



INTERNATIONAL TRADE AND INVESTMENT ORGANISATION
a forum for small and developing economies

LEVELING THE PLAYING FIELD

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INTRODUCTION

The concept of the level playing field has properly been a focus of attention in the Global Forum process. As was noted at the June 2004 Berlin Global Forum meeting, a level playing field is fundamentally about fairness. The Sub-Group delegated to make recommendations to the Global Forum noted that they were guided by “*the objective of the global level playing field: to achieve high standards of transparency and information exchange in a way that is fair, equitable and permits fair competition between all countries, large and small, OECD and non-OECD*”. The participants in the Berlin Forum also noted that building towards a level playing field required countries to take steps individually, in their bilateral relations and collectively.

The process for achieving a level playing field through individual country actions, bilateral relations and collective action has at least two discrete components. Each is necessary, but neither is sufficient without the other to achieve a level playing field. The first component, which has been the main focus of discussion within the Sub-Group and the Forum to date, relates to the identification and adoption by all relevant countries with significant financial services sectors of some common standard in relation to the exchange of tax information practice. The legal framework for such a standard has found expression in Article 26 of the OECD and UN Model Conventions and in the 2002 OECD Model Agreement on Tax Information Exchange.

The valuable work of the OECD secretariat, the Sub-Group and the Participating Partners over the past 12 months in identifying the legal frameworks for the exchange of tax information which are in place in OECD and non-OECD Participating Partners as well as a number of other countries which have significant presence in the global financial services sector, has made an important contribution to the understanding of each country’s approach to these standards. The completion of the template review process, which was an output under the ‘collective aspects’ set approved by the Berlin Global Forum, will undoubtedly add further insight.

The second component in the process for achieving a level playing field, which is necessary if exchange of information is to be implemented in a way that is fair, equitable and permits fair competition between all countries, large and small, and OECD and non-OECD, relates to how, under certain discriminatory conditions, the provision of tax information may be used to unfairly distort economic competition. Equity and long-term self-interest require that tax information recipient countries do not use that information in a manner which in effect produces, reinforces or enhances discrimination against either a tax information provider country, or its nationals, residents or enterprises. Similarly, equity and long-term self-interest require that countries not implement exchange of tax information when to do so would permit discrimination against their national interests or against their nationals, residents or enterprises.

The Relevance of Fairness and Non-Discrimination in Tax Information Exchange

The relevance of fairness and non-discrimination as between countries in the context of tax information exchange is not a new concept. A requirement for non-discrimination was articulated by Jeffery Owens, Head of OECD's Centre for Tax Policy and Administration in 2001, when he stated that "*OECD countries welcome competition which is fair, i.e., competition which is transparent, non-discriminatory and by jurisdictions which are prepared to co-operate to counter abuse.*"

Although Mr. Owens was speaking for the OECD member states, the sentiment is shared by ITIO members.

Gabs Makhlouf, then chair of the OECD's Committee on Fiscal Affairs, in his opening address to the 2002 Global Forum in George Town, Cayman Islands noted that dialogue is critical to achieving the objective of fair competition, and went on to say that *it is through dialogue that we will achieve our common goal of fair competition in the financial sector.*"

Deputy Secretary-General Seiichi Kondo at that same 2002 meeting in respect of the OECD's position on the rationale for pursuing a level playing field said in his remarks: "*I am sure that you also wish to see a successful outcome of this process so that by 2006 we will have achieved our common goal of a level playing field that will ensure fair competition.*"

German Minister of Finance Hans Eichel also noted the importance of fair competition on a level playing field in his address to the 2004 Global Forum meeting, noting that:

"We must make allowance for the legitimate interests of all financial centres to participate in global competition on equal terms."

How then might the mechanisms for exchange of tax information be implemented in order to ensure fairness and non-discrimination? In answering this question, several factors need to be considered.

Obviating Discrimination in the Context of Tax Information Exchange

Tax discrimination of the type that distorts economic competition between countries can be analysed in a variety of ways. One way is to look at what the discrimination is intended to achieve, that is, which country is to benefit and which is to be penalized. Many countries' taxation regimes give preferences to their own residents over non-residents and in some cases to their own citizens over non-citizens. Indeed, among countries with direct taxation regimes such preferences are very common. A second form of discrimination, which is perhaps less common, discriminates against persons from one foreign country in comparison with persons from other foreign countries. This type of bias shifts economic activity to the foreign country that receives the more favourable treatment. In the financial services sector, discrimination of the second type can take many forms ranging from "blacklists", to preferential withholding tax rates applied to payments to countries that have a comprehensive tax agreement with the country that is the source of payment in comparison with payments to countries that have a different form of tax information exchange arrangement with the country that is the source of payment.

There are a variety of options for eliminating such discrimination that may be undertaken by countries acting individually, in their bilateral relations, and collectively. **Individually**, tax information recipient countries may review their domestic legislation in order to identify and eliminate such discrimination. Tax information provider countries may also decline to enter into any tax information exchange arrangement that permits discrimination against that country or its nationals, residents or enterprises. Another available option is for individual countries to ensure that in any arrangements, benefits exist to offset any discriminatory effects created or potentiated by tax information exchange. In their **bilateral relations**, countries entering into tax information exchange arrangements may insert a limitation clause limiting access to tax information to situations that are non-discriminatory. Such a limitation may be used in situations in which the domestic legislation of a country treats transactions between one of their taxpayers and an entity in a second country in a less favourable manner than the same transactions carried out between the same taxpayer and an entity in a third country. Without the type of non-discrimination limitation suggested above, by agreeing to exchange information, a country might in effect be agreeing to work against its own interests, or the interests of its residents or nationals and in the process exacerbating an un-level playing field. As discussed below, the type of instrument selected for bilateral tax information exchange arrangements may also be relevant.

Comprehensive or Double Taxation Agreements versus Stand-Alone Tax Information Exchange Agreements

There are many different types of instrument that can be used for the exchange of tax information, some of which are bilateral in nature, and some of which are multilateral in nature. Multilateral arrangements tend to be used among countries with similar stages of development and integrated or very similar economies. The most common bilateral instruments providing for tax information exchange are so-called double taxation treaties in which countries partition taxation rights and frequently provide for reciprocal economic benefits. As the designation indicates, such instruments typically minimize the economic inefficiency of double taxation. There are about 2500 such comprehensive taxation agreements in existence. The treaty network arising from these agreements creates a web of economic benefits and preferences for the participants, which indirectly tends to operate to the detriment of countries outside of the treaty network.

A relatively recent construct is the stand-alone tax information exchange agreement (“TIEA”). There are only a few dozen stand-alone TIEAs in existence, most being implemented in the context of the US Caribbean Basin Initiative which provided for certain benefits to the countries which signed such agreements with the US. It is to be presumed that absent such benefits, and in particular in situations in which there are significant tax rate differentials, few countries have found TIEAs attractive as they do not provide the types of reciprocal economic benefits found within comprehensive taxation agreements.

Very recently, one ITIO member, the Isle of Man, working with an OECD member country, the Kingdom of the Netherlands, was able to put together a package of interim arrangements providing for exchange of tax information together with various economic measures while specifying that exchange of information would not operate in the context of discrimination. It is intended by these countries that further negotiations will produce a more conventional comprehensive taxation agreement. This is an example of innovative collaboration that serves the interests of both countries in advancing exchange of tax information in a manner which obviates the potential for the specified discriminatory effects.

Considerations in Defining the Next Steps

Paragraph 3 of the Report which was adopted at the Berlin Global Forum in June 2004 notes the guiding principle behind the effort to achieve a level playing field:

In developing proposals, the members of the Sub-Group were guided by the objective of the global level playing field: to achieve high standards of transparency and information exchange in a way that is fair, equitable and permits fair competition between all countries, large and small, OECD and non-OECD.

In considering the next steps to be undertaken by the Global Forum, this objective must be kept in mind. It is also worth bearing in mind that there are two discrete components in achieving a level playing field, the first which deals with existing legal frameworks and practices of financial centres, and the second which deals with fair and non-discriminatory implementation of exchange of information arrangements in a manner which ensures fair competition in the financial services sector.

How then is a level playing field in respect of the global competition for financial services going to be better delineated and achieved? The answer to this question undoubtedly requires that the actions of countries in their individual capacities, in their bilateral relations and collectively are recognized. It is also the case that focusing on a number of important questions relating to each of the components in achieving a level playing field will assist in structuring a level playing field. These questions may be summarized as follows:

The First Component in Achieving a Level Playing Field

- 1) *What legal frameworks for the provision/exchange of tax information do countries competing in the international financial services sector currently have?* This is the basic question which the responses to the recent template questionnaire are intended to answer.
- 2) *Which countries currently have comprehensive tax treaties or TIEAs with each other and what is the scope of such agreements?* The responses to the recent template questionnaire also answer this question in large part.
- 3) *What do these competing countries do, in practice rather than in theory, in relation to tax information exchange?* If small and developing countries with direct taxation systems may expect to receive requests for tax information, but are uncertain as to whether they should expect their own requests for information to be satisfied, how do they weigh entering into either a TIEA or a comprehensive taxation agreement?

The Second Component in Achieving a Level Playing Field

- 4)(1) *What level and types of treaty benefits do countries that require tax information from other countries to enforce their domestic taxation regimes-*
 - A. *accord to countries that provide to them access to such tax information, and*
 - B. *provide to countries that do not provide to them access to such tax information?*
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- 4)(2) *In instances where tax information is provided, are the reciprocal benefits qualified or quantified according to the nature of the tax information?* – for example - information only in respect of criminal tax matters, information on all tax matters, restrictions on the provision of information related to the scope of the exchange of information instrument, restriction to exchange of information to certain types of taxes, i.e. taxes on income only

The answer to this question can be found through examining tax treaties and related documents on a country- by -country basis.

- 5) *Do the countries which need access to tax information located outside of their borders for purposes of enforcement of their taxation regimes use those same taxation regimes to discriminate, (whether directly or indirectly), against the countries from which they are seeking tax information?* This is a much more complex question, but one which countries will carefully consider before entering into any type of information exchange arrangement.
- 6) *Would the tax information that a particular country might request give effect to or make worse any such taxation- based discrimination?* This question is related to question 5 above. The answer requires some understanding of the domestic legislation of the tax information recipient country. By way of a relatively simple example, if a country applies an effective tax rate of 20% for income from investments in foreign country A by virtue of the operation of a comprehensive treaty, but an effective tax rate of 40% for income from investments in foreign country B (which is without an equivalent treaty) in order to induce its investors to invest in A rather than B, and the enforcement of such tax rates requires each of countries A and B to provide tax information, then the provision of information by country B would have the effect of potentiating discrimination against itself.
- 7) *How might non-discrimination in relation to competition for financial services be assured in a double taxation agreement, and how might it be assured within a tax information arrangement?* The answer to this question is something that ITIO members wish to be considered in the Global Forum.
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