



THE OECD'S PROJECT ON HARMFUL TAX PRACTICES:

THE 2004 PROGRESS REPORT



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

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

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

This Report was derestricted by the OECD Committee on Fiscal Affairs on 4 February 2004.

Disponible en français sous le titre :
PROJET DE L' OCDE SUR LES PRATIQUES FISALES DOMMAGEABLES: RAPPORT D'ETAPE 2004

TABLE OF CONTENTS

PART I: INTRODUCTION.....	4
PART II: MEMBER COUNTRY WORK.....	5
Table of Conclusions Reached on Potentially Harmful Regimes Identified In 2000	7
PART III: WORK OF PARTICIPATING PARTNERS	11
Introduction	11
Model Agreement on Exchange of Information on Tax Matters	13
Joint Ad Hoc Group on Accounts	13
Results of the Dialogue Among Participating Partners.....	14
PART IV: FRAMEWORK OF CO-ORDINATED DEFENSIVE MEASURES.....	14
Introduction	14
Possible Defensive Measures	15
Framework for Co-ordinating Defensive Measures	16
PART V: TAKING THE WORK FORWARD	17

2004 PROGRESS REPORT

PART I: INTRODUCTION

1. OECD member countries seek to establish standards that encourage an environment in which fair competition can take place. They do so in the tax area through promoting principles that are designed to enable each country to apply its own tax laws without the interference of practices that operate to undermine the fairness and integrity of each country's tax system. A basic element of this work is the pursuit of a level playing field among all countries and jurisdictions. The OECD does not seek to dictate to any country what its tax rate should be, or how its tax system should be structured. Through its work, the OECD endeavours to build support for fair competition so as to minimise tax induced distortions of financial and, indirectly, real investment flows, and to increase the confidence of taxpayers in the even handed application of tax rules.

2. This work is carried out principally through the Forum on Harmful Tax Practices (the Forum), a subsidiary body of the Committee on Fiscal Affairs (the Committee). The OECD Council mandated that the Forum's work should be reviewed five years after its establishment, which occurred in 1998. The Council has also instructed the Committee to report on the results of the OECD's work in eliminating harmful tax practices in OECD member countries. This Report fulfils those mandates.

3. Since the last report to Council in 2001¹, the Committee's work has achieved significant and very positive results, as detailed in this Report. Part II of the Report focuses on the progress made in the work as it relates to OECD member countries. Part III of the Report describes the considerable progress that has been made in achieving a co-operative process with those countries and jurisdictions outside the OECD that have made commitments to transparency and effective exchange of information. Part IV of this Report describes a framework for the co-ordinated application of defensive measures to address harmful tax practices. Part V of the Report describes future work.

¹ Switzerland and Luxembourg abstained on the Council approval of the 1998 Report which also applies to any follow up work undertaken since 1998.

PART II: MEMBER COUNTRY WORK

4. OECD member countries having approved the 1998 Report agreed that they would act collectively and individually to eliminate harmful tax practices with respect to preferential tax regimes within OECD member countries. To that end, the Committee adopted in 1998 certain criteria for determining whether a preferential tax regime was harmful (the preferential regime criteria),² as well as guidelines for addressing harmful preferential regimes in member countries. Under the guidelines, member countries were asked to -

- Refrain from adopting new measures or extending the scope of, or strengthening existing measures that constitute harmful tax practices;
- Review existing measures for the purpose of identifying those that constitute harmful tax practices; and
- Remove the harmful features of any harmful preferential regimes within 5 years.

5. To carry out its work on identifying harmful preferential tax regimes, the Forum requested that each member country perform a self-review of its preferential tax regimes with regard to the preferential regime criteria. After the self-reviews were completed, a peer review process was undertaken for each reported preferential regime.

6. In 2000, the Committee identified 47 preferential tax regimes in 9 overall categories as potentially harmful. The 9 categories were insurance, financing and leasing, fund managers, banking, headquarters regimes, distribution centre regimes, service centre regimes, shipping regimes, and miscellaneous activities. To be as comprehensive as possible, a preferential tax regime was identified as potentially harmful if it had features that suggested that the regime had the potential to constitute a harmful tax practice even though there had not been an overall assessment of all the relevant factors to determine whether the regime was actually harmful. Accordingly, a regime was treated as potentially harmful if, for example, the question of actual harm depended on the regime's application in specific circumstances or the regime had features of concern under the preferential regime criteria but had not been determined to be actually harmful or not actually harmful. Holding company regimes and similar preferential tax regimes were also evaluated but were not identified in 2000 as potentially harmful preferential regimes in recognition of the fact that further analysis of the effects of such regimes was necessary in light of the complexities they raised.

² In brief, there are four main factors: (1) the regime imposes low or no taxes on the relevant income (from geographically mobile financial and other service activities); (2) the regime is ring-fenced from the domestic economy; (3) the regime lacks transparency, e.g. the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure; and (4) there is no effective exchange of information with respect to the regime. There are also a number of other factors to be considered, including the extent of compliance with the OECD Transfer Pricing Guidelines. Although a low or zero effective tax rate is the necessary starting point of an examination of a preferential regime, it alone is not sufficient to find harmfulness. Any evaluation requires an overall assessment of each of the above factors and once a regime has been identified as potentially harmful the economic effects would have to be examined (where necessary). Belgium and Portugal observe that since the modification of the tax haven aspects of the project in 2001, they have had and continue to have concerns regarding the balance of the project because of the continued application of the ring fencing criterion to OECD member countries.

7. The Committee acknowledged that further work was required in interpreting the manner in which the preferential regime criteria should apply. Therefore, guidance, or “application”, notes were developed to assist member countries in assessing which potentially harmful regimes were, or could be applied to be, actually harmful and in determining how to remove any harmful features. Application notes were developed on transparency and exchange of information, ring fencing, transfer pricing, rulings, holding companies, fund management, and shipping. The separate notes were combined into a single Consolidated Application Note (available on the OECD website at <http://www.oecd.org/ctp>).

8. The Committee recognised the importance of involving the business community in the development of the Consolidated Application Note. For that reason, the Committee regularly consulted the Business and Industry Advisory Committee to obtain its views. In addition, the Consolidated Application Note was circulated to 59 non-OECD economies and 10 international or regional organisations for comment and discussed at a Global Forum meeting in September 2002. Comments were received from these groups and incorporated into the note.

9. The Transparency and Exchange of Information chapter of the Consolidated Application Note incorporates the principles of the Model Agreement on Exchange of Information on Tax Matters (discussed further below) and provides guidance on the types of information and practices required under the transparency criterion so that relevant and reliable information will be available to respond to a request for information. The chapter on Ring Fencing clarifies the criterion and provides specific examples to illustrate the concept. The Transfer Pricing chapter generally describes how transfer pricing practices may be implicated in the preferential regime criteria; it does not replace or amend the 1995 OECD Transfer Pricing Guidelines in any way. Because several of the member countries’ preferential regimes were implemented through rulings practices, the chapter on Rulings provides guidance on the features of a rulings practice that may contribute to harmful tax practices. The chapters on Holding Companies, Fund Management, and Shipping address the application of the preferential regime criteria within the context of the specific features of those types of regimes.

10. Using the Consolidated Application Note as guidance, each OECD member country was requested to perform a further self-review of its preferential regimes identified in 2000 together with any potentially harmful regimes that had been introduced since the identification of the 47 potentially harmful regimes. All member countries participated in the review process. The reviews involved the provision of updated descriptions of the regimes, as many regimes had already been amended, along with a self-assessment of each regime under the preferential regime criteria. After the self-reviews were completed, a further peer review process was undertaken for each regime. During the course of these peer reviews, member countries were asked to provide their assessments of other member countries’ regimes under the preferential regime criteria and an evaluation of whether those regimes were harmful based on an overall assessment of all of the relevant factors and, where necessary, relevant economic considerations.

11. The determinations reached in relation to the regimes identified as potentially harmful in 2000 are summarised in the following table.

Table of Conclusions Reached on Potentially Harmful Regimes Identified In 2000

Country	Regimes	Abolished	Continuing Regimes		
			Amended to remove potentially harmful features	Not Harmful	Harmful
<i>Insurance</i>					
Australia	Offshore Banking Units			✓	
Belgium	Co-ordination Centres	✓			
Finland	Aland Captive Insurance Regime	✓			
Italy	Trieste Financial Services and Insurance Centre	✓			
Ireland	International Financial Services Centre	✓			
Portugal	Madeira International Business Centre	✓			
Luxembourg	Provisions for Fluctuations in Re-insurance Companies		✓		
Sweden	Foreign Non-Life Insurance Companies	✓			
<i>Financing and Leasing</i>					
Belgium	Co-ordination Centres	✓			
Hungary	Venture Capital Companies			✓	
Hungary	Preferential Regime for Companies Operating Abroad	✓			
Iceland	International Trading Companies	✓			
Ireland	International Financial Services Centre	✓			
Ireland	Shannon Airport Zone	✓			
Italy	Trieste Financial Services and Insurance Centre	✓			
Luxembourg	Finance Branch		✓		
Netherlands	Risk Reserves for International Group Financing	✓			
Netherlands	Intra-Group Finance Activities ³		✓		
Netherlands	Finance Branch ³		✓		
Spain	Basque Country and Navarra Co-ordination Centres	✓			
Switzerland	50/50 Practice ⁴				

³ The Netherlands has replaced this regime with an Advance Pricing Agreement/Advance Tax Ruling practice.

⁴ In the 2000 Report these were referred to as administrative companies. The 50/50 practice will be subject to further analysis.

Country	Regimes	Abolished	Continuing Regimes		
			Amended to remove potentially harmful features	Not Harmful	Harmful
Fund Managers					
Greece	Mutual Funds/Portfolio Investment Companies [Taxation of Fund Managers]			✓	
Ireland	International Financial Services Centre [Taxation of Fund Managers]	✓			
Luxembourg	Management companies [Taxation of management companies that manage only one mutual fund (1929 holdings)] ⁵				
Portugal	Madeira International Business Centre [Taxation of Fund Managers]	✓			
Banking					
Australia	Offshore Banking Units			✓	
Canada	International Banking Centres			✓	
Ireland	International Financial Services Centre	✓			
Italy	Trieste Financial Services and Insurance Centre	✓			
Korea	Offshore Activities of Foreign Exchange Banks	✓			
Portugal	External Branches in the Madeira International Business Centre	✓			
Turkey	Istanbul Offshore Banking Regime	✓			
Headquarters regimes					
Belgium	Co-ordination Centres	✓			
France	Headquarters Centres		✓		
Germany	Monitoring and Co-ordinating Offices		✓		
Greece	Offices of Foreign Companies	✓			
Netherlands	Cost-plus Ruling ³		✓		
Portugal	Madeira International Business Centre	✓			
Spain	Basque Country and Navarra Co-ordination Centres	✓			
Switzerland	50/50 practice ⁴				

⁵ See paragraph 15.

Country	Regimes	Abolished	Continuing Regimes		
			Amended to remove potentially harmful features	Not Harmful	Harmful
Switzerland	Service Companies		✓		
<i>Distribution Centre Regimes</i>					
Belgium	Distribution Centres ⁶		✓		
France	Logistics Centres		✓		
Netherlands	Cost-plus/Resale Minus Ruling ³		✓		
Turkey	Turkish Free Zones			✓	
<i>Service Centre Regimes</i>					
Belgium	Service Centres ⁶		✓		
Netherlands	Cost-Plus Ruling ³		✓		
<i>Shipping</i>					
Canada	International Shipping			✓	
Germany	International Shipping			✓	
Greece	Shipping Offices			✓	
Greece	Shipping Regime (Law 27/75)			✓	
Italy	International Shipping			✓	
Netherlands	International Shipping			✓	
Norway	International Shipping			✓	
Portugal	International Shipping Register of Madeira			✓	
<i>Miscellaneous Activities</i>					
Belgium	Ruling on Informal Capital ⁶		✓		
Belgium	Ruling on Foreign Sales Corporation Activities	✓			
Canada	Non-resident Owned Investment Corporations	✓			
Netherlands	Ruling on Informal Capital ³		✓		
Netherlands	Ruling on Foreign Sales Corporation Activities	✓			
United States	Foreign Sales Corporations	✓			

12. As the above table demonstrates, 18 regimes have been abolished or are in the process of being abolished, 14 have been amended so that any potentially harmful features have been removed and 13 have been found not to be harmful based on further analysis. The Committee decided that where a regime is in the process of being eliminated, it shall be treated as abolished in the above table if (1) no new

⁶ Belgium has replaced this regime with an Advance Tax Rulings practice.

entrants are permitted into the regime, (2) a definite date for complete abolition of the regime has been announced, and (3) the regime is transparent and has effective exchange of information. The Netherlands' Risk Reserves for International Financing, Portugal's Madeira International Business Centre, Belgium's Co-ordination Centre and Iceland's International Trading Company regimes are treated as abolished on this basis.

13. The Australian Offshore Banking Unit regime and the Canadian International Banking Centre regime caused some concerns under the ring fencing criterion. In its overall assessment, the Committee determined that these potentially harmful regimes were nevertheless not actually harmful on the basis that they do not appear to have created actual harmful effects. This determination was made on the specific facts relating to the current limited nature and reduced scope and size of the regimes. Of crucial importance to this determination was the fact that the relevant countries apply very high standards regarding transparency and exchange of information for tax purposes.

14. The shipping regimes identified as potentially harmful in 2000 have, on the basis of the further guidance developed in the shipping application note, been determined not to be harmful. The application note elaborates on the preferential regime criteria in the context of the particularities of the shipping industry. For example, the ring fencing criterion is only concerned with different tax treatment for the same or similar activities. The note provides guidance to assist in determining when shipping activities are comparable (e.g. fishing vessels and vessels engaged in the transport of passengers or goods are not comparable). None of these regimes raised any transparency or exchange of information concerns.

15. The Forum was presented with a number of holding company regimes and similar preferential regimes in the course of the original review process leading up to the 2000 Report. Specifically, it examined the regimes of Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg, Netherlands, Portugal, Spain, and Switzerland. As stated previously, no holding company regimes and similar preferential regimes were identified in 2000 as potentially harmful because the Committee determined that, given the complexities of such regimes, further work was required to interpret the manner in which the preferential regime criteria should apply to such regimes. Chapter VI of the Consolidated Application Note discusses the application of the preferential regime criteria to holding companies and similar preferential regimes. Importantly, the application note recognises that holding company and similar preferential regimes serve a legitimate purpose in allowing the repatriation of foreign source income without incurring multiple levels of taxation. After reviewing these regimes with regard to the guidance provided by Chapter VI of the Consolidated Application Note, all of the regimes examined were found to meet the gateway criterion of low or no tax. Notwithstanding its abstention recorded in footnote 1, Switzerland is nevertheless ready to agree on effective exchange of information, in the context of its bilateral tax treaties, with respect to holding companies. In addition, the regimes of Austria (as amended), Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg (participation exemption), Netherlands, Portugal and Spain, were found not to be harmful. Luxembourg stated that it has submitted to its Parliament modifications to its 1929 Holding Company regime which, in full conformity with the 3 June 2003 ECOFIN and Code of Conduct Conclusions, will remove all the harmful features of this regime as defined in the EU Code of Conduct and agreed by ECOFIN. The Committee acknowledges the proposed modifications of the regime but remains concerned that the harmful feature of lack of effective exchange of information⁷, as defined in the 1998 Report, has not been addressed. The Committee will discuss this point further.

16. The Guidelines for dealing with harmful preferential tax regimes provide for the possibility that any country may request that the Forum examine any measure, whether its own or another country's. In accordance with this provision, the Forum also undertook reviews of a number of new

⁷ In this context, Luxembourg recalls its abstention to the 1998 Report and its underlying reasons for that abstention.

regimes that have been introduced since the identification of potentially harmful preferential regimes in 2000. Specifically, a number of tonnage tax regimes for shipping activities that were introduced since 2000 by Belgium, Denmark, Finland, France, Ireland, Spain and the United Kingdom have been examined. In addition, the Netherlands Advance Pricing Agreement/Advance Tax Ruling Practice and the Belgium Advance Tax Rulings Practice⁸ were also considered. These regimes are not considered by the Forum to constitute harmful tax practices.

17. As stated in Part V of this Report, future work will include monitoring continuing and newly introduced preferential tax regimes, including replacement regimes. This will permit any member country to request a further review of existing regimes in the event that it considers the nature of the regime has changed or that the extent and manner of its use have changed in such a way as to suggest that it may be actually harmful or to request a review of any newly introduced preferential tax regimes to the extent they raise concerns under the preferential regime criteria.

18. The conclusion that a regime is not actually harmful under the preferential regime criteria does not reflect any judgement by OECD member countries on the policy underlying the regime. In addition, the determination that a regime is not harmful does not in any way preclude the application of any domestic measure (such as CFC, FIF or any anti-abuse provisions) of a country to that or any other regime⁹.

PART III: WORK OF PARTICIPATING PARTNERS

Introduction

19. Since the last report to Council in 2001, the number of countries and jurisdictions outside the OECD that have committed to the principles of effective exchange of information and transparency has increased from 11 to 33, with the most recent commitments having been made by Vanuatu in May 2003 and the Republic of Nauru in December 2003.¹⁰ These countries and jurisdictions along with OECD

⁸ The new Co-ordination Centre regime has not been evaluated as full details of the regime have not yet been finalised. Therefore the evaluation of the Belgian Advance Tax Rulings Practice did not consider those aspects that are particular to Co-ordination Centres.

⁹ Some OECD member countries are of the opinion that the application of these kinds of provisions could be contrary to a tax treaty or other provisions of international law. See paragraph 27 of the Commentary to Article 1 of the OECD Model Convention.

¹⁰ The relevant countries and jurisdictions are Anguilla (Overseas Territory of the United Kingdom); Antigua and Barbuda; Aruba, the Netherlands Antilles (Aruba, the Netherlands Antilles and the Netherlands are the three countries of the Kingdom of the Netherlands); Commonwealth of The Bahamas; Kingdom of Bahrain; Belize; Bermuda (Overseas Territory of the United Kingdom); the British Virgin Islands (Overseas Territory of the United Kingdom); the Cayman Islands (Overseas Territory of the United Kingdom); the Cook Islands (fully self-governing country in free association with New Zealand); Cyprus; the Commonwealth of Dominica; Gibraltar (Overseas Territory of the United Kingdom); Grenada; Guernsey/Sark/Alderney (Dependency of the British Crown); Isle of Man (Dependency of the British Crown); Jersey (Dependency of the British Crown); Malta; Mauritius; Montserrat (Overseas Territory

member countries (collectively referred to as Participating Partners) have worked together under the auspices of the OECD's Global Forum to develop international standards regarding transparency and effective exchange of information. As described more fully below, a subset of the Participating Partners have developed a Model Agreement on Exchange of Information on Tax Matters which serves as a model for the negotiation of bilateral or multilateral agreements and the Participating Partners are currently working on standards regarding the transparency criterion.

20. The Committee recognises that there is a need for an ongoing dialogue to work towards the implementation of the transparency and exchange of information standards.¹¹ To facilitate this dialogue, the OECD and non-OECD Participating Partners established an Informal Contact Group to, among other things, discuss and propose a schedule of meetings arranged under the auspices of the Global Forum on general issues relating to the work on harmful tax practices and/or on specific technical issues and, where feasible, develop joint proposals (on substance and/or procedure as the case may be) to present to Global Forum meeting participants for consideration. The Participating Partners forming the group, which provide regional representation, are the Cayman Islands (Overseas Territory of the United Kingdom), France, Gibraltar (Overseas Territory of the United Kingdom), Ireland, Japan, Panama, Samoa, and the United States. The Commonwealth of the Bahamas, Belize, Guernsey/Sark/Alderney (Dependency of the British Crown) and Mauritius serve as alternative members of the group for the Cayman Islands (Overseas Territory of the United Kingdom), Gibraltar (Overseas Territory of the United Kingdom), Panama and Samoa. The Netherlands serves as alternative member of the group for France, Ireland, Japan and the United States.

21. The Informal Contact Group planned the meeting of all Participating Partners held in Ottawa, Canada on 14-15 October to address the issue of the level playing field. The meeting brought together representatives of 40 OECD and non-OECD Participating Partners. Virtually all the participants reaffirmed their commitments to the principles underlying the exchange of information standard and acknowledged the need to continue their discussions to establish bi-lateral mechanisms for effective exchange of information. They agreed that the level playing field is fundamentally about fairness. Participants acknowledged that progress had been made but recognised that a global level playing field does not yet exist and that further progress could and should be made to achieve it so that all countries can reach the high standards which the Participating Partners wish to see achieved. In particular, they agreed that ways should be explored to involve significant financial centres that are not currently participating in the Global Forum process. The participants agreed to work intensively over the coming months to progress the global level playing field issue and the broader question of improving the process by which this work can be accomplished. A small sub-group of participants has been established to develop proposals for consideration by the full Global Forum for achieving a global level playing field and a process by which this work can be taken forward. The sub-group held its first meeting on 3-5 February 2004.

of the United Kingdom); the Republic of Nauru; Niue (fully self-governing country in free association with New Zealand); Panama; Samoa; San Marino; the Republic of the Seychelles; the Federation of St. Christopher and Nevis; St. Lucia; St. Vincent and the Grenadines; Turks and Caicos (Overseas Territory of the United Kingdom); the US Virgin Islands (External Territory of the United States); and the Republic of Vanuatu. The United Kingdom confirms that it will remain responsible for any international obligations arising from any international fiscal treaties, agreements or commitments which affect its Overseas Territories or Crown Dependencies within the framework of the OECD Harmful Tax Practices initiative, including any that may be necessary to fulfil commitments entered into by those Overseas Territories or Crown Dependencies.

¹¹ See paragraph 4 of the Introduction of the Model Agreement on Exchange of Information in Tax Matters.

Model Agreement on Exchange of Information on Tax Matters

22. The Model Agreement on Exchange of Information on Tax Matters (the Model Agreement) was developed within a specially created working group, the “Global Forum Working Group on Effective Exchange of Information.” This group, which was co-chaired by Malta and the Netherlands, consisted of representatives from Aruba, Australia, Bermuda, Kingdom of Bahrain, Canada, Cayman Islands, Cyprus, France, Ireland, Isle of Man, Italy, Japan, Malta, Mauritius, Norway, Netherlands, Netherlands Antilles, the Republic of the Seychelles, the Slovak Republic, San Marino, the United Kingdom, and the United States. The Model Agreement is available on the OECD website at <http://www.oecd.org/ctp>.

23. The Model Agreement seeks to promote international co-operation in tax matters through exchange of information. The Model Agreement is not a binding instrument but contains two models drawn up in light of the commitments undertaken by all Participating Partners. In its introduction, the Model Agreement notes that it is important for as many financial centres as possible throughout the world to meet the standard of tax information exchange and it encourages all economies to co-operate in this endeavour.

24. The Model Agreement covers information exchange upon request for both civil and criminal tax matters. It specifically provides that information must be provided even where the requested country itself may not need the information for its own tax purposes so that the requesting country can enforce its own tax laws. Under the Model Agreement, contracting parties further agree that their competent authorities must have the authority to obtain and provide information held by banks, other financial institutions and persons acting in an agency or fiduciary capacity and to obtain and provide information regarding the ownership of persons. At the same time, the Model Agreement incorporates important safeguards to protect the legitimate interests of taxpayers. For instance, a request for information can be declined if the information would disclose a trade or business secret or if the information is protected by the attorney-client privilege. The Model Agreement further ensures that countries are not at liberty to engage in fishing expeditions or to request information that is unlikely to be relevant to the tax affairs of a specific taxpayer. In this regard, it specifies what type of information a requesting country needs to provide to a requested country to demonstrate the foreseeable relevance of the information to the request. Finally, the Model Agreement requires any information exchanged to be treated as confidential and subjects disclosure of the information to third persons or third countries to the express written consent of the requested country. The Model Agreement is now being used by Participating Partners and has already formed the basis for several tax information exchange agreements that have recently been signed. The Model Agreement is also being used by the Committee's Working Party on Tax Evasion and Avoidance as a basis for revising Article 26 of the OECD Model Tax Convention on Income and on Capital.

Joint Ad Hoc Group on Accounts

25. Exchange of information for tax purposes can only be effective when reliable information, foreseeably relevant to the tax requirements of a requesting jurisdiction, is available or can be made available in a timely manner and there are legal mechanisms that enable the information to be obtained and exchanged. This requires standards for the maintenance of accounting records and access to such records. The Participating Partners have come together under the auspices of the Global Forum to develop such standards relating to transparency. The group, the Joint Ad Hoc Group on Accounts (JAHGA), is co-chaired by the British Virgin Islands and France. The JAHGA Group's objective is to develop common standards for transparency to facilitate effective exchange of information for tax purposes. The JAHGA group is working to make sure there is a proper balance between the requirement to ensure access to

reliable financial information and the need to avoid placing unnecessary compliance burdens on taxpayers and administrations. An initial meeting of the JAHGA group was hosted in the Cayman Islands in October 2002. The group agreed that its task was to develop standards that would apply both within and outside the OECD. It discussed existing practices regarding the maintenance and access to accounting records, the circumstances under which a country or jurisdiction should have the responsibility for ensuring reliable accounting records (i.e., nexus), the nature of the accounting records that generally should be kept, how the reliability of such accounts can be ensured, and how long such records should be retained. In general, this work is consistent with the trend undertaken by many international organisations to foster transparency (e.g., Financial Action Task Force, Financial Stability Forum, International Monetary Fund).

Results of the Dialogue Among Participating Partners

26. The 33 countries and jurisdictions outside the OECD that have made commitments to transparency and effective exchange of information have made progress in fulfilling their commitments. For example, the vast majority have already taken action to improve transparency by immobilising or abolishing bearer shares. Similarly, many of them have enhanced transparency by regulating trust and company service providers and ensuring that they maintain ownership information on the entities to which they provide services. Progress has also been made with respect to establishing the legal framework that will permit exchange of information to take place. Some Participating Partners have entered into agreements to exchange information or are in the course of negotiating such arrangements that incorporate the principles of the Model Agreement.

27. While the overwhelming majority of countries and jurisdictions identified in 2000 have agreed to work toward transparency and effective exchange of information, a small number have not yet made commitments to those principles. These countries are identified in a List of Unco-operative Tax Havens issued by the Committee in April 2002 and revised in May 2003 and December 2003 to remove Vanuatu and the Republic of Nauru, respectively, from the list. The OECD is very pleased that Vanuatu and the Republic of Nauru have joined the growing number of countries that are committed to transparency and effective exchange of information and hopes that the remaining countries will follow this example. The remaining Unco-operative Tax Havens are Andorra, the Principality of Liechtenstein, Liberia, the Principality of Monaco, and the Republic of the Marshall Islands. The OECD is engaged in a constructive ongoing dialogue with a number of these countries and looks forward to future commitments to transparency and effective exchange of information.

PART IV: FRAMEWORK OF CO-ORDINATED DEFENSIVE MEASURES

Introduction

28. OECD member countries as well as non-OECD economies currently use a variety of measures to address harmful tax practices. The Committee recognises, however, that there are limits to the usefulness of unilateral and bilateral measures to respond to a problem that is inherently global in nature. Thus, the Committee has examined ways in which defensive measures may be co-ordinated to more effectively neutralise the deleterious effects of harmful tax practices. As noted in paragraph 32 of the

2001 Report, a potential framework of co-ordinated defensive measures would not apply to uncooperative tax havens any earlier than it would apply to OECD member countries with harmful preferential regimes.

29. The Committee considers that a framework of co-ordinated defensive measures should be guided by the following principles:

- a) A framework of co-ordinated defensive measures should be proportionate and targeted at neutralising the deleterious effects of harmful tax practices.
- b) The framework should take into account whether a member country already has applicable existing defensive measures and the effectiveness of those measures.
- c) The framework should recognise that each participant retains the sovereign right to apply or not apply any defensive measures as appropriate, either within or outside a framework of co-ordinated defensive measures.
- d) Each participant may choose to implement and enforce the defensive measures in a manner that is proportionate and prioritised according to the degree of harm that a particular harmful tax practice has the potential to inflict and taking into account the effectiveness of its existing defensive measures.
- e) There are different forms of harmful tax practices and different defensive measures may be appropriate in different circumstances.
- f) A co-ordinated response to harmful tax practices which results from a dialogue between member countries will reinforce the effectiveness of unilateral measures and overcome the inherent limits of such measures.
- g) Any common framework must be carefully crafted to avoid imposing unnecessary compliance burdens on taxpayers or administrative burdens on tax administrations.
- h) A framework for a common approach to defensive measures must be dynamic, able to adapt to changing circumstances and will need ongoing implementation and verification procedures to be effective.

Possible Defensive Measures

30. As noted above, the possible defensive measures that might be co-ordinated must remain flexible. It is not, therefore, possible to produce an exhaustive or exclusive list of measures that might be used. Based on the identification of some measures currently in use in OECD member countries and non-OECD economies, a number of measures have been identified as being potentially useful to neutralise the deleterious effects of harmful tax practices. These defensive measures are--

- The use of provisions having the effect of disallowing any deduction, exemption, credit or other allowance in relation to all substantial payments made to persons located in countries or jurisdictions engaged in harmful tax practices except where the taxpayer is able to establish satisfactorily that such payments do not exceed an arm's length amount and correspond to bona fide transactions.
- The use of thin capitalisation provisions restricting the deduction of interest payments to persons located in jurisdictions engaged in harmful tax practices.

- The use of legislative or administrative provisions having the effect of requiring any resident who makes a substantial payment to a person located in a country or jurisdiction engaged in a harmful tax practice, enters into a transaction with such a person, or owns any interest in such a person to report that payment, transaction or ownership to the tax authorities, such requirement being supported by substantial penalties for inaccurate reporting or non-reporting of such payments.
- The use of legislative provisions allowing the taxation of residents on amounts corresponding to income that benefits from harmful tax practices that is earned by entities established abroad in which these residents have an interest and that would otherwise be subject to substantially lower or deferred taxes.
- The denial of the exemption method or modification of the credit method. Where a country levies no or nominal tax on most of the income arising therein because of the existence of harmful tax practices, it may not be appropriate for such income to receive an exemption otherwise intended to relieve double taxation. Member countries that permit foreign tax credits may wish to modify those rules to prevent the pooling of income benefiting from harmful tax practices with other income. In addition, such countries may wish to implement systems to verify the amounts claimed actually constitute creditable taxes.
- The use of legislative provisions ensuring that withholding taxes at a minimum rate apply to all payments of dividends, interest and royalties made to beneficial owners benefiting from harmful tax practices.
- The use of provisions for special audit and enforcement programs to co-ordinate enforcement activities involving entities and transactions related to countries and jurisdictions engaged in harmful tax practices.
- Terminating, limiting and not entering into tax treaties. Participating countries could adopt, and make public, a policy of not entering into tax conventions with countries and jurisdictions involved in harmful tax practices. Those that are parties to conventions with such countries and jurisdictions may wish to take appropriate measures to ensure that these conventions are limited or terminated. Alternatively, participating countries could consider that all existing or proposed treaties with a country or jurisdiction engaging in harmful tax practices contain a limitation of benefits clause which would prevent the benefits of the treaty from being claimed by third country residents who had no real connection with the country or jurisdiction. With respect to terminating an existing treaty, it is recognised that such action has important implications which go beyond the revenue impact of the treaty.

Framework for Co-ordinating Defensive Measures

31. Based on the principles identified in the introduction to this Part, any OECD member country that believes that a specific harmful tax practice of a country or jurisdiction that is unco-operative in eliminating harmful tax practices should be addressed in a co-ordinated fashion can propose such co-ordination. It should describe the specific harmful tax practice at issue and identify the harm that the practice causes. The member country should also identify the specific types of defensive measures it is taking and the measures it would like other member countries to consider taking. OECD member countries will then discuss the issue. This discussion could involve the degree to which other member countries are affected by the specific practice, whether they already have defensive measures that apply and any other relevant considerations. Recognising the sovereign right of member countries to apply or not to apply

defensive measures as well as the differing effects that harmful tax practices have on different member countries, any action may involve all or only some OECD member countries.

32. The above approach will permit member countries to increase the effectiveness of national measures by making them applicable on a co-ordinated basis while at the same time ensuring that the application of the particular measure is proportionate and prioritised and appropriate for the circumstances of each member country.

33. Non-OECD economies that wish to associate themselves with the work on harmful tax practices may also want to co-ordinate their actions with those of OECD member countries. To this end, OECD member countries may consider informing the other Participating Partners and non-OECD economies that have associated themselves with the work about the defensive measures that they are taking in a particular case so that non-OECD economies may take those measures into account in considering what action is in their sovereign interest.

PART V: TAKING THE WORK FORWARD

34. Substantial progress has been made in advancing the goals of the harmful tax practices project and many of the objectives originally set for this project have been accomplished.

35. In connection with member countries, the future work will consist of monitoring continuing and newly introduced preferential tax regimes that member countries think raise concerns under the preferential regime criteria.

36. The work with the jurisdictions will continue to focus on the development and the implementation of the transparency and exchange of information standards and the establishment of a level playing field. OECD members will continue to provide technical assistance to those Participating Partners that request it so as to meet these standards and in order to help their economies as they move away from harmful tax practices.

37. The OECD members will intensify their dialogue with other non-OECD economies through bilateral contacts and through Global Forum events. The objective of this dialogue is to encourage countries outside the OECD area to associate themselves with the principles of the project and encourage the creation of a level playing field. With the progress made on other aspects of the work, the Committee will now be able to focus and accelerate its work in this area.

38. The Committee is pursuing work aimed at improving exchange of information such as the revision of Article 26 and taking forward the principles agreed in the 2000 report on Improving Access to Bank Information for Tax Purposes.¹²

¹² For a description of developments in this area, see “*Improving Access to Bank Information for Tax Purposes: The 2003 Progress Report*”.

39. There will be a need to monitor the development of new tax havens and encourage such havens and the existing 5 uncooperative tax havens to make commitments to transparency and exchange of information for tax purposes.

40. There will be a need to consider the application of the co-ordination of defensive measures as described above in Part IV.

41. Finally, in 2004, the Committee will review, in the context of the overall structure of the CFA and its work programme, the role of the Forum and the most effective way to carry out the ongoing work.