voluntary, and nations that sign maintain the right to exempt themselves from particular provisions. At some point, the OECD may demand that jurisdictions sign on, and perhaps there will be a time when jurisdictions have no choice other than to acquiesce. But signing on before that point would be a mistake. Over the past 15 years, the fight over tax competition shows that any concession becomes the starting point for the next set of demands.

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