THE OECD'S PROJECT ON HARMFUL TAX PRACTICES:

2006 UPDATE ON PROGRESS IN MEMBER COUNTRIES

OECD

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PART I: INTRODUCTION

1. Today's more open, competitive commercial environment has benefited households and businesses around the world by lowering the cost of capital and providing greater choices for consumers. The removal of trade barriers and the resulting increased competition has created new opportunities for growth and stimulated greater efficiency in the operation of financial and other markets. At the same time, a more liberalised global economy presents challenges for governments, including in the tax area.

2. One of the challenges governments face is ensuring that their tax systems remain competitive and do not act as a barrier to increased productivity. The wave of tax reform that has swept through OECD and other countries over the last 15 years has been driven in part by the desire to achieve this goal. Personal and corporate income tax rates have been significantly reduced, particularly in Europe, and the tax base has been widened to remove many tax-induced distortions.

3. The global economy will not reap the full benefits of this more competitive environment unless the competition between countries is based upon transparent and internationally accepted standards, including standards of international cooperation in tax matters necessary to counter the increased cross-border opportunities to unlawfully avoid or evade national taxes enacted by democratically elected legislatures.

4. The 30 member countries of the OECD - all countries characterised by having market-based economies – have traditionally looked to the OECD to establish these standards. In keeping with this role, the OECD Council in 1998 approved the report, "Harmful Tax Competition, An Emerging Global Issue" (the 1998 Report) [1] which responded to a request by Ministers to develop measures to counter harmful tax practices and laid the foundations for the OECD work in this area. The OECD Council mandated the Committee on Fiscal Affairs (the Committee) to report periodically to the OECD Council on the results of its work. This report seeks to fulfil that mandate by summarising the significant progress that has been made since the publication of the Committee's last progress report on this initiative in 2004**.**[2]

5. The work initially proceeded on three fronts: 1) identifying and eliminating harmful features of preferential tax regimes in OECD member countries 2) identifying "tax havens" and seeking their commitments to the principles of transparency and effective exchange of information and 3) encouraging other non-OECD economies to associate themselves with this work. The approach to the work has evolved over time and following the commitments made by 33 countries[3] to the principles of transparency and effective exchange of information, the two elements of the non-OECD member country work have

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

[2] *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (2004). The previous progress reports are *Towards Global Tax Co-operation* (2000) and *The OECD's Project on Harmful Tax Practices: The 2001 Progress Report* (2001).

[3] References in this document to "countries" should be taken to apply equally to "territories", "dependencies" or "jurisdictions".

increasingly been carried out jointly through the OECD Global Forum on Taxation (the Global Forum), the framework within which the OECD engages in a dialogue on tax issues with non-OECD economies.

6. By promoting the implementation of the principles of transparency and effective exchange of information, OECD countries seek to enable each country to retain sovereignty over national tax matters and to apply effectively its own tax laws. The decision on the appropriate rate of tax is a sovereign decision of each country. OECD member countries do not seek to dictate to any country, either inside or outside the OECD, whether to impose a tax, what its tax rate should be or how its tax system should be structured. The aim of this work is to create an environment in which all countries, large and small, OECD and non-OECD, those with an income tax system and those without, can compete freely and fairly thereby allowing economic growth and increased prosperity to be shared by all. Transparency and international co-operation through effective exchange of information are important elements of such an environment.

7. The present report focuses only on the progress made in connection with the work on potentially harmful preferential tax regimes of OECD member countries.

PART II: MEMBER COUNTRY WORK

8. The 1998 Report established a number of criteria[4] for determining whether a preferential tax regime was harmful. OECD member countries that approved the 1998 Report committed to eliminate any of their preferential tax regimes found to be harmful. In 2000, the Committee identified 47 preferential tax regimes as potentially harmful[5] based on the criteria contained in the 1998 Report and the guidance developed by the Committee on the application of these criteria.[6] The Committee also reviewed holding company regimes but felt that further analysis of these regimes was needed. As a result, the Committee declined to identify any holding company regime as potentially harmful in 2000.

9. Following extensive analysis and a process of both self and peer reviews, the Committee in its 2004 Progress Report reported that of the 47 preferential tax regimes that had been identified as potentially harmful, 18 regimes had been abolished and 14 had been amended to remove their potentially harmful features. Another 13 were found not to be harmful on further analysis.

[4] The 1998 Report identified four main criteria for determining whether a preferential tax regime is harmful: (1) no or low taxation on the relevant income, (2) lack of transparency, (3) lack of effective exchange of information, and (4) the regime is ring-fenced from the domestic economy. The “no or low taxation” criterion is used merely as a gateway criterion to determine those situations in which an analysis of the other criteria is necessary. The adoption of a low or zero tax rate by itself is never sufficient to identify a preferential tax regime as harmful. Furthermore, the 1998 Report is limited to geographically mobile activities, such as financial and other services, including the provision of intangibles and does not cover activities such as manufacturing. Belgium observes that since the modification of the tax haven aspect of the project in 2001, it has and continues to have concerns regarding the balance of the project because of the continued application of the ring fencing criterion to OECD member countries.

[5] See *Towards Global Tax Co-operation* (2000).

[6] See Consolidated Application Note: Guidance in Applying the 1998 Report to Preferential Tax Regimes, available at www.oecd.org/ctp.

10. In addition, the Committee reviewed holding companies and similar preferential regimes and determined that the regimes of Austria (as amended), Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg (participation exemption), Netherlands, Portugal and Spain were not harmful. The Committee also noted that notwithstanding Switzerland's abstention to the 1998 Report and the follow-up work, Switzerland was nevertheless ready to agree on effective exchange of information, in the context of its bilateral tax treaties, with respect to its holding companies.

11. Finally, the Committee considered a number of regimes that had been introduced since the initial identification of potentially harmful regimes in 2000 but concluded that none of these regimes were harmful within the meaning of the 1998 Report. The Committee noted, however, that the newly proposed Belgian co-ordination centre regime had not been fully evaluated because the full details of the regime had not yet been finalised.

12. Therefore, there were only three regimes on which the Committee did not reach a conclusion at the time of the 2004 Progress Report: the proposed Belgian co-ordination centre regime, the Swiss "50/50 practice," and the Luxembourg 1929 holding company regime.

13. Subsequently, Belgium informed the Committee at its June 2005 meeting that the proposed co-ordination centre regime would not be put into effect. As a result, the Committee considered the regime withdrawn. Switzerland also informed the Committee that it had withdrawn the Circular that authorised the 50-50 practice. No new rulings would be permitted and a transition period would ensure that the regime was gradually phased out. The Committee therefore decided to treat the Swiss "50/50" regime as abolished.

14. Concerning the Luxembourg 1929 holding company regime, the Committee noted that amendments to the regime had been made in 2005 (Law of 21 June 2005) but concluded that the amendments did not address the concerns of the Committee relating to the harmful feature of lack of effective exchange of information. The Committee concluded that the regime in its present form was harmful. [7]

15. The table below summarises the conclusions of the Committee's work to date with respect to OECD member country preferential tax regimes.

[7] Luxembourg declares that regarding the assessment of its tax regime for 1929 holding companies, the view of the European Commission is that the regime appears to constitute state aid that is not compatible with the common market, whereas the ECOFIN Council and the European Commission had accepted that the regime in its amended form was in conformity with the Code of Conduct and therefore it was no longer considered harmful within a political analysis. While Luxembourg is involved in a legal dispute with the European Commission, it expresses its disagreement with the present report that considers the Luxembourg regime to be harmful in the form of an abstention.

Potentially Harmful Regimes Identified in 2000			
1	Australia	Offshore Banking Units	Not Harmful
2	Belgium	Co-ordination Centres	Abolished
3	Belgium	Ruling on Informal Capital	Amended
4	Belgium	Ruling on Foreign Sales Corporation Activities	Abolished
5	Belgium	Distribution Centres	Amended
6	Belgium	Service Centres	Amended
7	Canada	International Banking Centres	Not Harmful
8	Canada	International Shipping	Not Harmful
9	Canada	Non-resident Owned Investment Corporations	Abolished
10	Finland	Åland Captive Insurance Regime	Abolished
11	France	Headquarters Regime	Amended
12	France	Logistics Centres	Amended
13	Germany	Monitoring and Co-ordinating Offices	Amended
14	Germany	International Shipping	Not Harmful
15	Greece	Shipping Offices	Not Harmful
16	Greece	Shipping Regime (Law 27/75)	Not Harmful
17	Greece	Offices of Foreign Companies	Abolished
18	Greece	Mutual Funds/Portfolio Investment Companies	Not Harmful
19	Hungary	Venture Capital Companies	Not Harmful
20	Hungary	Preferential Regime for Companies Operating Abroad	Abolished
21	Iceland	International Trading Companies	Abolished
22	Italy	Trieste Financial Services and Insurance Centre	Abolished
23	Italy	International Shipping	Not Harmful
24	Ireland	International Financial Services Centre	Abolished
25	Ireland	Shannon Airport Zone	Abolished
26	Korea	Offshore Activities of Foreign Exchange Banks	Abolished
27	Luxembourg	Provisions for Fluctuations in Re-insurance Companies	Amended
28	Luxembourg	Finance Branch	Amended
29	Luxembourg	Management companies managing only one mutual fund (1929 Holding Companies)	Harmful[8]
30	Netherlands	Risk Reserves for International Group Financing	Abolished
31	Netherlands	Intra-group Finance Activities	Amended
32	Netherlands	Finance Branch	Amended
33	Netherlands	International Shipping	Not Harmful
34	Netherlands	Cost-plus/Re-sale Minus Ruling	Amended
35	Netherlands	Ruling on Informal Capital	Amended
36	Netherlands	Ruling on Foreign Sales Corporation Activities	Abolished
37	Norway	International Shipping	Not Harmful
38	Portugal	Madeira International Business Centre	Abolished
39	Portugal	International Shipping Register of Madeira	Not Harmful
40	Portugal	External Branches in the Madeira International Business Centre	Abolished
41	Spain	Basque Country and Navarra Co-ordination Centres	Abolished
42	Sweden	Foreign Non-Life Insurance Companies	Abolished
43	Switzerland	50/50 Practice	Abolished
44	Switzerland	Service Companies	Amended
45	Turkey	Istanbul Offshore Banking Regime	Abolished
46	Turkey	Turkish Free Zones	Not Harmful
47	United States	Foreign Sales Corporation	Abolished

[8] See footnote 7.

Holding Company Regimes and Similar Preferential Regimes	
Austria (as amended), Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg (Participation Exemption), Netherlands, Portugal, Spain and Switzerland	Not Harmful
Luxembourg 1929 Holding Company Regime	Harmful[9]

Preferential Tax Regimes Introduced after 2000	
Shipping Regimes in Belgium, Denmark, Finland, France, Ireland, Spain and the United Kingdom	Not Harmful
Netherlands Advance Pricing Agreements/Advanced Tax Ruling Practice	Not Harmful
Belgium's Advance Tax Ruling Practice	Not Harmful/ Withdrawn[10]

16. The Committee considers that this part of the project has fully achieved its initial aims and that the mandate given by the Council on dealing with harmful preferential tax regimes in Member Countries has therefore been met. Future work in this area will focus on monitoring any continuing and newly introduced preferential tax regimes identified by member countries. This process permits any member country to request a review of any newly introduced preferential tax regime. It also permits any member country to request a review of any existing preferential tax regime to the extent it considers that the nature of the regime or the extent and manner of its use have changed in ways that may make it harmful under the criteria established in the 1998 Report.

[9] See footnote 7.

[10] The Committee decided to treat the proposed new Co-ordination Centre Regime (which is covered by the Belgium Advanced Tax Ruling Practice) as withdrawn. See paragraph 13 supra.