Harmful Tax Competition: Who Are the Real Tax Havens?

by Marshall J. Langer

The following is the text of a speech Marshall J. Langer presented at a meeting of the International Tax Planning Association on November 20 in New Orleans. Langer, a member of the Florida Bar, resides in England and the Caribbean. He is counsel to Shutts & Bowen in London and Miami. He is the co-author of Rhoades and Langer, U.S. International Taxation and Tax Treaties *(Matthew Bender) and several other books.*

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Nearly 20 years ago, in January 1981, Richard A. Gordon, U.S. Internal Revenue Service Special Counsel for International Taxation, submitted a lengthy report to the IRS and the U.S. Treasury and Justice Departments entitled: *Tax Havens and Their Use by United States Taxpayers — An Overview;* it is commonly called the "Gordon Report."[1] Here are a few excerpts from the Gordon Report and my current observations concerning them:

Gordon stated:	*My current observations*:
"The decision of a country not to tax transactions or to attempt to attract offshore financial business is a legitimate policy decision. When local laws and practices deny information to countries whose tax base is being eroded or whose laws have been violated, a situation exists that attracts criminals and is abusive to other countries."	The United States, the United Kingdom, and many other OECD countries have local laws and practices that deny information to other countries and that are at least as abusive as those of the so-called *tax havens*.
"The United States alone cannot deal with tax havens. The policy must be an international one by the countries that are not tax havens to isolate the abusive tax havens. The United States should take the lead in encouraging tax havens to provide information to enable other countries to enforce their laws."	The OECD is a *cartel* of about 30 wealthy countries that has given itself the power and authority to tell the rest of the world how to behave. Its claim that it will also police its own members lacks credibility. This is a matter that should be handled by the United Nations, the IMF, or the WTO, not a self-appointed OPEC-like cartel.
"The term 'tax haven' has been loosely defined to include any country having a low or zero rate of tax on all or certain categories of income, and offering a certain level of banking or commercial secrecy. Applied literally, however, this definition would sweep in many industrialized countries not generally considered tax havens, including the United States (the U.S. does not tax interest on bank deposits of foreigners)."	The United States still does not tax interest on bank deposits of foreigners, nor does it generally require any reporting of these deposits except those paid to Canadian residents. Therefore, it cannot and does not give any information concerning such deposits to any country other than Canada. The United States now also exempts portfolio interest and capital gains, both long-term and short-term, other than real estate gains.

The OECD on the Attack

The Organization of Economic Cooperation and Development is a Paris-based organization of 29 (soon to be 30) of the wealthiest countries in the world. The member countries of the OECD are: Australia; Austria; Belgium; Canada; Czech Republic; Denmark; Finland; France; Germany; Greece; Hungary; Iceland; Ireland; Italy; Japan; Korea; Luxembourg; Mexico; Netherlands; New Zealand; Norway; Poland; Portugal; Spain; Sweden; Switzerland; Turkey; United Kingdom; United States. The Slovak Republic is scheduled to become the 30th member country before the end of 2000.

The OECD is essentially a cartel consisting of the world's richest countries, most of which are high-tax jurisdictions. The OECD has done some excellent work in the field of eliminating double taxation through the dissemination of its model income tax treaty and commentaries. These are now used by both member and non-member countries when they negotiate tax treaties to eliminate double taxation. However, the OECD selects its members in a way that excludes most countries. The OECD's policies are clearly designed to assist its member countries, rather than the world at large. No one other than its own members has ever given it a mandate to tell other countries how to behave. It functions to help its members even if that means harming other countries whose policies are detrimental to those of OECD members. Most OECD member countries are high-tax countries. They abhor any

[1]The 250-page "Gordon Report" is out of print but a copy can be found in Appendix A of Langer, Marshall J., *Practical International Tax Planning* (PLI, 3rd edition, 1985-1999).

non-member country that functions as a low-tax country. The people who run the OECD are government bureaucrats who live in high-tax Paris on tax-free salaries paid for by the taxpayers of the OECD member countries.

In April 1998, the OECD published an 80-page report entitled: *Harmful Tax Competition — An Emerging Global Issue.*[2] OECD member states Luxembourg and Switzerland abstained from this report. The 1998 report was later supplemented by a 30-page report entitled *Towards Global Tax Co-operation* published in June 2000.[3] It named six tax havens that had agreed to cooperate with the OECD and 35 others that were given one year to agree to cooperate or they would face severe sanctions. The June 2000 OECD report conceded that some OECD member-countries had some tax haven attributes and indicated that these member countries would discontinue *these practices* by no later than the year 2005. The report even identified some potentially harmful member country preferential regimes. The problem is that these have been determined based on a self-review of preferential regimes by each of the member countries. The results of this self-review are completely lacking in credibility. For example:

- The United States admits to only one preferential regime — the *foreign sales corporation* — which the WTO has already successfully attacked;
- The United Kingdom does not admit that it has any preferential regimes;
- Switzerland admits only that its *administrative and service companies* may be preferential regimes; and
- Ireland admits to only two preferential regimes — the *international financial services centre* and the *Shannon Airport Zone.*

Not Everyone Agrees

Daniel J. Mitchell, a Senior Fellow of the Heritage Foundation, has written an excellent report sharply attacking the OECD proposal to eliminate harmful tax practices.[4] Mitchell says that this OECD effort " . . . contradicts international norms and threatens the ability of sovereign countries to determine their own fiscal affairs." He adds that the OECD proposal " . . . would create a cartel by eliminating or substantially reducing the competition these high-tax nations face from low-tax regimes."

It does not surprise anyone when I tell them that the most important tax haven in the world is an island. They are surprised, however, when I tell them that the name of the island is *Manhattan*

Congressman Dick Armey, the majority leader of the U.S. House of Representatives (and just reelected to that post for the 2001-2002 Congress), wrote a blistering letter to Treasury Secretary Lawrence Summers in September 2000.[5] He said in the letter that he was deeply concerned by the Clinton administration's active support for the OECD effort to stamp out tax competition, which he described as designed to create a tax cartel. Congressman Armey's position makes it unlikely that the new Congress will carry out the Clinton administration's threat to legislate against so-called uncooperative tax havens.

Many of the countries attacked by the OECD as tax havens probably are tax havens by any reasonable definition. But so are many non-member countries of the OECD that have not been attacked by the OECD because it was not politically prudent for the OECD to do so. Moreover, most OECD countries are themselves tax havens.

No one outside the OECD has empowered the OECD to use its massive economic power to crush tax competition offered by low-tax countries that are not OECD members. Even worse, most OECD member states are guilty of egregious unfair tax competition that is much more serious and harmful than that of which the OECD is complaining. These activities by OECD members have been conveniently ignored in the OECD's self-assessment of harmful activities by its own members.

OECD Member States as Tax Havens

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[2]The April 1998 OECD report on *Harmful Tax Competition* is available from the OECD Online Bookshop. For details, *see* the OECD Web site at http://www.oecd.org.

[3]The June 2000 OECD report may be downloaded without charge from the OECD Web site at http://www.oecd.org.

[4]*See* Mitchell, Daniel J., "An OECD Proposal to Eliminate Tax Competition Would Mean Higher Taxes and Less Privacy," *Tax Notes Int'l*, Oct. 16, 2000, p. 1799, or *2000 WTD 200-15,* or *Doc 2000-26564 (23 original pages).*

[5]*See 2000 WTD 177-22* or *Doc 2000-23604 (2 original pages)* for the text of Majority Leader Dick Armey's letter.

Moreover, the second most important tax haven in the world is located on an island. It is a city called *London* in the United Kingdom.

Both the United States and the United Kingdom are, of course, OECD member states. Neither will ever admit that it is an abusive tax haven that aggressively and openly attracts wealth from all corners of the earth.

Bank Deposit Interest

The United Nations defines an *offshore institution* as " . . . any bank anywhere in the world that accepts deposits . . . on behalf of persons legally domiciled elsewhere."[6] U.S. banks have paid tax-free interest to foreign persons for nearly 80 years. Hundreds of billions of dollars of U.S. bank deposits are held in the United States by nonresident aliens and foreign corporations. If the U.S. Congress ever seriously tried to tax the interest paid on these deposits, that money would immediately disappear from U.S. banks and probably move to other OECD countries. Almost every country in the world similarly exempts bank deposit interest paid to foreigners.

A U.S. citizen or resident receiving interest from a U.S. bank deposit must pay federal income tax of up to 39.6 percent on that income. In most cases, he or she must also pay state income taxes. The amount of interest paid to a U.S. citizen or resident is reported annually by every U.S. bank to the IRS.

Anyone claiming to be a nonresident alien or foreign corporation pays zero U.S. income tax on U.S. bank deposit interest. Except for residents of Canada, the amount of interest paid is not even supposed to be reported to the IRS, so the amount of that interest is obviously not being reported to other countries under U.S. tax treaties or tax information exchange agreements.

Hundreds of billions of dollars of tax-free, interest-bearing bank deposits are held in U.S. banks by nonresident aliens and foreign corporations. In 1975, the Joint Committee on Taxation estimated that over US $3.1 billion in interest had been paid to foreign persons during 1974 on over US $36 billion of bank deposits.[7] The amount is undoubtedly much higher today. Many of these deposits may be held by U.S. persons who falsely claim to be nonresident aliens.

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Bank deposits held by foreign persons have been effectively exempt from U.S. income tax since 1921. Until 1986, interest paid by a U.S. bank to a foreign person was nontaxable, under a silly source rule that treated such interest as foreign-source income. That is what the law said — and it said so continuously from 1921 to 1986. Until 1986, the U.S. Internal Revenue Code provided that interest on "deposits with persons carrying on the banking business," received by a foreign person, was foreign-source income if it was not effectively connected with the conduct of a U.S. trade or business. In 1966, this rule was extended to cover interest on deposits with savings and loan associations and insurance companies as well as banks.

Interest paid on deposits with banks and savings institutions is no longer treated as foreign-source income. Since 1986, it has been treated as domestic-source income, but it remains exempt from U.S. tax when received by a foreign person if it is not effectively connected with the conduct of a U.S. trade or business.[8] If interest on the deposit is exempt from income tax, the deposit itself is also exempt from estate tax.[9] Even though the account is not taxable, each deposit up to US $100,000 in an insured U.S. bank is covered by Federal Deposit Insurance Corporation insurance.

Congressional Debate

The Congress has debated the wisdom of retaining the bank deposit exemption on several occasions during the 1960s and 1970s, with varied results. President John F. Kennedy's *Alliance for Progress* was supposed to encourage Latin Americans to repatriate their flight capital and to reinvest it in their own countries. The Latin American governments complained to the United States that U.S. tax law encouraged Latin Americans to invest in the United States. In 1966, Congress decided to impose a tax on bank deposit interest paid to foreign persons but, for balance

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[6]*See* Mitchell, Daniel J., note 4 above, at 1805.

[7]*See U.S. Taxation of Foreign Source Income of Individuals and Corporations and the Domestic International Sales Corporation Provisions,* Committee Print Prepared for the Use of the Committee on Ways and Means by the Staff of the Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., at p. 23 (Sept. 29, 1975).

[8]IRC section 861(a)(1)(A) and (c).

[9]IRC section 2105(b)(1).

of payments reasons, it postponed the effective date of such tax until the end of 1972. The effective date was postponed on two other occasions, the last of which was due to expire at the end of 1976. Then, after further debate, the Tax Reform Act of 1976 made the exemption permanent once again.

There have been mixed feelings in Congress on this issue. The banks claim that they will lose much or all of the billions of dollars deposited by foreign persons in interest-bearing bank accounts if the government attempts to tax the interest. On the other hand, U.S. taxpayers are not happy about paying U.S. income tax on income on which foreigners pay nothing. Nevertheless, Congress seems convinced that imposition of the statutory 30-percent U.S. withholding tax would drive most of these deposits out of the United States. They are almost certainly correct.

During 1975 and 1976, Congress debated whether to extend the deposit exemption for three more years or to make it permanent. In November 1975, the House of Representatives voted to make the deposit interest exemption permanent.[10] In 1976, the Senate Finance Committee agreed to follow the House version and make the deposit exemption permanent.

The bill was debated on the floor of the Senate in July 1976.[11] Senators Bob Packwood of Oregon and Ted Kennedy of Massachusetts sought to extend the exemption for only three more years, so that Congress would be forced to review the subject again. During the debate, my former law partner Senator Dick Stone of Florida stated that, in gateway cities like Miami, deposits from Latin Americans amounted to as much as one-third of all bank deposits. Senator Brock of Tennessee stated that no U.S. financial institution could survive the loss of one-third of its deposits in a short period of months. Following this debate, the Senate voted to extend the exemption for three years.

The lobbyists for banks, savings and loan associations, and insurance companies then went to work. The conference report followed the House bill and the 1976 Tax Reform Act made the temporary exemption permanent.[12] No one in Congress seems to have even looked at the provision since 1976.

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Reporting Nonreportable Interest

There is an interesting anomaly concerning the relatively recent requirement that a U.S. bank must report to the IRS the amount of interest paid to Canadian residents. The instructions to IRS Form 1042-S require a bank receiving new or renewed forms from customers to identify Canadian account holders and to report the bank deposit interest paid to them. It then says:

> Although you only have to report payments you make to residents of Canada, you can comply by reporting bank deposit interest paid to all foreign persons if that is easier.

Some foreign clients to whom I have shown that sentence were horrified by the thought their U.S. bank might choose the easy way out. The United States has over 8,500 separate banks with over 60,000 branches, any of which might be reporting to the IRS nonreportable bank deposit interest paid to foreign persons who are not Canadian residents simply because *that is easier*.

Other Tax-Haven Attributes

The United States has some other significant tax-haven attributes that have been conveniently ignored by the June 2000 OECD report:

- Since 1984, *portfolio interest* paid to a foreign person is also paid free of U.S. income tax.[13] Interest paid to foreign persons on government bonds, notes, and treasury bills, and on many corporate bonds, is free of income tax but may be subject to some reporting requirements. All such interest is fully taxable when paid to a U.S. citizen or resident;
- Long-term capital gains derived by a U.S. citizen or resident are taxed at a reduced rate, generally 20 percent. Short-term capital gains, such as those derived from day trading, are fully taxed at a federal income tax rate of up to 39.6 percent. Guess what? All capital gains, other than those derived from the sale of U.S. real estate or a real property holding company, are tax free when paid to a foreign person. I was recently consulted about a case in which a foreign indi-

[10] *See* H.R. 10612, Section 1041, 94th Cong, 1st Sess (1975).

[11] *See* 122 *Congressional Record*, S 12502-S 12508 (July 26, 1976).

[12] Public Law 94-455 (1976).

[13] IRC sections 871(h), 881(c).

vidual earned over US $120 million in day trading profits during 1999 that have been treated as tax-free capital gains;

- The United States imposes an estate and gift tax of up to 55 percent on all transfers of property at death or by lifetime gift made by a U.S. citizen or domiciliary. Although this tax, theoretically, also applies to transfers of U.S. property by a nondomiciled alien, such transfers have always been exempt if the alien individual holds the U.S. property in a foreign holding company; and
- Although the United States wants every country to give it tax information, U.S. law does not permit the IRS to give any tax information to a foreign country, unless that country has either a tax treaty or a tax information exchange agreement (TIEA) with the United States.[14]

International Shipping

The June 2000 OECD report suggests that Canada, Germany, Greece, Italy, the Netherlands, Norway, and Portugal all have preferential tax regimes involving international shipping. The United States should certainly be on that list. Large numbers of cruise ships sail regularly from Florida and Gulf Coast ports to Mexico, Central America, and the Caribbean. If the cruise ship companies used U.S.-registered ships owned by U.S. companies, they would be subject to full U.S. income tax. Guess how many of these cruise ship companies use U.S. ships? None. By using foreign-flag vessels owned by foreign companies, the cruise ship companies reduce their tax burden to zero. The Internal Revenue Code exempts all income derived by a foreign company from international shipping operations if the company's country of residence grants an equivalent exemption to U.S. persons.[15] Over 90 countries offer such an equivalent exemption, either under a tax treaty, a separate transportation agreement, or a determination by the IRS.[16] It is almost difficult to find a country that does not qualify. Some of those that do qualify include the Bahamas, the Cayman Islands, Hong Kong, the Isle of Man, Liberia, Malta, the Netherlands Antilles, Panama, and St. Vincent and the Grenadines.

The Internal Revenue Code exempts all income derived by a foreign company from international shipping operations if the company's country of residence grants an equivalent exemption to U.S. persons.

Limited Liability Companies

Until a few years ago, it was common practice for nonresidents of the United Kingdom to form a company in the United Kingdom, manage it from a place outside the United Kingdom, such as Monaco, and carry on business only outside the United Kingdom. This offered great cosmetics. Many people mistakenly assumed that the company with its London registered office was subject to U.K. taxes, but it was not. It paid the same taxes as if it had been set up and run from the Cayman Islands. The United Kingdom phased out these companies from 1988 to 1993. Ireland, which had offered the same benefits, took over this business for a while and then it too eliminated most of them. These nonresident companies are still being incorporated in other British Commonwealth countries such as Singapore, which is not on the OECD tax haven list.

The most popular successor to the nonresident U.K. company seems to be the U.S. limited liability company (LLC), which offers essentially the same cosmetics. Assume, for example, that an individual who is neither a citizen nor resident of the United States forms a single-person LLC in Delaware. He uses it to carry on business entirely outside the United States. Unlike a U.S. corporation, the single-person LLC need not file tax returns, and it is not subject to U.S. tax if it is not engaged in business in the United States and it has no U.S. income. It is a "tax nothing" for U.S. tax purposes. Its registered office is in Wilmington, Delaware, and it offers essentially the same cosmetics as the former nonresident U.K. company. Delaware and Nevada LLCs are considered by many to be cheaper and better than most other offshore companies.

Harmful U.S. Tax Preferences

The 1998 OECD report on harmful tax competition set forth four key factors for identifying and assessing harmful preferential tax regimes. Applying these factors to some of the U.S. regimes for taxing nonresidents, the United States is clearly identifiable as a harmful preferential tax regime:

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[14] *See* IRC section 6103.

[15] IRC section 883(a).

[16] *See* Rhoades and Langer, *U.S. International Taxation and Tax Treaties,* Chapters 47 and 73.

- *The United States imposes no tax on the relevant income.* The OECD considers a potential tax haven regime harmful if it imposes no or low effective tax rates on the relevant income. The U.S. taxes its residents, citizens, and domestic corporations but exempts all nonresident aliens and foreign corporations on interest paid by banks, savings and loan associations, and insurance companies. It does the same with respect to portfolio interest and most capital gains;
- *The U.S. regime is "ring fenced."* The U.S. tax-free deposits, portfolio interest, and capital gains are *ring fenced.* Residents, citizens, and domestic corporations are excluded from taking advantage of these benefits;
- *There is a lack of transparency.* Most U.S. residents are completely unaware of the fact that foreigners enjoy these benefits. Although the U.S. government does not *advertise* the existence of these benefits to foreigners, banks and brokerage houses see to it that any foreigner who needs to know does know all about them; and
- *There is a lack of effective exchange of information.* With one exception, the United States does not provide information concerning those who benefit from these regimes to its tax treaty partners.[17] The IRS does not even collect information about most of the income and gains arising from these regimes. It will try to get information in response to a specific request by a tax treaty partner but only if that country can tell the IRS where to look for the information. It cannot do even that for a country that does not have a tax treaty or TIEA with the United States.

Resident or Foreigner

Recent events in Ireland offer an interesting insight into foreign-held bank deposits in that country. Ireland imposes a withholding tax called *DIRT* (deposit interest retention tax) on all domestic holders of bank deposits. Foreign holders of Irish bank deposits file documents that exempt them from paying DIRT. In July 1999, Ireland's Comptroller and Auditor General John Purcell released a 500-page report as part of a government investigation into the alleged widespread use of false nonresident bank accounts to avoid the DIRT regime. The Irish Revenue has estimated that at least 10 percent of the bank deposits claimed to be foreign owned were bogus. Allied Irish Banks recently paid I£ 90 million for tax, interest, and penalties to the Irish Revenue to discharge its DIRT liabilities and several other banks have also made substantial settlements.[18] The Irish Revenue authorities will now go after many of the clients who made the bogus exemption claims.

Although the U.S. government does not *advertise* the existence of these benefits to foreigners, banks and brokerage houses see to it that any foreigner who needs to know does know all about them.

In September 1999, Japan abolished its 15 percent withholding tax on coupon interest paid on Japanese government bonds held by nonresident investors. An article in the *Daily Tax Report*[19] quoted an official of the Japanese Ministry of Finance as saying that "Japanese investors masquerading as 'foreign investors' have been taking advantage of a legal loophole and getting away without paying the 15-percent withholding." The ministry hopes to block this loophole by the end of 2000.

Many tax-free U.S. bank deposits allegedly owned by foreign persons may be similarly questionable. It would be easy for Uncle Juan to open a bank account during a visit to the United States. The bank will treat him as the depositor but he will give signing authority on the account to his nephew, Jimmy, a U.S. resident. Most future additions to the account and withdrawals will be made by Jimmy, who is the true beneficial owner of the account. No one in the bank will pay any attention to the fact that Jimmy makes these deposits and withdrawals. To avoid possible problems that might arise from the untimely death of Uncle Juan, the account will be registered in Uncle Juan's name but be payable on death to Jimmy. Since the account appears to be that of Uncle Juan, the bank will not only pay tax-free interest but the account itself will also be exempt from estate tax if Uncle Juan dies. I have often wondered how many billions of dollars of U.S. bank deposits have been structured this way.

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[17]As noted above, the IRS does provide Canada with information as to U.S. bank deposit interest paid to Canadian residents. Do all Canadian residents opening U.S. bank accounts provide their U.S. banks with Canadian addresses?

[18]*See* Brown, John Murray, "AIB Settles Tax Evasion Case," *Financial Times,* Oct. 4, 2000.

[19]*See* "Japan Considers Broader Tax Exemption for Nonresident Government Bond Investors," *Daily Tax Report,* Nov. 17, 2000, p. G-1.

Other Tax-Free Regimes

The United States is not the only OECD member state to offer tax-free bank deposits to foreign individuals and companies. Most OECD countries do so directly. Switzerland does so indirectly by permitting Swiss banks to take fiduciary deposits that are placed in foreign branches of Swiss banks in countries such as Luxembourg. The use of these fiduciary accounts openly avoids the 35-percent Swiss withholding tax. Canada offers tax-free bank deposits to foreigners in currencies other than the Canadian dollar.

After intense pressure, the Austrian Parliament recently took steps to phase out Austria's anonymous passbook savings accounts by June 2002. Such accounts have existed since the days of the Austro-Hungarian Empire. Austria has 24 million anonymous accounts — about three for each man, woman, and child in the country — leading some observers to conclude that many of these accounts are held by foreigners. These accounts are said to be worth a total of about US $100 billion.

Austria will keep its strict bank secrecy. Even Austrian tax authorities cannot obtain information from banks without the approval of a judge. That approval will not be given unless the judge is satisfied that there is reasonable suspicion of a criminal act.

Holding Companies

The June 2000 OECD report conceded that holding company regimes and similar preferential tax regimes in 13 of the 29 OECD member states may constitute harmful tax competition. But the OECD has not yet decided what to do about such regimes. It is currently examining such regimes in Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg, the Netherlands, Portugal, Spain, and Switzerland. Several other OECD countries should probably also be on that list, including Hungary and the United States (for its LLCs).

Britain: A Superb Tax Haven

The United Kingdom has never taxed the foreign income of U.K. residents who are not domiciled in the United Kingdom, unless that income was remitted to the U.K. resident.[20] From 1803 until 1914, U.K. residents were taxable on overseas income only if the income was remitted to the United Kingdom. Since 1914, overseas income has been generally taxable, except for non-U.K. domiciliaries who remain taxable only on a remittance basis. Thus, an individual who is resident — but not domiciled — in the United Kingdom pays no U.K. tax on his income that arises abroad, unless he remits it to the United Kingdom. He is not taxed on any remittances of *capital*.

The United States and most OECD countries offer tax-free bank deposits to foreign individuals and companies.

The U.K. Inland Revenue published a *green paper* in 1988 that proposed significant changes in the way Britain taxes foreign individuals who regularly spend substantial time in the country. If these changes had been adopted, individuals regularly spending an average of over four months per year in Britain would be taxed on their worldwide income, much as they are in the United States. The British government, then run by the Conservative Party, abandoned the proposed changes in 1989, bowing to pressure from Greek shipping interests and others who threatened to close down their U.K. businesses.

The Labour Party was elected in May 1997, and Gordon Brown became Chancellor of the Exchequer. Many expected him to change the rules in view of a document he had issued in 1994, while his party was in opposition. The document is entitled *Tackling Abuses — Tackling Unemployment*,[21] and it stated, in part, that:

> Taxation of nonresidents, non-domiciles, and those with offshore accounts should be overhauled in line with the recommendations of the Inland Revenue. It is not fair that a wealthy few be allowed to work or live in the United Kingdom without making a fair contribution through taxation. . . . In Britain it is easy for a few, even if they live or work here, to avoid substantial amounts of tax through claiming to be nonresident or non-domiciled; and

[20]For an interesting discussion of the U.K. domicile rules and their impact on U.K. taxation, *see* Goodeve-Docker, Nigel, "The Arcane World of Domicile and Tax," *Offshore Investment,* Oct. 2000, pp. 17-22.

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

> Those who are non-domiciled are able to live in the United Kingdom free of tax. . . . In 1988, the Inland Revenue recommended a radical new approach to residents and domiciles.

The Labour Party has now been in power for over three years and there has been no attempt to change these rules. The headline in a recent two-page spread in London's *Sunday Times*[22] read: "Foreign-born millionaires save £10bn from Brown's tax U-turn." Here are a few of the points raised by the article:

- Hundreds of foreign-born multi-millionaires living in the United Kingdom enjoy what the article calls the "non-dom" loophole. Prior to the 1997 general election, Brown and his shadow Treasury team were scathing about the failure of the Tories to close the loophole. Since winning the election and becoming Chancellor, Brown has chosen to retain it;
- "The loophole is perfectly legal. But critics of the scheme say it is scandalous that huge amounts of personal wealth are beyond the taxman's reach;"
- One *non-dom,* Lord Paul of Marylebone, is a Labour Peer who ranks among the 100 richest people in Britain. His company gave several hundred thousand pounds to the Labour Party. He is described as one of Labour's biggest benefactors;
- The following statement was attributed to an unnamed senior Inland Revenue official: "This is an anachronism, a hangover from the dark ages. It's a loophole for the wealthy few that isn't available to most of us. It has turned the U.K. into a tax haven and is hardly appropriate for a government committed to modernization;"
- Although Inland Revenue and the Treasury have repeatedly refused to estimate how many people in Britain claim *non-dom* status, there must be hundreds of thousands of them. Estimates range from 250,000 to more than one million. The French embassy in London has estimated that there are at least 180,000 French nationals living in Britain, most of whom are described as "ultra-high-net-worth" individuals. They include the French super-model, Laetitia Casta, who, after being selected as "the face of France," has moved to London; and
- The article quoted Pierre Gerbier, a private banker at the Royal Bank of Canada, as saying: "The non-dom rules make Britain a tax haven under the cover of the European Union. You have all the advantages of living in a developed and stable EU country but with very low taxes."

Other Tax-Haven Attributes

Here is a brief list of some other tax haven attributes of OECD member states:

- *Belgium* does not tax most capital gains. People from the Netherlands and other high-tax countries regularly move to Belgium and remain in the country long enough to sell their securities tax free;
- *Canada* permits its new *landed immigrants* to escape tax on their foreign income for the first five years they are resident in Canada by setting up a pre-immigration offshore trust;
- Since 1986, *France* has provided tax breaks to investors in French overseas departments and territories. Until now, some investors were permitted to deduct their entire investment and to get some kind of double deduction for any losses. Beginning in 2001, these benefits will be partially curtailed;
- In February 2000, the *Wall Street Journal* reported that some towns in *Hungary* are attracting increasing numbers of offshore companies by offering them tax rates as low as 3 percent.[23] No one in either the European Union or the OECD seems to have paid any attention to these towns. Hungary apparently also still has no tax on interest income.
- *Iceland*'s new international trading companies are on the OECD list of preferential tax regimes. These companies pay taxes at only 5 percent, compared to the normal 30 percent imposed in Iceland. It is interesting that the law creating these entities was not even enacted until 1999, a year after the 1998 OECD report on Harmful Tax Competition was published;
- *Ireland*, like the United Kingdom, has numerous nondomiciled residents who are not taxed on any foreign-source income unless it is remitted to Ireland;
- *Italy* still tolerates the village of *Campione d'Italia* on Lake Lugano, whose residents fall between the cracks and pay no tax to either Italy or Switzerland;[24]
- *Luxembourg* still has several types of tax-free holding companies. It has also been a magnet for bank deposits by other Europeans. Luxembourg refused to sign the 1998 OECD

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[22] *Sunday Times (London),* June 18, 2000, pp. 12-13.

[23] *See* Reed, John, "Corporate Giants Find Relief From Big Taxes in Tiny Towns," *Wall Street Journal Interactive Edition,* Feb. 9, 2000.

[24] *See* Langer, Marshall J., *The Tax Exile Report,* Chapter 41 (Scope International, 6th Edition, 1997). This book is now out of print.

report on Harmful Tax Competition, but it accepted the fact that it was included in the June 2000 OECD report;

- In September 2000, *The Washington Post* reported that the town of San Francisco Magu in *Mexico* has been exempt from all taxes, including income taxes, for the last 260 years;[25]
- In June 2000, the European Commission granted a request by *Portugal* to approve a new scheme that encourages business investment in *Madeira* by providing tax-free allowances;
- *Spain* and the European Commission have both approved the Canary Islands Special Zone tax regime under which a qualified company can pay a tax rate of between 1 and 5 percent; and
- *Switzerland,* like Luxembourg, refused to sign the 1998 OECD report on Harmful Tax Competition, but it accepted the fact that it was included in the June 2000 OECD report. In June 2000, the Swiss Federal Council confirmed that maintaining Swiss bank secrecy is a non-negotiable condition for cooperation with the European Union and the OECD. The Swiss economics minister was quoted as saying that the OECD project was "imbalanced and unilateral." Switzerland also openly offers lump-sum (forfait) tax agreements to new residents. The amount of tax to be paid is negotiated by the prospective new resident's advisors with the cantonal tax authorities. Austria and some other OECD countries offer similar arrangements, but do so less openly. There is no mention of these arrangements in any of the OECD reports.

The Arbitrary Blacklist

The OECD has been somewhat arbitrary in its designation of harmful tax havens. In addition to omitting many harmful practices by its own member countries, it has omitted other countries that regularly appear on blacklists named by OECD and non-OECD countries. It would be interesting to find out why the OECD did not include countries such as Costa Rica, Cyprus, Guam, Hong Kong, Malaysia (Labuan), Malta, Singapore, and Uruguay, all of which can be used, and are used, as tax havens.

Conclusion

It is obvious that the United States, Britain, and many of the other OECD member states are significant tax havens. The OECD countries should not attack other jurisdictions unless and until they first clean up their own act, something I suspect many of them will never really do. If there is to be a dialogue concerning the elimination of harmful tax haven attributes, it should be carried on by an organization such as the United Nations, the IMF, or the WTO, in which all countries are represented, not by the OECD tax cartel. ✦

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[25]Jordan, Mary, "In Mexican Town, Only Certainty Is Death," *Washington Post,* Sept. 25, 2000, p. A14.