



Strategic Memorandum

Date: September 9, 2009

To: Supporters of tax competition, fiscal sovereignty, and financial privacy

From: Dan Mitchell

Re: What happens after ~~Cabo~~ Mexico City?

Last week's OECD Global Tax Forum featured an unusual beginning as a looming hurricane in the Pacific forced the event from Cabo to Mexico City. This created special challenges for the Center for Freedom and Prosperity delegation since the government did not put jets at our disposal for the last-minute trip, as they did for official delegates. But we persevered and made our way to the Mexican capital.

That may have been our most significant accomplishment. The Strategic Memorandum we released last week warned that the OECD had its own version of the Brezhnev Doctrine ("what's mine is mine; what's yours is negotiable"), and that the Paris-based bureaucracy would expand its demands. Unfortunately, we were right.

The Return of the "Tax Avoidance" Issue: Multinationals Are the Next Target

The most remarkable development is that the OECD tried to resuscitate its campaign against legal tax avoidance – and how it happened is rather revealing. During the first day of the two-day conference, no mention was made of any campaign against tax avoidance and other forms of legal tax planning. The OECD even circulated a draft "summary of outcomes" after the dinner that evening, and it began with the innocuous statement that, "The main objectives of the meeting are..."

But the next morning, the version that was used as the working document included a dramatic change. Delegates (at least the ones from low-tax jurisdictions) were shocked to see the following revised text:

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...

This new clause was no minor edit. It revealed that the OECD still clings to the radical theory of "capital export neutrality." CEN, as it is known, presupposes that all differences in tax rates (as well as any differences in how taxable income is defined) should be eliminated. The OECD used CEN arguments in its original reports when it first launched

the “harmful tax competition” project,¹ but quickly learned to steer clear of such extreme sentiments in hopes of making its agenda seem more reasonable.

What happened next was also quite revealing. Many of the low-tax jurisdictions understandably objected. They understood that language about tax avoidance and so-called harmful tax practices created a giant opening for further mischief since the bureaucrats at the OECD would have carte blanche to pursue the radical CEN agenda. Interestingly, the OECD and the high-tax nations (with the exception of the demagogues from Brazil) did not argue in favor of the language. Instead, they used passive resistance and asserted that time was short and that it was necessary to discuss other topics. The OECD and its allies obviously hoped that the jurisdictions would either forget about the language or grow tired of fighting (more on this OECD tactic later).

Fortunately, this did not happen. The small tax havens (from the 2000 blacklist) kept complaining. Low-tax nations inside the OECD also raised objections to this radical proposal. And other participants, such as Singapore, added their voices to the opposition. And while the OECD almost surely would have been willing to run roughshod over the little havens, the bureaucrats could not treat bigger nations in the same dismissive fashion.

Interestingly, the U.S. delegation stayed silent during this debate. But silence is just part of the story. It is almost inconceivable that the OECD would have pulled this stunt without advance approval from the American representatives (and OECD bureaucrats and U.S. officials were huddled in the hotel bar the previous evening, so there certainly was ample opportunity for scheming). Indeed, the head of the U.S. delegation, Stephen Shay of the Treasury Department, was the chair of the session that morning when the OECD’s surprise language was unveiled.

This does not bode well for the tax competition battle. It means that this process will not be over until low-tax jurisdictions are completely neutralized. The CEN theory unambiguously is based on the notion that taxpayers should never be allowed to benefit from better tax policy in other jurisdictions. The OECD is using tax evasion as a wedge for a broader campaign against any forms of tax planning. From the perspective of uncompetitive welfare states, this makes sense. Politicians from nations such as France want to postpone fiscal collapse and imposing a modern-day version of capital controls is an effective way to delay the day of reckoning. But it also is an effective way to reduce economic growth (and hurt living standards) in low-tax jurisdictions.

If the OECD is successful, there will be two main losers. Low-tax nations and territories obviously will suffer since they will be denied an opportunity for faster growth (ironically, OECD nations became rich in the 1800s when the burden of government was very small and there were no income taxes). The other big losers will be multinational companies. A campaign against tax avoidance – and other “harmful tax practices,” to borrow the OECD’s terminology – is largely an attack against the ability of major companies to engage in legal tax planning.

¹ See page 4 of http://www.heritage.org/Research/Taxes/upload/10525_1.pdf for examples from the 1998 and 2000 reports.

The OECD has fired the first salvo in what promises to be a major war. Interestingly, the OECD's Business and Industry Advisory Committee (BIAC) initially was highly critical of the anti-tax competition project.² But then, in a classic case of short-sighted behavior, BIAC officials were seduced into supporting the project after being assured that the project was only targeting tax evasion.³ So they cheered when the alligator ate somebody else, and now they doubtlessly will act surprised and offended that the alligator is hungry for another meal and they are the ones on the menu.

Will the So-Called Tax Havens Pay for the Privilege of Being Mistreated?

One pervasive feature of the Global Forum was the OECD's cavalier treatment of the smaller jurisdictions. The OECD routinely treated these jurisdictions with contempt. When the nations and territories that comprised the original 2000 blacklist raised points about either process or substance, they were – for all intents and purposes – ignored.

When asked about promises and commitments for double-taxation agreements, the OECD said there was not time to discuss that issue. When pressed on the review process, the OECD said that will have to be decided by the Steering Committee. When any debate or discussion became uncomfortable, the OECD either bumped it to a committee (controlled, naturally, by high-tax nations) or simply set it aside with nebulous comments about revisiting the issue.

But the real insult to injury is that the OECD then proposed that all participants – including the persecuted low-tax jurisdictions – should have to pay to be part of the Global Forum. This is akin to being dragged into a court after being falsely being charged with a crime, getting thrown in jail unjustly, and then being sent a bill for the cost of the kangaroo court proceedings.

The low-tax jurisdictions are in a tough position, to be sure. All the world's powerful nations are aligned against them. But there must come a point where they simply refuse to pay for a project that is designed to eviscerate their competitive position – especially since the OECD treats them with contempt. If they feel they must acquiesce to the demands of the big nations, that is unfortunate, but they should not engage in a process of self-flagellation by paying the OECD for the supposed privilege.

Conclusion

This has not been a good year for supporters of tax competition, fiscal sovereignty, and financial privacy. The election of a pro-tax ideologue in the United States substantially strengthened the forces pushing for a global tax cartel. All jurisdictions have now been bullied into agreeing that privacy laws no longer should protect foreign investors. This weakens tax competition, but the real issue now is whether this liberalizing process will be completely eradicated. The OECD's campaign against "tax avoidance" should be a wake-up call.

² A Business View on Tax Competition, available at <http://www.biac.org/statements/tax/htc.pdf>.

³ "Promoting Tax Competition," available at <http://www.oecd.org/dataoecd/63/11/1915964.pdf>.