ENDING THE OFFSHORE SECRECY SYSTEM

An Action Programme to Strengthen International Financial and Fiscal Regulatory Cooperation

March 2009

It is now widely understood that any serious efforts to improve international cooperation and coordination of supervision of the international financial system must include a determined crackdown on the use of `offshore' entities. This should include action to end the ways in which major international financial centres also collaborate in the offshore system, which indeed they themselves originally devised and have helped to maintain.

Offshore entities are extensively used to maintain secrecy which undermines the effectiveness of regulation in the public interest. The strict secrecy provided by tax havens and the offshore system enables in particular abusive avoidance and evasion of both taxation and financial regulation. They have contributed to the current financial crisis in two main ways. First, the opportunities for tax minimisation have greatly increased the volume of funds available for financial speculation, and distorted the international allocation of capital by reducing the cost of capital for financial operations, e.g. by hedge funds, as opposed to real investment. Secondly, the secrecy they provide has contributed to the opacity which has destroyed confidence in the assets and balance sheets of multinational banks and financial institutions, inflicting great damage on the world economy.

International tax avoidance and evasion create a major obstacle for developing countries seeking to generate domestic finance for development, and hence reduce their dependence on aid. It is now time to end the use of artificial legal persons formed in jurisdictions of convenience which distorts and sullies legitimate business activities.

To that end, TJN proposes the following Action Programme.

Improving Coordination between Fiscal and Financial Regulators

The Compendium of Standards and Codes compiled by the Financial Stability Forum (FSF) should include appropriate standards for International Cooperation in Tax Matters (see below). The FSF itself should be reformed both to include a wider range of countries, especially developing countries, and to provide opportunities for input by civil society organisations.

The Reports on the Observance of Standards and Codes (ROSCs) of international financial centres conducted through the International Monetary Fund (IMF) and World Bank should be made more transparent and provide an opportunity for input by civil society organisations (following fundamental governance reform of the IMF and World Bank to enhance transparency and accountability). It should include assessments of each jurisdiction's compliance with international tax cooperation standards, conducted by expert reviewers appointed by the UN Tax Committee. No financial centre should be judged compliant unless it has established adequate and transparent mechanisms for comprehensive cooperation in tax matters. Counter-measures for non-compliance with tax co-operation standards are dealt with separately (see below).

Each jurisdiction should establish adequate arrangements for cooperation between tax authorities and regulators responsible for financial supervision, including bodies responsible for fighting money-laundering, corruption and other criminal activities. There should be adequate arrangements within each country, and internationally, subject to proper safeguards, for exchange of information between fiscal and financial regulatory authorities. This should include access by tax authorities to transaction reports related to money-laundering.

International Cooperation in Tax Matters

An international standard for cooperation in taxation should be established, providing for comprehensive exchange of information for assessment and collection of taxes, including automatic, on request and spontaneous exchanges of information. This should be based on existing instruments, such as the Council of Europe/OECD Convention of 1988 on Mutual Cooperation in Tax Matters, and the EU Savings Directive. The Council of Europe/OECD multilateral Convention should be made open for signature by all states. Council of Europe and OECD member states should accede to it, making no significant reservations, and those which have such reservations should withdraw them. Its provisions on automatic exchange of information should be made operational by all participating states. They should also extend its provisions to all their dependent territories.

The European Union should enact the revised version of its EU Savings Directive proposed in November 2008 whilst withdrawing the option for tax to be withheld at source on income paid to non-resident taxpayers in some participating jurisdictions, so that

automatic information exchange occurs in all circumstances whilst extending the range of payments covered by the Directive to include dividends and capital gains. The European Union should engage in negotiation with non-member states to extend the geographic scope of the EU Savings Tax Directive to additional jurisdictions, with a particular emphasis upon extension to the USA and the principal current non-participating tax havens of Dubai, Singapore, Hong Kong and Panama, and to developing countries which may have suffered from capital flight.

The OECD Centre for Tax Policy and Administration should accelerate its long-standing work on technical standards for automatic exchange of tax information in electronic form, in conjunction with other appropriate bodies such as the European Commission, the IMF Fiscal Affairs Department and the World Bank. These standards should be internationally agreed and implemented as soon as possible.

The international standard should include rules for obtaining information from both individual nationals and residents, and legal persons formed under the laws of, or resident in, each country. It should include in particular a requirement that all banks and other financial, legal and corporate service providers collect information, which should be available for regulatory purposes to the appropriate supervisors or regulators (including tax authorities), on the beneficial owners of all payments made, whether to residents or non-residents, individuals and legal persons. It should prohibit legal provisions specifically designed for non-residents, such as legal entities formed to conduct activities exclusively outside the jurisdiction. Compliance should mean actually establishing satisfactory arrangements for exchanging information with other states multilaterally, and not just making non-binding `commitments' or bilateral deals.

Progress towards compliance with this standard should be monitored by an appropriate panel of experts, with input from civil society, according to a timetable with a relatively short transition period. Those states which have achieved a satisfactory level of compliance with this standard should then take appropriate defensive measures within their laws to deny recognition to transactions involving entities in non-compliant jurisdictions. This could include, for example, subjecting taxpayers with links to such jurisdictions to special scrutiny, treating entities formed in such jurisdictions as abuses of law, refusing deductibility of interest or other payments to entities taking advantage of secrecy in such jurisdictions, and prohibiting banks from having branches or affiliates in such jurisdictions. Such measures should as far as possible be coordinated.

The UN Committee of Tax Experts should be mandated as a high priority to work on a Unitary approach for taxation of transnational corporations. This should be done in conjunction with the work of the EU on development of a Common Consolidated Corporate Tax Base, and taking account of the experience of the Multistate Tax Commission in the USA with unitary taxation and formula apportionment, and it should draw on the support of the OECD Committee on Fiscal Affairs.

IMPROVED CORPORATE FINANCIAL TRANSPARENCY

The International Accounting Standards Board (IASB) should include within its International Financial Reporting Standard on segment reporting a requirement that multinational corporate groups report on a country by country basis on all their transactions (both third-party and intragroup), labour costs and number of employees, finance costs (third-party and intragroup), profits before tax, provisions for tax and tax actually paid, and tangible and intangible asset investments, without exception for any jurisdiction. This would provide a comprehensive view of each group for investors, stakeholders and tax authorities, with the objective of reducing the cost of capital, ensuring the efficient allocation of resources, eliminating transfer mispricing abuse, and facilitating a more effective and transparent international allocation of the tax base.

The constitution of the IASB should be reformed so that this organisation ceases to be a privately owned company with its finances controlled by the large firms of accountants and the financial services community and instead becomes an international agency as a specialist Commission of the United Nations Economic and Social Council, with appropriate provision for input by business and civil society organisations. The IASB project for a revised conceptual framework should be comprehensively reconsidered to reflect the lessons of the current crisis, which show that the IASB's approach has been one-sided in the priority it has given to the information needs of mobile financial investors. Hence, IASB standards should also evaluate the going concern in terms of its socially embedded use of a society's economic resources and thus contribute to a more socially fair and sustainable economy.

Those national and international bodies producing reporting standards for Corporate Social Responsibility should recognise that payment of the proper level of tax due is the ultimate corporate social responsibility of any company, and should include an obligation to disclose financial and taxation data on a country-by-country basis in the form noted above, which could be based on the IASB standard- if and when an adequate standard is produced.

Professional bodies regulating the activities of financial intermediaries should create Codes of Conduct that their members should be required to comply with as a condition of their membership that promote transparency and responsibility in relation to regulatory and tax compliance. Such Codes should specifically prohibit the promotion of financial obfuscation and abusive tax avoidance. These could be based on the Code of Conduct which is being prepared by the UN Tax Committee. For these purposes: (i) tax compliance means that the correct amount of tax is paid in the correct place at the correct time, on the basis that the economic substance of transactions is properly reflected by the form in which it is reported for taxation purposes; and (ii) abusive tax avoidance means that a transaction is constructed for the main or sole purpose of securing a tax advantage which it was not intended that the law provide.