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WHAT IS THE U.S. POSITION ON OFFSHORE TAX HAVENS?

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JULY 18, 2001

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WHAT IS THE U.S. POSITION ON OFFSHORE TAX HAVENS?

WEDNESDAY, JULY 18, 2001

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., in room SD–628, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin, Carper, Stevens, and Collins.

Staff Present: Linda Gustitus, Chief Counsel and Staff Director; Mary D. Robertson, Chief Clerk; Elise Bean, Deputy Chief Counsel; Ken Saccoccia, Congressional Fellow; Greg Heath, Intern; Christopher A. Ford, Minority Chief Counsel; Alec Rogers, Counsel to the Minority; Eileen Fisher, Investigator to the Minority; Gary Mitchell, Detailee/Department of Education; Bos Smith, Intern; Cecily Cutbill (Senator Carper); Tara Andringa (Senator Levin); Jim Williams (Senator Durbin); Janet Sinclair (Senator Thompson); and Ann Fisher (Senator Cochran).

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Good afternoon, everybody. Over 15 years ago, this Subcommittee began a series of groundbreaking hearings on the problems created by the use of offshore banks and offshore corporations. Entitled "Crime and Secrecy," these hearings and related staff reports presented a detailed yet sweeping picture of how U.S. citizens were using offshore banks and businesses to launder criminal proceeds and evade taxes using offshore secrecy laws to hide their assets from U.S. law enforcement. The investigation recounted over 150 American prosecutions of crimes using offshore bank accounts, corporations or trusts to hide funds related to drug trafficking, financial fraud, bribery, tax evasion or other crimes. One staff report included an IRS-prepared list of 29 offshore tax havens—17 of which are on the tax haven list being discussed today.

The Subcommittee did this work in full cooperation with the Reagan Administration, which was deeply concerned about criminal activity using offshore tax havens. High-level Reagan Administration officials testified at the Subcommittee hearings, worked with Congress to pass legislation, launched new initiatives to pierce offshore bank and corporate secrecy laws, increase information exchange, and imposed sanctions on tax havens that refused to cooperate with our law-enforcement efforts.

The Reagan Administration officials recognized that the problem with offshore tax havens is not some abstract issue, but at its core affects all American taxpayers. In a 1983 radio address, President Reagan said this about tax evasion, "I agree with what one editorial writer said about those who cheat. 'When they do not pay their taxes, someone else does—you and me'."

The first Bush and the Clinton Administrations were just as concerned and just as active. In 1989, the first Bush Administration helped establish the Financial Action Task Force on Money Laundering, and this has become the leading international body fighting money laundering, and has spent countless hours wrestling with money laundering problems in offshore havens. The Clinton Administration worked with Congress to write the first nationwide anti-money laundering strategy and worked internationally to strengthen other countries' anti-money laundering laws.

Offshore tax havens are countries that allow corporations, trusts and other businesses to be established within their territory on the condition that any business they conduct is only with persons who are offshore, meaning with persons who are not citizens or domestic businesses operating inside the country.

Offshore tax havens charge hefty fees for establishing and maintaining an offshore business. The offshore businesses are often shell operations, established by attorneys, trust companies or banks within the offshore jurisdiction, and operate under corporate secrecy laws that make it difficult to learn the true owner of a business. These offshore businesses also usually open accounts at banks licensed by the offshore jurisdiction and conduct financial transactions under bank secrecy laws that make it difficult to trace transactions or identify bank account owners.

The money deposited in these banks is usually held in correspondent accounts that the banks have opened at larger banks in the United States or other countries. Many of the offshore corporations and trusts serve as mere place holders for individuals who want to hide their identity and their activities.

The questions that we hope to answer today are how this administration views offshore tax havens, and whether it plans to continue the efforts of the United States and other countries to convince offshore tax havens to cooperate with efforts to detect and stop tax evasion and the criminal activity that is associated with it.

Since the 1980's, the list of offshore havens has doubled, from about 30 to 60. The number of offshore companies has exploded, with one country alone responsible for incorporating over 350,000 of those offshore companies. Assets in these offshore entities have climbed from an estimated $200 billion in 1983 to an estimated $5 trillion today, including $3 trillion in offshore bank accounts. That is a 25-fold increase. While some offshore tax havens have strengthened their bank regulations, anti-money laundering controls, and cooperation with international criminal and tax investigations, others have strengthened their secrecy laws, kept their regulatory agencies starved for resources, and refused any cooperation for tax collection purposes.

In 1999, this Subcommittee took a renewed look at offshore havens in connection with an examination of money laundering using

U.S. private and correspondent banking services. The evidence was similar to the 1980's, with offshore banks and businesses being used to launder illegal proceeds related to drug trafficking, financial fraud, tax evasion and other crimes. We will hear today that despite significant advances, U.S. law enforcement officials continue to be stymied in their efforts to pierce bank and corporate secrecy laws in many offshore tax havens.

As the size of the offshore problem has increased, so has international concern.

Offshore havens, by their nature, are dependent upon the goodwill of other countries to operate. Offshore banks use correspondent accounts with banks in leading financial centers around the world to move, protect and invest their clients' money. Offshore brokers have to obtain access to other countries' capital markets since they are barred from the domestic markets of the countries that created them, and offshore businesses must have clients from other countries as their customers since, by definition, offshore businesses are prohibited from doing business in the country in which they are licensed.

During the 1990's, the United States and other G–7 countries used the Financial Action Task Force on Money Laundering, or FATF, to urge countries around the world to strengthen their anti-money laundering efforts. Then, in June 2000, for the first time, FATF members drew up a list of countries that were not cooperating with anti-money laundering efforts and threatened them with sanctions if they did not improve. That listing had a remarkable effect on a number of countries, convincing them to improve their anti-money laundering laws to get off or stay off the list.

Some of the listed countries have still failed to act and they are scheduled to become subject to the first round of FATF sanctions later this year. FATF sanctions reportedly include warning international corporations to not do business in these countries and requiring banks to collect detailed information from customers before conducting transactions in these countries.

A parallel effort was undertaken to increase international cooperation on tax enforcement. This effort was undertaken by the Organization for Economic Cooperation Development, or OECD, which in 1996, with strong U.S. support, initiated a tax haven project.

Like the FATF listing, the project issued a preliminary list of 35 tax havens in June of 2000,[1] and asked the listed countries to improve their cooperation on tax matters or become subject to sanctions in 2001. Tax haven countries were asked to make written commitments in three areas: to provide effective information exchange on criminal tax matters by the end of 2003 and on civil tax matters by the end of 2005; to revise their secrecy laws to increase transparency, especially disclosure of ownership of bank accounts and business structures; and to end any tax preferences given to offshore entities.[2] The listed countries were given until July 2001, this month, to make the commitments or be included in a list of uncooperative tax havens that would be subject to sanctions.

[1] See Exhibit 5, which appears in the Appendix on page 91.
[2] See Exhibit 6, which appears in the Appendix on page 92.

At first, just like the FATF effort, the OECD tax haven effort made progress. For example, last year, to avoid being listed and sanctioned, the Cayman Islands issued a letter making the desired commitments and agreeing to tax information exchange provisions that it had flatly rejected for years. It was a surprising and welcome turnaround. The Cayman Islands was not alone. Nine other jurisdictions: Aruba, Bermuda, Cyprus, the Isle of Man, Netherlands Antilles, Malta, Mauritius, San Marino and the Seychelles made similar commitments.[1] Almost all the other countries on the year 2000 tax havens list began dialogues with the OECD about changing their ways. That is the power of a concerted international effort.

However, instead of issuing a final list of uncooperative tax havens this month and initiating sanctions, the OECD's effort faltered when in May, U.S. Treasury Secretary Paul O'Neill announced that he had "serious concerns" about the project. Secretary O'Neill said it could be seen as suggesting that, "low tax rates are somehow suspect," and as trying to "dictate" higher tax rates in low-tax jurisdictions.[2] Now, that criticism was made even though the project had accepted commitments from the Cayman Islands and then exempted it from the tax havens list, all the while the Cayman Islands maintained a zero income tax rate.

Secretary O'Neill's actions were viewed by the international community and the media as a major retreat by the United States. Headlines read as follows: The *Wall Street Journal,* "U.S. Could Abandon Initiative To Crack Down On Tax Havens"; the *Miami Herald,* "U.S. Won't Pressure Offshore Tax Havens, O'Neill Says"; the *New York Times,* "A Retreat On Tax Havens."[3]

Frankly, many of us in Congress who worked on tax haven issues over the years were stunned. Today's hearing was called so that Secretary O'Neill could explain the position of the administration with respect to tax havens and to clear up any confusion.

We understand that the United States and its OECD allies have successfully concluded negotiations on a proposal that is agreeable to all parties.[4] While press reports suggest that the United States will support the revised OECD tax havens project, opponents of international efforts to crack down on tax havens still claim the opposite.

For years now, offshore tax havens have damaged U.S. interests by facilitating crime, money laundering and tax evasion. An estimated $70 billion in U.S. tax revenue is lost each year to assets hidden offshore, a figure so huge that if even half that amount were collected, it would pay for a Medicare prescription drug program without raising anyone's taxes or cutting anyone's budget.

Besides robbing U.S. taxpayers of this revenue, uncooperative offshore tax havens are an ongoing affront to honest taxpayers. U.S. citizens have one of the best records of voluntary payment of tax in the world today, because they are willing to pay their fair share to keep this country great and enjoy the benefits of a strong

[1] See, for example, Exhibit 9, which appears in the Appendix on page 97.
[2] See Exhibit 2, which appears in the Appendix on page 83.
[3] See Exhibits 16, 17 and 18, which appear in the Appendix on pages 111, 112, and 114 respectively.
[4] See Exhibit 29, which appears in the Appendix on page 166.

defense, safe food, clean water, good roads and the other advantages that this country offers. Tax evasion is a crime in this country. It is a serious crime because it undermines overall confidence in the tax system and it deals a terrible blow to the basic fairness that makes our democracy work.

Too many offshore tax havens continue to play host to crime and tax evasion. It is in the national interest of this country to respond, as it has been since the Reagan Administration took on this issue. Tax evasion means higher taxes for honest taxpayers, and it is a problem that deserves immediate attention and tough action. We have tried going after tax havens on our own, but they pose an international problem requiring an international solution.

Our hope in this hearing today is to find out whether the United States will continue its efforts to detect and stop tax evasion in offshore tax havens, whether it will continue to play a constructive role in the international effort to detect and stop tax evasion, and whether the United States is still committed to both tax information exchange, that is the core of the project, and to sanctions for offshore tax havens that refuse to change their ways.

Senator LEVIN. Senator Collins.

OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you, Mr. Chairman, and I want to thank you for convening this hearing. You have been the Senate's leader in the effort to crack down on money laundering and I look forward to hearing from our witnesses today. Much of our discussion today will focus upon a framework for collective multinational action proposed by the Organization for Economic Cooperation and Development (OECD). The OECD's goal of eliminating what it has called harmful tax practices has focused upon developing a framework whereby OECD-member countries, including the United States, Japan and most of the nations of Western Europe, would use financial pressure in order to force offshore tax havens to change some of the practices that make them notorious jurisdictions of choice for tax cheats.

For the countries of the OECD, this has been a high priority because many billions of dollars are believed to be lost each year in foregone tax revenue from citizens who hide income from domestic tax authorities by concealing it in bank accounts in jurisdictions with strict bank secrecy rules, but little or no income tax of their own. The OECD has proposed a mechanism by which countries with particularly egregious practices would be designated as harmful tax havens and pressured to reform.

As Senator Levin indicated, this Subcommittee is very familiar with the practices of offshore jurisdictions with strict bank secrecy rules. The Chairman's previous hearings on money laundering demonstrated that such jurisdictions are, indeed, popular banking locations for those seeking to hide illicit funds or simply unreported income from law-enforcement authorities in their home countries. One witness at our March hearing, for example, testified that he believed the vast majority of his clients at his offshore bank were American citizens engaged in tax evasion.[1] It is obviously impos-

[1] See Exhibit 8, which appears in the Appendix on page 96.

sible to know with any certainty exactly how much money is concealed in this fashion, but some estimates of lost U.S. tax revenues are as high as $70 billion a year.

This clearly is no small problem and it is easy to see why OECD governments would want to reduce the number of jurisdictions that offer themselves as safe havens to such tax scofflaws. As it was originally proposed, however, the OECD's framework raised some significant and legitimate concerns, particularly with regard to that organization's broad definition of a tax haven that might ultimately be subject to financial sanctions by OECD governments, and with regard to its general thrust against what has become known as tax harmonization.

According to the organization's 1998 report on this subject, for example, simply having no or nominal taxation might alone be sufficient to identify a tax haven if that country offered or was merely perceived to offer itself as a place where nonresidents could escape taxes in their home country. Particularly, given the OECD's talk of the damaging effect that countries with low tax rates had in attracting capital from other higher tax countries, it is not difficult to understand why some critics feared that this program, which had the support of the Clinton Administration, sounded less like an initiative for fighting tax evasion than a program for encouraging low-tax jurisdictions to raise their taxes so as to provide less economic competition for the generally higher-tax countries of the OECD.

The current administration has raised some legitimate questions about the specter of imposing multinational sanctions upon countries, simply because they had adopted certain low-tax economic policies. At the same time, however, the Bush Administration has supported measures that would target the real problem the OECD framework is designed to fight, and that is tax evasion. Secretary O'Neill has called for improved case-by-case information sharing between government tax authorities to help make it harder to conceal income unlawfully in a secrecy jurisdiction. This, after all, is something our government already does with many countries, with a number of safeguards intended to prevent the abuse of personal financial information given to other governments in connection with civil or criminal tax enforcement proceedings.

The United States has an extensive network of bilateral tax treaties and other intergovernmental information sharing agreements. Reaching similar arrangements with today's tax havens under the OECD framework would be an important step toward ensuring not only the improved enforcement of U.S. tax laws, but also more effective U.S. prosecution of money launderers, drug smugglers, and other criminals who may seek to hide their elicit gains in overseas bank secrecy jurisdictions. As Secretary O'Neill put it in a letter published in May of this year, "the United States needs information from offshore tax havens in order to prosecute tax evaders."[1] An international organization such as the OECD "can be used to build a framework for exchanging specific and limited information necessary for the prosecution of illegal activity."

[1] See Exhibit 2, which appears in the Appendix on page 83.

Mindful of the potential dangers of opening the door to tax harmonization, the Secretary called for the OECD effort to be, "refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few." Thanks in large measure to Secretary O'Neill's efforts, I understand that the OECD is now on the verge of agreeing to focus upon information exchange and transparency and to lessen its previous focus on tax harmonization.

I also understand that Secretary O'Neill has asked his staff to carefully assess the range of anti-money laundering programs now underway at the Treasury Department. As I understand it, he inherited a department unable to even tell how much it spends to fight money laundering. The Treasury Department itself apparently has come up with estimates that differ by more than $300 million, and there does not seem to be any clear idea of exactly what should be counted as an anti-money laundering program in the first place.

I support Secretary O'Neill's efforts. I believe it is high time for the department to figure out not only how much is being spent, but also which programs are effective in the important fight against money laundering. We in Congress, and on this Committee, in particular, spend a great deal of time trying to get government agencies to identify meaningful criteria by which they and we can judge their effectiveness.

I hope that Secretary O'Neill will use this opportunity to identify what works best in fighting against money laundering, so that the department can use its limited resources more effectively. We will accomplish more in the fight against such crime if we focus our attention upon those programs that work best in eradicating it. Again, Mr. Chairman, I look forward to hearing from our witnesses today and I appreciate your efforts in this regard.

Senator STEVENS. Excuse me, I have to leave to attend another hearing.

Senator LEVIN. Thank you, Senator Stevens.

Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Mr. Secretary, how are you doing? You look like you are holding up well. Thank you for being with us today and for sharing your input. How is John Duncan doing? John was the chief of staff to Bill Roth, my predecessor, and as a Senator for some 30 years, Senator Roth was Chairman of the Governmental Affairs Committee, and as I recall, back in the mid-1980's, he held hearings as a Member of the Committee, maybe even Committee Chairman at the time, to highlight offshore tax havens. It is kind of ironic given his history and seeing John out here and having you before us today and sitting in this seat. Somehow it seems appropriate.

There is one thing I want to add to the comments we have heard from Senator Levin and from Senator Collins. We are experiencing a drop-off in revenues into the Treasury, and as we debate the appropriation bills in the Senate this week, today, next week, the next couple of weeks, I am reminded that the revenues are drop-

ping and the appetite for spending is still pretty robust. We need to find wherever there is a dollar or two that is owed to the Treasury, we need to find it and get our hands on it. If you ask most people if they want to pay more taxes, they say no, thank you, but they still want their favorite program to be funded. People do not like the idea that they pay their fair share of taxes and somebody else does not. This is just one that we take seriously in Delaware and have for a long time, and we look forward to hearing from you and to working with you to make sure that all of us are paying our fair share. Thank you.

Senator LEVIN. Thank you, Senator Carper. Our first witness this afternoon is the distinguished Secretary of the Treasury, Paul O'Neill, and we are really very pleased to have you with us, Mr. Secretary. I particularly appreciate the fact that you were so responsive to my request to testify before this Subcommittee. We appreciate the cooperation that you and your staff have shown to this Subcommittee, and we look forward to hearing what you have to say this afternoon.

We have a rule here called Rule 6, which requires all witnesses to take an oath to testify before this Subcommittee, and at this time I would ask that you please stand and raise your right hand. Do you swear that the testimony you are about to give to this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Secretary O'NEILL. I do.

Senator LEVIN. Mr. Secretary, we have a timing system here which we use, and we would ask that you take a look once in awhile, and when the green turns to yellow, that you conclude your remarks. All of your prepared statement will, of course, be printed in the record. We are going to try to limit testimony of all of our witnesses to 10 minutes and ask that you try to stick to that if you possibly can, and then we will have more time for questions. Thank you again for joining us.

TESTIMONY OF HON. PAUL H. O'NEILL,[1] SECRETARY OF THE U.S. TREASURY

Secretary O'NEILL. Thank you, Mr. Chairman, for arranging this hearing and inviting me to be the lead witness. It is nice to be here with you and with Senator Collins. Thanks very much for your comments, and for the question about how John is doing. I tell you what, I am going to give him a passing grade as soon as he gets all of my nominees released. Until then, he is on probation.

Mr. Chairman, with your permission, I will simply introduce for the record my prepared statement and maybe make just a few introductory remarks and then open myself for your questions, so I do not take too much time, because I do know you have a full group of interesting witnesses that you need to hear from.

Let me do this as simply as I know how. I was fascinated by your introductory statement and your citation of the *Wall Street Journal* and the *Miami Herald,* and there are other newspaper accounts that are in the book. One of the things I find fascinating, frankly, coming back to Washington after being away for awhile, is to find

[1] The prepared statement of Secretary O'Neill appears in the Appendix on page 45.

the degree, in this case in every specific instance, where the things that you cited are really editorial comment masquerading as news, and I would make that distinction in this sense.

I do not think that there is anything I have said, either on the record or off the record, about the OECD project or money laundering, that anyone I know would disagree with. What people seem to disagree with is the representations that have been made about what I may have meant or what I may have inferred. No one has challenged me on the principles, which I believe are the right principles with regard to the OECD project, which are namely these: That we in the United States—as a matter of fact, I took a sworn oath to pursue the absolute, 100-percent fulfillment of the law, executing and pursuing the law as it has been written and enacted by the Congress and signed by the President of the United States over a period of 225 years, and take that obligation very seriously. Part of that obligation, in this case, is, as I understand it, to pursue to the ends of the earth those people who have tax obligations to the United States, which they seek to avoid or evade.

In that regard, there is no doubt, as you know very well, because you have been, as Senator Collins said, a leader on this subject—there are people in our midst who are citizens of the United States who choose to and try to use every means that they can to avoid paying their fair share of taxes, and as you said, that means the rest of us are—quoting President Reagan—"the rest of us pay the taxes of those who choose not to do so." I find no one who disagrees with me that we should pursue every legitimate way that we can to ensure that people pay their exact, correct amount of taxes, and that necessitates, because there are lots of global dealings now, that we have arrangements to collect and be able to use information from jurisdictions all around the world to fulfill that responsibility.

The second principle that I have laid down and have been very clear about is that I do not think it is appropriate—perhaps I am wrong on this—I do not think it is appropriate for the United States or the OECD, for that matter, to tell any sovereign Nation what the structure of its tax code should be, period. We may not like what other countries do, but I do not think it is our right to tell other countries what their tax structure should be.

I would say to you I found no one who disagrees with these two principles. When I got the reaction, indirectly, I must say, from some of the people who are involved in the OECD project, that, "Well, for goodness sake, we agree with these principles, and we are not trying to do anything else," I said, "Wonderful, then we have no disagreement. Let's go on with our work."

So, I must tell you I am really quite surprised, in a way, to see the flurry of concern and activity, that somehow stating what seemed to me to be clear principles creates in the minds of people who buy their ink by the barrel, the suspicion somehow that there is a bad motive in laying down principles which everyone says they agree with. I am really quite surprised.

With regard, if I may, to the subject of money laundering for a moment—and in this case I would say to you what I have been doing in this area falls within the aim of what I think my responsibility is as Secretary of the Treasury, to be Secretary of the whole

Treasury. And by that, I mean something beyond working on the fascinating subjects of international monetary policy and the IMF and the World Bank and all the rest of those very exotic things. I think I have a duty to ensure that the Treasury Department not only executes the laws faithfully, but efficiently and effectively, and so I have raised questions about every single thing within the Treasury Department, to first of all understand what it is we are supposed to be doing and then to raise questions about how we could do it better.

For example, our laws that were written in 1934, and this was one that I was involved in yesterday, require us to collect $300 million from nonalcoholic users of—people who use alcohol for nonbeverage purposes—we collect $300 million from them and then give it back to them in a so-called drawback process. Does that law which requires the use of many intelligent people make any sense removed from 1934? My answer to that is no. Why are we doing it? Nobody seems to know.

In that same regard, I have said with regard to money laundering, which I first began to be interested in when I made my courtesy call on you as a nominee, and you and the staff showed me the report from last year on what the U.S. Government was doing in money laundering and taught me how to use the tables in the back of the book that showed that according to last year's report, we, the Federal Government—not just the Treasury—we, the Federal Government, are spending a billion dollars a year on money laundering. Having been here—I am dating myself now—I was remembering this today—when Lyndon Johnson was struggling to keep the U.S. budget under $100 billion, a billion dollars still seems like a lot of money to me.

When you and your staff taught me that we are spending $1 billion on money laundering, I was really quite impressed. A few weeks later, as I began my pursuit of administrative efficiency and effectiveness and faithful pursuit of the laws, I got around to scheduling meetings to talk to the people who are responsible for money laundering, and I said to them that I am fascinated by how much money we are spending. What are we getting? Show me some indication of how big is this problem and how much progress have we made on it and how good are we at anticipating measures and countermeasures to outfox the people who are guilty of doing all this.

They said, "Well, here is a new report for this year, Mr. Secretary," and having learned from you where to look in the book, I looked at the back of the book, and I was astounded to find that from 1 year to the next our spending on money laundering went down from $1 billion to $650 million. Having been in the budget director's or deputy director's job for some years, I said to them the only other program I can remember going down was a $16 million program for Adis egypti, which was to kill mosquitoes with DDT in the South, which eventually went away because it was environmentally unsound.

I said I just cannot believe we have got a $350 million year-to-year decrease, and they said, "Well, we don't." I said that is what this report shows, because Senator Levin showed me one that said we are spending $1 billion. They said, "Well, that is because a mis-

take was made in the way the report was compiled last year." I said—now, this is public and private sector experience—my experience is if you find one rotten apple in the barrel, there will probably be some more. I would like to know how much of all the rest of this should I believe if I cannot believe the top-line figure, that is a published figure from the Federal Government saying we are doing this, when we are not doing it at all. We are only doing two-thirds of it.

Now, in truth, I must tell you, I do not even believe the $650 million, because there are—how do I say this right? There are assumptions or inferences about levels of activity that are then multiplied by the total spending of a department or agency that make up substantial parts of the $650 million.

My pursuit of this subject is not over, because I do believe, as you have said, through the litany of history, that these are subjects of great importance, that we should do everything we can to ensure that every American pays every legitimate tax responsibility they have. It is fairly clear, partly because of the enormous complexity of our tax system, that is not happening today, in addition to the reasons that are related to so-called tax havens.

I do believe that we can be and we will be much more efficient in pursuing tax cheats, and bringing to justice those who launder money, and hopefully getting at the activity behind the money laundering in the first place. So, if you have a doubt, please have no doubt about my determination that we will do a job that is better than anything you have ever seen before in chasing tax evaders and in finding money launderers and doing something about it, because we will have a connected process to accomplish these purposes.

Senator LEVIN. Thank you very much, Mr. Secretary. We appreciate that commitment that you expressed there at the end of your statement.

Would you agree that secrecy is at the heart of tax haven operations and abuses, our inability to get information from those tax havens?

Secretary O'NEILL. Yes, I do.

Senator LEVIN. That is the way tax havens advertise themselves. They promise and promote secrecy and that is what people pay for when they use these tax havens, but that is the heart of the problem, you would agree; is that correct?

Secretary O'NEILL. Actually, I do not think so. I think the heart of the problem may be a human characteristic that is pretty hard for us to do anything about, which is to cheat. The whole problem begins with the intent not to do what your role as a citizen is. That is the nub of the problem. There are then organizations and individuals who facilitate human weakness, and indeed, that is really a heck of a problem, but underneath it, there are still an awful lot of people who obviously do not want to fulfill their obligations as a citizen.

Senator LEVIN. But you would agree that the advantage that these tax havens offer and why individuals and corporations and companies open accounts in these offshore jurisdictions is usually the promise of secrecy?

Secretary O'NEILL. Well, it is painting with a broad brush, but all right. I suppose if we did a full listing of why are the reasons that people would open accounts in different places, you can find lots of different reasons. I puzzled myself about our own situation, which I am sure you know, we do not tax investment interest income for foreign-based individuals in the United States. I wonder what that looks like from the other side.

Senator LEVIN. I am talking about the secrecy aspect here, not the tax aspect.

Secretary O'NEILL. I understand. Well, we, in this particular case, we have a secrecy aspect. We do not notify their government that they had——

Senator LEVIN. Upon request, we do not notify?

Secretary O'NEILL. Well, I suppose we would if we had a treaty with them. I am not sure that we would otherwise.

Senator LEVIN. But upon request with those countries with whom we have agreements——

Secretary O'NEILL. We would.

Senator LEVIN. And these tax haven countries, these offshore countries will not enter into those kind of treaties with us; is that not correct?

Secretary O'NEILL. I do not know. It looks to me like we are making a fair degree of progress. If my memory serves me right, we have got 66 treaties that provide for the free flow and exchange of information, but with careful protection around the aspects of privacy.

Senator LEVIN. How many of these tax havens countries do we have treaties with?

Secretary O'NEILL. I do not honestly know, and when you say tax havens countries——

Senator LEVIN. These offshore countries that have been listed either by the OECD or by FATF; how many of those countries?

Secretary O'NEILL. Five.

Senator LEVIN. Five, all right. So, then, most of the ones on the list we do not have an agreement with to disclose to us upon request; is that correct?

Secretary O'NEILL. Yes, but, Senator, I think the work that is going on with the FATF and with the OECD is moving us in a direction—it seems to me that we are making real progress with the work that has gone on in the past and the work that is going on now, to establish information treaties, because there does seem to be a uniformity of agreement now, as Senator Collins indicated in her opening statement, that we are all going to move ahead with this together.

Part of what I heard about this subject early on, I heard at the Hemisphere Summit of Finance Ministers, where the finance ministers from some of these small countries, from so-called tax havens countries, were making a plea that they were being treated unfairly and with discrimination because the OECD was not applying the same rules to itself that it was now going to impose on them. When I was in the room last week at the G–7 meeting, Finance Minister Trumanti, who is the new finance minister in Italy, who is also a tax lawyer incidentally, one of the most respected tax lawyers in Italy—he said to me, "You know, if some of this OECD

work that was going on had continued the way it was, we would have been found in Italy to be a tax haven by their definition," which I found really fascinating from one of the world's experts about tax policy.

Senator LEVIN. Let me get back to the tax secrecy issue and the countries that we do not have tax agreements with—these offshore countries that have thousands and thousands and thousands of these accounts where we cannot get information—to try to see if we cannot see what we are going to do about it, because that is the important thing.

This is the testimony that we had from John Mathewson, who said that: "out of approximately 2,000 accounts opened in 1985 in his bank, 95 percent of Guardian Bank's clients were U.S. citizens and virtually 100 percent were engaged in tax evasion."[1] Do you have any reason to differ with that?

Secretary O'NEILL. No. This is the case I keep seeing.

Senator LEVIN. He is the only one that has ever come forward.

Secretary O'NEILL. I know. I keep asking, though, how come there is only one?

Senator LEVIN. Because he confessed to a crime, that is why.

Secretary O'NEILL. I know, but if we are spending $1 billion a year on this subject, why is there only one case?

Senator LEVIN. Let's take a look at the exhibit, then. Let's take a look at Exhibit 7.[2] Let's see how many of these accounts there are, since you seem to think this is a rare case.

Secretary O'NEILL. No, Senator, I did not say this is a rare case. I said why is there only one.

Senator LEVIN. Well, you seem to be dubious.

Secretary O'NEILL. No. I am wondering why, because I think we share a view that this is a serious problem and we are spending all this money. Why is there only one case?

Senator LEVIN. How do you know it is a serious problem if there is only one case. You have concluded——

Secretary O'NEILL. I am following your lead, Senator.

Senator LEVIN. Other than that, you do not think it is a serious problem?

Secretary O'NEILL. No, I do, indeed, think this is a very serious problem. I think I am with you completely on that subject. I am only questioning why, if we both agree—and most people would agree this is really a serious problem—we have one person and one case that everybody keeps citing. Why have we not brought more fugitives to the bar of justice?

Senator LEVIN. I am trying to figure out if you think it is such a serious problem, why you are emphasizing that there is only one case where a guy who has committed a crime, has plead guilty and has been willing to step forward—I do not understand why you focus on that fact instead of focusing on what you agree is a serious problem. Now let's talk about the problem. We have got the OECD list of offshore tax havens.

Secretary O'NEILL. Including the U.S. Virgin Islands.

Senator LEVIN. Right. Will you take a look at Exhibit 7, please?

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[1] See Exhibit 8, which appears in the Appendix on page 96.
[2] See Exhibit 7, which appears in the Appendix on page 93.

Secretary O'NEILL. Yes, sir.

Senator LEVIN. And tell me whether or not you think that the numbers on that exhibit do not reflect the problem that we have a serious situation here with tax evasion at these offshore banks and companies.

Just take a look at these numbers here. In Andorra we have 20 U.S. taxpayers—let me go down to where we have the actual numbers. In Anguilla, we have eight taxpayers who have said on their tax return that they have foreign accounts of $10,000 or more, a grand total of eight. We have 1,988 offshore companies. Antigua and Barbuda, we have 87 taxpayers in the United States that admit that they owe taxes in their tax returns. We have 12,000 offshore companies in Antigua and Barbuda.

Secretary O'NEILL. Senator, do you have any idea how many of those are U.S. companies.?

Senator LEVIN. Nobody knows for sure except that the evidence that we are able to collect when we go to those companies is that a great proportion of these are American people. The assets that are owned by Americans proportionally in the world is huge. You have, here in Aruba, 37 accounts of $10,000 or more, yet there are 7,400 offshore companies in Aruba. In Belize, 81 Americans acknowledge that they owe income tax, and yet there are 16,000 offshore companies in Belize. In the British Virgin Islands, 185 tax returns acknowledge that they own accounts, and yet 360,000 offshore companies were created by the British Virgin Islands. Do you believe that reflects a problem?

Secretary O'NEILL. I have no idea. One thing, Senator——

Senator LEVIN. Why do you think there is a problem? Why do you agree there is a problem?

Secretary O'NEILL. Senator, it does seem really clear that we have people who are intentionally evading U.S. tax laws, that are taking money out of the United States or out of other places where it should be taxed under our tax regime. So, I have no doubt that this is a serious problem. But one thing that I have learned both in my public and private career is to know the difference between what you know and what you do not know. By looking at these numbers, I can see a bunch of numbers parading across the table, and I can make inferences about it probably for the next 4 hours, but they would all be inferences and I know the difference between a fact and inference. So, I am amused by this data.

I saw the story about it in the *Wall Street Journal* this morning. The reporter called us up yesterday afternoon and said that he really did not know what to do with this, but do you have a comment? They wanted a comment before they even knew what to write. It would suggest to me that it is not a wonderful way to do business. Yes, I am interested in looking at this data. We will try and pursue this data. I would be really interested to know, whoever compiled this, of the 360,000 accounts in the British Virgin Islands—it is an enormous number of accounts. What could they possibly be? Maybe there is some explanation. I do not know and I would certainly be happy to dedicate some resources to figure out what all of this stuff means, but looking at the numbers parading across the table, I do not know anything except there are some interesting numbers that suggest a really strange pattern.

Senator LEVIN. I am not amused by these numbers. I have got to tell you, I am not amused at all, because I think it is very clear what these numbers indicate. Although you cannot pin down with precision what percentage of those accounts are U.S. accounts, we know from experience and we know from the evidence that we do have that a significant portion of the assets in this world and particularly in that part of the world are American assets. So, I do not view this as amusing at all.

I want to just look at Antigua. We looked at an Antiguan bank called the American International Bank. By the end of 1997, American International Bank had approximately 8,000 clients. The owner of the bank estimated that about half of its client base would be from the United States. That is the owner of the bank who estimated that. That would be about 4,000 U.S. clients in that one bank alone in Antigua—4,000. Now, the IRS has told us, and we are very appreciative of the IRS effort on this, that a grand total of 87 Americans disclosed Antiguan accounts on their income tax. Yet, in one bank in Antigua, I emphasize, in one bank in Antigua you have an estimate by the owner of the bank that there are 4,000 U.S. clients. That is one of about 20 offshore banks, by the way, that are licensed in Antigua.

Panama is another example. The chart shows that 342 U.S. taxpayers acknowledge having an account in Panama.[1] Panama has created 370,000 offshore companies. It has 34 offshore banks. We have some information about the Mark Harris organization in Panama. The owner, Mark Harris, and companies he controls are found to be behind a number of international bank investment frauds. Recently, some of the clients of Harris have been indicted in the United States for money laundering and tax evasion. This is what a *Business Week* article said in 1998, "Sitting in his fifth-floor offices in a Panama City high-rise, Harris, an immaculately groomed 33-year-old ex-American citizen, says that 80 percent of his several thousand clients are Americans or Canadians."

Now, we can go down with the evidence that is there. These figures, it seems to me, just demonstrate dramatically—and the evidence that we have to support these figures—that tax evasion is rampant in these tax haven countries and the current enforcement policies over the IRS requirement to report a financial interest in foreign accounts are ineffective or non-existent.

I must say, I am discouraged by what you have told us in your responses to my questions today, when you use words like this kind of a chart, Exhibit 7, is "laughable." It is not "laughable."

You cannot prove exactly what percentage of 360,000 offshore companies in the British Virgin Islands, or 100,000 companies in the Bahamas are American owned. You cannot prove that precisely, but there is enough evidence, just in interviews with people, that a significant percentage of those companies and accounts are American. Yet we have peanuts. We have got in Antigua 87 accounts admitted. There are 12,000 offshore companies. So, I have got to tell you, Mr. Secretary, I think you diminish the problem, that you underestimate the problem, with your rhetoric.

[1] See Exhibit 7, which appears in the Appendix on page 93.

Some of your rhetoric acknowledges that you say you believe there is a problem, that there is a real tax evasion problem, and I welcome that. I truly do. But when it comes to looking at the dimensions of the problem, the evidence that we have, it seems to me that you minimize the problem by the way in which you respond to the evidence that is available. Now, I want to give you a chance to respond. My time is up, then I will turn it over to Senator Collins.

Secretary O'NEILL. Thank you. First, if you do not mind, and I do this with all respect, please let me take away from you—you characterized what I said about this as "laughable." I did not say "laughable," but I fear knowing how the media works, if you put "laughable" in my mouth, it will be in their pen. So I want to take "laughable" away from you. I did not say that.

Second, I want to see if we cannot be together, because I do think we should be together on these issues. What this data says to me, without knowing any more about it, and without making any inferences, is that we need a tax treaty with all of these jurisdictions like the other 66 we have, so that we can pursue Americans who are cheating their co-citizens by evading our tax laws through these jurisdictions. I hope we can agree that is the right thing to do. And then we will have an opportunity to find out whether these are Americans who are cheating their co-citizens or not, and not rely on appearances or inferences, but actually go after them.

Senator LEVIN. We have been seeking disclosure from these tax havens for decades without success. We have had very little success and only when—it is the threat of sanctions and it is the threat of international action which has caused them to come through with tax treaties or disclosure. So, we more than welcome tax treaties, but we will come back on a second round to find out how long we are going to standby without either tax treaties or disclosure before we join in a sanctions regime.

Secretary O'NEILL. Senator, if I may say one thing about that, I am looking at this list now and you are telling me for decades that we have had this list and we have not done anything about it?

Senator LEVIN. No, I am saying that we have been trying with many of these tax havens to do something about it for decades, and the only thing that has succeeded, I suggested, is when the international community took action, and then we got some of these tax havens to sign treaties and end these offshore practices which have cheated American taxpayers of the amount of money which other taxpayers have owed. That is all I said.

Secretary O'NEILL. It is probably dangerous, but what I would do with this, in my previous incarnation, which I am going to do for you right now without consultation with my staff, I would say look, how about if we make a deal? I will come back here a year from now, and I will have worked out a tax treaty with what represents more than 50 percent of all the offshore companies, which lets me work with major jurisdictions instead of small ones, and demonstrate to you that we are serious about this and the problem you have been haranguing people about for years and apparently have not done a very good job of it. We are going to show you real progress and we will show it to you fast enough that you will not

have to wait for a new Secretary to come around and you can talk to them.

Senator LEVIN. We started with President Reagan doing the haranguing.

Secretary O'NEILL. I am going to go get something done for you.

Senator LEVIN. Good. I just want to let you know the Reagan Administration and the Bush Administration that came after that, and the Clinton Administration, have been trying for decades. That is the effort that has been made. I really hope you succeed where they have failed and we have failed to do more than we have, and we look forward to that report back in a year with your .500 batting average, and we turn this over to Susan Collins.

Senator COLLINS. Thank you, Mr. Chairman. Secretary O'Neill, I want to go back to the infamous prosecution that started this dialogue between you and Senator Levin. Was the point that you were trying to make in pointing to this single case that since the Federal Government is spending between $650 million and $1 billion a year in fighting money laundering, you would expect to see many more high-profile prosecutions—and thus more convicted felons cooperating with law-enforcement authorities and with this Subcommittee? Was that the point you were trying to make?

Secretary O'NEILL. That is precisely right. I am sorry if I did it badly.

Senator COLLINS. The question of the review that you are undertaking at the department has raised concerns about the administration's commitment to money laundering. Would it be fair to say that your review is motivated not by any desire to do less in fighting money laundering, but rather by a desire to ensure that we accomplish as much as possible with the resources that we are devoting to this important fight?

Secretary O'NEILL. Precisely right.

Senator COLLINS. Is this typical of the reviews you are doing across the department as you are looking at all of the responsibilities?

Secretary O'NEILL. Absolutely, and it comes from, I must say, 25 years worth of demonstrating an ability to produce value, not rhetoric, but value. I believe these same ideas and persistence and consistency can produce value where people have hungered for it for years and have been disappointed, dissatisfied, and unfulfilled.

Senator COLLINS. Indeed, as Secretary of the Treasury, you have every motivation in the world to maximize the fair collection of tax revenues, and to make sure that taxpayers are not evading their responsibilities by secreting money in offshore accounts.

Secretary O'NEILL. Precisely right.

Senator COLLINS. I understand that the Treasury Department and the Justice Department have not always coordinated their efforts against money launderers as well as they should have, and I am wondering if that might be one of the reasons we have seen relatively low prosecution rates and less of an emphasis placed on money laundering investigations and convictions. Could you tell me what the relationship is between your department and the Department of Justice Criminal Division, as far as making money laundering cases a priority?

Secretary O'NEILL. I am glad you asked, and am sure you know that Jimmy Gurulé is a distinguished American who has served in the Justice Department and has recently been a chaired professor at Notre Dame. He has given up his career at Notre Dame as a professor at the law school and has agreed to come back to serve the people. He has been nominated by the President, and he is working as a consultant. It would help an awful lot if we could get our nominees approved so that people like Jimmy Gurulé can lean into these problems. We had a meeting yesterday to talk about coordination in our effort on money laundering with the Justice Department so that we can focus on cases where we can produce results.

One of the things you find when you begin to investigate how the processes work is often times there has not been a prosecution because the Justice Department did not find some of these cases worthy in the context of all things that they saw that they needed to do. So, after a case was made, there was not an attempt to prosecute, which is very discouraging to the whole process. I think with Jimmy coming on board, it is going to be possible to break down the bureaucratic barriers between the organizations of the Federal Government who work on and focus on these problems. I believe we can make, again, great progress, because I personally, and I am sure this is true of Jimmy and the other people, we do not have a stake in bureaucratic turf. We want to solve these problems.

Senator COLLINS. In your various comments on the OECD framework, you have repeatedly emphasized the importance of focusing the project upon what you have called the core elements of transparency and information sharing. Just for the record, did the administration ever consider abandoning these core elements that underlie the fight against tax evasion and money laundering?

Secretary O'NEILL. Never.

Senator COLLINS. So, is it fair to say that the administration has always been and remains committed to effective information sharing in order to facilitate the identification and prosecution of tax cheats and money launderers?

Secretary O'NEILL. Absolutely.

Senator COLLINS. I have read that you have had considerable success in persuading OECD to focus on the core elements and to modify its approach, and according to some press reports, OECD member governments are on the verge of agreeing to a 2001 progress report that will incorporate many of the changes that you have suggested.[1] Could you comment on that?

Secretary O'NEILL. It is being held up right now by a side issue. It is much like the side issue that is holding up my nominees. I am sorry to keep returning to this, but if you cannot tell, it is much on my mind. I and my Under Secretary for International Affairs are supposed to go to London and Moscow next week on an important follow-up visit to the meetings that the President had with President Putin, and that means probably John Duncan, who is sitting over here, is going to be the acting Secretary in case Argentina falls apart or something, which is not the most wonderful of situations.

[1] See Exhibit 29.b., which appears in the Appendix on page 166.

In any event, we are dedicated and determined that we are going to do a better job than has ever been done on the subject. We have no intent of abandoning the pursuit of violators of our laws. But, I might say one other word. There is a collateral consideration that we all need to pay attention to and be mindful of, and that is that we not violate one of the most important freedoms that we have as Americans, and that is, within the right boundaries, a right to privacy. So, I think we are dedicated to doing all these things in a way that is still consistent with the rights of Americans as individuals.

Senator COLLINS. Mr. Secretary, it is my understanding that a number of former IRS commissioners wrote to you in response to some press reports that raised concerns about the administration's commitment to improved information sharing and the fight against tax evasion and money laundering.[1] I know that two of those officials will testify today, but I would like to give you the opportunity to clarify or respond to the concerns that were raised by these commissioners. One of whom I understood wrote a follow-up letter to you agreeing with many subsequent comments that you made.[2]

Secretary O'NEILL. Well, thank you. I was frankly thunderstruck when I got the letter from these distinguished people, because I could not believe that they had read what I said, and I think you will hear today that they were responding to press accounts. As I said before, they did not respond to what I said at all. They responded to misrepresentations in the media, and I am sorry to be so blunt about it, but there is no other way to characterize it. If you look at the pieces that are in this book, if you can find any connection between the representations that were made in these stories and what I have said on the record and off the record, there is no connection whatsoever. But, intelligent people, including these distinguished citizens who have served in their government, took what they read at face value. Many of them know better, because they have been subjected to this, but they had forgotten.

So, when they read it in the newspaper, they filed—you would not believe, I get 2,000 letters a week and many of them are responding to things that I never said, never imagined and never would imagine, but I am still getting letters about it as though it were the real stuff simply because it appears in print. These days, with the wonderful technology we have with Lexis Nexis and all the rest of that, once this stuff is on the record, it never goes away. It is always a primary source. So, when I am 95, I am going to be getting letters saying we cannot believe you did not want to prosecute money launderers. I will let them speak for themselves.

Senator COLLINS. Would you like to respond more specifically to the concerns that they raised?

Secretary O'NEILL. I honestly believe that they will tell you, at least I hope that they will tell you today, that they did not disagree with what I said at all. They disagreed with what was represented that I might have thought. So, I think we do not have a difference of opinion. As far as I can tell, maybe Mr. Alexander would like to nod his head that he agrees with me. We ought to pursue every tax

[1] See Exhibit 4, which appears in the Appendix on page 87.
[2] See Exhibit 23, which appears in the Appendix on page 120.

cheat to the ends of the earth and we should not tell other nations how to structure their tax systems. Don, do you agree with that? Stand up and say yes, Don. [Laughter.]

Senator COLLINS. Mr. Chairman, I would ask——

Senator LEVIN. I think we will keep the gavel right where it is.

Secretary O'NEILL. I am sorry, sir.

Senator COLLINS. I would ask unanimous consent that the letter from Donald Alexander, in which he salutes the Secretary and says that he agrees with him on two very important points relevant to this debate, be included in the record.[1]

Senator LEVIN. It will indeed be.

Senator COLLINS. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

Senator LEVIN. Thank you, Senator Collins. Mr. Secretary, in your prepared statement you indicate on page 6 that the United States argued for and strongly supports a delay of more than 2 years before any sanction can be applied to a tax haven. Then, on page 10, you state that you are not ready to speculate as to what measures, if any, the United States or other countries might consider applying in 2 years if it were to come to that. That is the tone of your statement relative to tax havens.

I would like to contrast that with the much stronger tone that the Treasury has taken in the money laundering field. FATF, which is the leading international anti-money laundering organization and of which the United States is a member, has also put out a list of countries and has threatened sanctions. It put out that list in June 2000, the exact same month as the OECD list.

FATF warned the listed countries to strengthen their anti-money laundering laws or become subject to sanctions by the FATF member countries. Last month, the FATF list was updated. Four countries had improved their laws so much that they were de-listed. Three countries, Russia, Nauru, and the Philippines, had done so little that they were told that they would become subject to sanctions on September 30 of this year unless they took significant action.

On June 22, the Treasury Department put out a press release noting that sanctions will go into effect on September 30, 2001, and clearly supported the imposition of sanctions. This is now the FATF list we are talking about on money laundering. Here is what the Treasury said, "The Treasury Department supports countermeasures against countries refusing to implement constructive legal reforms to address ongoing money laundering concerns. The Treasury Department, in conjunction with the Department of State and the Department of Justice, remains firmly committed to this global battle and we praise the steps that FATF has taken today." That is plain language that clearly supports sanctions against three listed countries and that relates to the money laundering area.

Now, contrast this with the prepared statement relative to the OECD tax haven project. On page 9, your statement says that the threat of sanctions by a "group of 30 large, developed countries is, by its nature, highly coercive and should be reserved only for juris-

[1] See Exhibit 23, which appears in the Appendix on page 120.

dictions acting in bad faith whose practices demonstrably facilitate the non-compliance by taxpayers with the tax laws of other countries." I agree with you, coordinated actions or sanctions by 30 countries is coercive, but that is the point. That is exactly what they are intended to do, to be coercive with those tax havens that all 30 countries have agreed are outside of international norms and to go after the tax evasion that costs the taxpayers so much.

Now, when you include this language about not wanting to impose sanctions on tax havens unless they act "in bad faith," and have practices that "demonstrably facilitate" tax evasion, are those standards included in the tax haven project of OECD or is that a whole new test for whether the United States is willing to impose sanctions?

Secretary O'NEILL. Well, I think, as you know, Senator, because you are an expert in these things, these are two separate cases. The FATF process is a separate process from the OECD process. I do not have any trouble with the idea of sanctions properly applied and fairly applied at all, but I did have trouble—now, I must tell you I found it pretty compelling to listen to the finance ministers of people from countries as small as 4,500 people say, "Well, if you are going to do this to us, is Switzerland going to comply?" I thought that was not a bad argument: "Well, if you are going to do this to us and you are going to use the power of the 30, are you going to do it to yourself or not?" I thought that was a pretty good question.

Senator LEVIN. Well, now, the statements that you made in your press release supporting the actions against those offshore countries in the area of money laundering did not make those qualifications. You did not have those qualifications.

Secretary O'NEILL. It is a completely different——

Senator LEVIN. Is it? They are linked to tax evasion.

Secretary O'NEILL. No, well, I think they are not completely unlinked. They obviously have a degree of linkage, but the OECD process was different from the FATF process. Otherwise, why would there be two? If we did—I think we are, with the FATF process, we are encompassing the world.

Senator LEVIN. Is tax evasion, in your judgment, less important than money laundering?

Secretary O'NEILL. No.

Senator LEVIN. Let me ask you about the 2-year delay that the United States argued for and strongly supports relative to sanctions. Again, I emphasize that we have been going after some of these tax havens for decades, literally, but now you have urged a 2-year delay in the sanctions being applied. Can you tell us how it is in our interest for the United States to delay the imposition of sanctions on tax havens for failure to disclose for an additional 2 years now, where we have been trying to get disclosure and transparency from those countries since the 1980's?

Secretary O'NEILL. Actually, my memory is, what we have done is we have linked the effective date to the effective date for the OECD, which, again, seems not an unreasonable process. It seems to me, if it is good enough for us, it is good enough for those we are going to punish.

Senator LEVIN. Yes, but you are applying now a different standard. You are withholding sanctions in the area—I think you are urging the delay of sanctions in the area of tax evasion. You did not apply that same standard, I believe, in your press release relative to money laundering.

Secretary O'NEILL. This is not a delay. It is a delay in when we should begin triggering so-called defensive actions, and it is triggered to when are we going to start doing this to Switzerland.

Senator LEVIN. Switzerland is hardly equivalent to Nauru.

Secretary O'NEILL. Really?

Senator LEVIN. Yes.

Secretary O'NEILL. I am not so sure.

Senator LEVIN. Nauru has very few people, has allowed $70 billion to go through 400 offshore banks that it set up and let loose on the world. That is a tiny country causing major problems.

Secretary O'NEILL. I do not think we know how many blind accounts there are in Switzerland.

Senator LEVIN. Let me just finish. Switzerland has a highly developed regulatory regime. It already cooperates with international criminal investigations and you are equating those two. We do not have that kind of cooperation from Nauru, do we?

Secretary O'NEILL. I am saying that—at least my sense is that Switzerland is a place that is still a mysterious place for bank accounts.

Senator LEVIN. I am sure it is a mysterious place in lots of ways, but the question is whether or not you want to equate a country which has 400 offshore banks—a little country, very few people, $70 billion goes through those offshore banks, and you want to say delay the sanctions regime on them for 2 more years. Let me ask you, what is it in this 2 years that you want Nauru to do in order to avoid sanctions? Give us the list of things that you would like to see them do to avoid sanctions.

Secretary O'NEILL. We have specified within the work with the OECD the conditions we would like to see people meet. I think that list now, with the withdrawal of some very contentious definitional issues, is pretty well agreed to, and it is agreed to by all the members of the OECD. So, I do not think this is a contentious issue. It is a question of what is fair. And maybe what you are saying, and maybe it is a point I should take in—but fine, we should say we are going to apply these standards right now to everybody, and we will do it in the next 6 months. It is a point worth considering, but I am not so sure that some of the members of the OECD would like to have this sanction on themselves against a tighter time schedule, but it is something worth raising with them.

Senator LEVIN. Do you now support the tax haven project of the OECD?

Secretary O'NEILL. I support, and the Bush Administration supports, the OECD agreement which is now waiting for a final ratification—as I said, there is a side issue holding it up. I think we are in complete agreement among the participants in OECD about what we should do and how we should do it.

Senator LEVIN. Do you support the imposition of sanctions on uncooperative tax havens?

Secretary O'NEILL. If there is no option, I would prefer that we bring them all along and we get everyone to agree to the standards that have been suggested, but at the end of the day, I think we have to look at the prospect of sanctions in the event countries continue not to provide full information and transparency.

Senator LEVIN. I am just not clear on that answer. You say, "look at the prospect of sanctions." My question was whether you support the imposition of sanctions on tax havens that do not cooperate.

Secretary O'NEILL. Yes, but I am saying something different to you. Again, if something—maybe it is only a small sample, the reason I have this sense, but when I talked to them, the finance ministers at the Hemisphere Conference in Toronto in April, I did not really find them saying we are not going to cooperate. They said this process is not fair, and I think you know that there are several of these countries that have now come forward and said they are willing to do these things. Again, maybe this is a relapse to a habit of mine that comes from 25 years outside of Washington. I found that if you give people, that you are trying to do something with, an opportunity to do the right thing, most of them will do it. So, I do not begin with the notion that I have got to find a cannon and blast the hell out of everybody in order to get them to do this. Maybe we will, but I do not begin with that premise.

Senator LEVIN. We have been trying to gain that cooperation for decades, without success. Now, maybe you are saying by not applying the threat of sanctions or by saying maybe we will or maybe we will not, that they will come along and do something they have not done for decades. I am dubious, but we welcome your bet of 500 percent compliance in 1 year. We look forward to that. However, my question still remains, where you fail, where you're continuing to say come on along, we know you have not for the last couple decades, come along, despite all the efforts of all the administrations, my question to you was actually a fairly direct question.

You just sort of say consider, or the prospect of, and my question is, unless people believe that if they do not come along in the 2-year grace period which you are now offering, that, in fact, sanctions are going to be applied, it seems to me there is less likelihood that they will, in fact, come along. My question to you is, if at the end of that period you find tax havens which are not cooperative, are you then ready, willing and determined to apply sanctions? That is my question.

Secretary O'NEILL. My answer to that is yes, but I would say something else to you about this. The fact we have been working on this for decades and as you say nothing much has happened—I do not think we should do that, and in that regard, when I say I am for sanctions in the event we cannot encourage or coddle people into doing the right thing, we should have sanctions that mean something, not sanctions that are prefatory or suggestive or something. But, in saying that, I think we need to be careful that we are willing to live with the consequences. So, yes, I am for sanctions. I am for sanctions that really do something, but with an understanding that when you take moves, you may start a process that you do not completely like the results of. So, yes, I am for sanctions.

Senator LEVIN. Good. I think you also point out finally in your testimony that some of the proposed sanctions would require legislation. The prior administration has drafted legislation that would enable the United States to join its colleagues in the OECD in imposing some of these key sanctions identified for coordinated action, such as denying tax deductions or credits for transactions in the listed uncooperative tax havens. Will you be supporting the enactment of that type of legislation this year?

Secretary O'NEILL. I am not sure we can get it done this year, but, yes, as a general point, yes.

Senator LEVIN. When you say get it done, do you mean get us your views on it or get the legislation passed?

Secretary O'NEILL. Get the legislation passed.

Senator LEVIN. But you do support it?

Secretary O'NEILL. Yes.

Senator LEVIN. I guess there was one other statement you made that really troubled me, and that is on page 9 of your prepared statement, "Drafting lists and devising defensive measures ultimately will not help countries curb noncompliance with their tax laws."

It seems to me that implies, sort of challenges, the essence of the tax haven effort, which is about listing countries and threatening sanctions as a way to get tax havens ultimately to change their ways, to increase disclosure, to cooperate with efforts to stop tax evasion. By the way, the exercise is working. Drafting lists backed by international sanctions is working.

You say frequently you can get people to do things they do not want to do without threatening sanctions. Well, I hope you are right. I hope your .500 batting average works without the sanctions, but we do know that the threat of sanctions with FATF worked. We have a number of countries now that are coming along. That is why the Cayman Islands changed its stance after years of resistance to avoid being listed. Nine other countries have done the same thing. So, your statement about drafting lists and devising defensive measures ultimately will not help countries curb noncompliance with their tax laws—I am wondering if you could just clarify?

Secretary O'NEILL. I thought I gave you the careful answer I did about if I am for sanctions or not, and I will say again, in that regard, acting like you are going to do something without really accomplishing something seems to me to be a pretty poor bargain. That is the intent of that language, to say we are really serious. We are going to do something. Then we are going to have to devise some things that really make a difference, that really hurt people if they do not do what we want them to do, but we need to do that with some caution and some understanding of the possible consequences of our actions.

Senator LEVIN. I fully agree with that. We have had decades of that contemplation. We now finally have seen consolidated international action to go after both the money launderers and now, after tax cheats, and I hope this administration is going to put its shoulder to that wheel. We need disclosure. That is what you call the core. We cannot get after the tax cheats without disclosure. We are not going to get those disclosure agreements without sanctions

in at least many cases. That is what history proves. That is history now speaking.

You can hold out the hope that you will, based on your hope and your good faith and your good nature, but nonetheless history has shown that it is the threat of sanctions, of being listed and ultimately sanctions being taken against countries, that have caused them to come along. I am afraid that is what is going to be true here, but we look forward to two things. One is your specific comment on the proposed legislation to allow us to participate in those sanctions, so that we can try to get that legislation passed as soon as we possibly can.

Second, we look forward to the box score a year from now and we will see how many of these offshore tax havens have, indeed, signed agreements with us, signed treaties and disclosed. And we will bet a very full breakfast if that is agreeable with you.

Secretary O'NEILL. Senator, we are going to show you a performance that you wished and hoped for for decades and we are going to turn it in for you.

Senator LEVIN. I cannot tell you how much I look forward to it and we thank you for coming today.

Secretary O'NEILL. Thank you.

Senator LEVIN. We will now turn to our second panel. Let me now call on our second panel. As I think both of you are aware, under the rules of this Subcommittee, after I give you an introductory comment, we will require that you stand and take the oath like all other witnesses. But first let me welcome Robert Morgenthau.

Mr. Morgenthau is a virtual institution in the city of New York. He has served as Manhattan's District Attorney for more years then I can count and maybe more years than he wants to count, although I am not sure about that. But I know it is not more years than the people of New York want to count, because I have enough relatives in New York to know just what a momentous career and a wonderful contribution you have made in going after some of the biggest international white-collar crime cases in this country, along with a host of other types of crime. But you have been involved, Mr. Morgenthau, in trying to get cooperation from offshore tax havens for decades. We are delighted to have you here.

Second, Michael Chertoff, Assistant Attorney General of the Criminal Division, Department of Justice. Mr. Chertoff is new to the position in the Department of Justice, but not new to the prosecutorial world. He served as Assistant U.S. Attorney for the Southern District of New York from 1983 to 1987, First Assistant U.S. Attorney for the District of New Jersey from 1987 to 1990, and then U.S. Attorney in New Jersey from 1990 to 1994. We are really delighted to have such a distinguished panel before us this afternoon. You are two people who have dedicated your lives and your professional careers to public service, and we look forward to hearing your views on the current state of U.S. anti-money laundering efforts. As I indicated, pursuant to Rule 6, I will now swear in our two witnesses. Do you swear or affirm that all the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. MORGENTHAU. I do.

Mr. CHERTOFF. I do.

Senator LEVIN. Mr. Morgenthau, let me call on you first.

TESTIMONY OF HON. ROBERT M. MORGENTHAU,[1] MANHATTAN DISTRICT ATTORNEY, NEW YORK, NEW YORK

Mr. MORGENTHAU. Thank you, Senator. I appreciate that very generous introduction. I want to say that in an earlier career, I had the privilege of appearing before the most distinguished judge in the U.S. District Court for the Eastern District of Michigan, namely Judge Theodore Levin.

Senator LEVIN. You might be proud to know that the courthouse there is now named after him, and I must tell you it was not through my doing, although I was absolutely delighted and should have thought of it. It was John Dingell and his colleagues in the House who thought about that. So, when you visit Detroit, you will notice that it is the Theodore Levin Courthouse.

Mr. MORGENTHAU. He had a remarkable career, and he was an outstanding judge. I am grateful for the opportunity of appearing here today. I think the Chairman, in great detail, outlined the problems that this country is facing under money laundering and other criminal conduct through these very numerous tax havens. I want to congratulate you on taking on this very difficult assignment of not only trying to expose what is going on, but trying to figure out what can be done about it.

It is a huge problem, a gigantic problem. Increasingly, despite all of the efforts, tax havens are becoming a magnet for U.S. dollars. In the Cayman Islands alone, there are $800 billion U.S. dollars, on deposit. In the last year, that amount has increased by $120 billion. It is more than twice the amount of the dollars on deposit in all of the banks in New York City. Pretty soon, if this trend continues, New Yorkers are going to have to go to the Cayman Islands to cash their paychecks. This amount is equivalent to 20 percent of all the dollar deposits in the United States. It amounts to $3,000 for every man, woman and child in the United States, according to the latest census. It is the equivalent of $20 million for every resident of the Cayman Islands.

I mention this because it is important to understand how big this problem has become. Of nearly 600 banks that are chartered in the Caymans, which include 47 of the world's 50 largest banks, only 100 or so have a physical presence, according to the web site of the Cayman Island Monetary Authority. Only 31 banks of that 600 are currently licensed to do business with Cayman residents. Similarly, there are 45,000 companies registered in the Caymans whose only businesses is outside the country. They are not permitted to do business in the country. Of course, Long Term Capital, the giant hedge fund that collapsed 3 years ago, was chartered in the Caymans, but managed out of Greenwich, Connecticut.

While the Caymans have been particularly attractive to U.S. residents, they certainly do not stand alone, and this Subcommittee is familiar with the many other tax havens that are in existence.

Then we come to the question, what is all this money doing offshore? It is not there because of the sunshine and the beaches. The

[1] The prepared statement of Mr. Morgenthau appears in the Appendix on page 56.

money is there because the people who put it there want a free ride. Depositors, investors, banks, businessmen want to avoid or evade laws, regulations and taxes in their own countries, including the United States. Some of this avoidance, of course, is legal under present law, but much of it is not, and whether legal or not, the presence of $800 billion in a single offshore jurisdiction, hidden from the scrutiny of bank supervisors, securities regulators, tax collectors and law enforcement, is a gigantic problem.

Those of us in law-enforcement uncover only a very small percentage, a tiny percentage, of the criminal conduct that is done through these tax shelters. Of that number that we identify, we are successful in prosecuting only a small number, because of the difficulty in getting the evidence. So when we talk about the cases we made, we have got to remember that is only just a tiny fraction. I am going to discuss a few of them just to show the type of cases that are involved, that are used in these jurisdictions.

In 1997–1998, my office convicted A.R. Baron and Company and 13 of its former officers and employees for running an organized criminal enterprise. Baron was called a boiler room or a bucket shop, pushing questionable stocks and specializing in market manipulation, unauthorized trading of customers' accounts and countless other methods of taking advantage of innocent investors. Their illegal activities cost investors over $75 million. The lead defendant in the Baron case used a Liberian shell company and accounts in the Isle of Jersey to trade in the stock the firm was underwriting, a violation of U.S. securities laws.

He also sheltered his illegal profits or some of them in a Cook Island trust. You know the Cook Islands are a New Zealand-protectorate in the South Pacific. A New York lawyer drew up the papers for Mid-Ocean Trust Company in Rarotonga, the Cook Islands, to act as the trustee. The affairs of the trust were managed here in New York by the so-called protector of the trust, who happened to be the lead defendant's father. Mid-Ocean Trust did business in New York through one of the largest banks in Australia, which had branches in Rarotonga and New York, and which refused to honor a New York subpoena on the grounds that to do so would violate Cook Islands secrecy laws.

We only solved that case when we had enough other evidence. This defendant plead guilty and was facing a sentence of 50 years. At that point, he told us about his assets in the Cook Island trust.

Another case which is still going on involves the brokerage firm Meyers Pollock. So far, we have convicted 37 defendants for enterprise corruption and securities fund. Again, they used shell companies and offshore bank accounts to paint the tape, as it is known, to generate fictitious trades, drive up the prices and, of course, to cheat on their taxes. The losses in Meyers Pollock are somewhere between $100 million and $200 million.

Securities fraud is not the only area we found. We found bribery of bank officers to sell Third World debt at below fair value. The scheme was an extremely intricate one involving companies in Antigua and the British Virgin Islands, payments to a vice president of a prominent U.S. bank, the vice president of the second biggest bank in the Netherlands, two other banks, all of this routed through offshore entities. This was a case where we got lucky. We

were able to solve it, and the principal defendants have all pled guilty. But, again, I give this as an example, not to show what a good job we are doing, but to show you the kind of activity that is involved.

A year ago, in a different sort of case, a Manhattan jury convicted Sanif and Kenneth Kimes, a mother-son team of so-called drifters, for murdering an elderly Manhattan widow to gain control of her expensive townhouse. In our investigation of the case, we found that to arrange the payment of filing fees and taxes on a forged deed to the townhouse, the pair drew on funds held in a brokerage account in Bermuda in the name of the Atlantis Group, a shell company. The money, which was part of the proceeds of a separate fraud committed in Las Vegas, came to Bermuda by the way of an account established by the defendants at Swiss American Bank in Antigua, a Swiss American bank that was neither Swiss, nor American, that helped finance the crime and set up the Atlantis Group shell company in Antigua. Incidentally, the people who established the Swiss American Bank were Marc Rich, former Governor Marvin Warner of Ohio, and Bruce Rappaport. I mentioned that case to show you how intricate these dealings are and how difficult they are to solve.

For all of these defendants, the principal attraction of doing business in offshore havens was not the lower or non-existent tax rates. They sought to take advantage of other benefits that are almost invariably provided in tax haven jurisdictions which provide strict bank and corporate secrecy, lack of transparency in financial dealings and the lack of any meaningful law-enforcement or supervision in the financial area. For white-collar criminals, the lack of transparency and the code of strict secrecy is particularly useful because it prevents law enforcement from following the money, breaks the trail of dirty money, often leaving investigators at a dead end.

There are two major problems that arise from these transactions. One is the fact that you do not have a level playing field for taxpayers. You have some taxpayers paying their full taxes that are owed, and you have others paying none. As Justice Holmes said back in 1927, "Taxes are what we pay for a civilized society." Well, the tax cheats are not paying their share, and that is a significant problem, because people have to believe that the tax system is fair. It has to be perceived to be fair, or more and more people are not going to pay their taxes. It is going to be a growing problem. It is going to snowball, and the same way with unregulated business.

The securities transactions, financial dealings, are going through a jurisdiction without any supervision. They have a major, unfair advantage over companies that are regulated, and it is also extremely dangerous, dangerous because they can result in financial disaster, as it almost did in the Long Term Capital, with the collapse of those partnerships that had assets of $1.8 trillion. Only a few days ago, the Financial Times reported a complaint by the deputy speaker of the assembly in the Caymans, that said, "It is the poor who pay taxes in this country." All the rich foreigners pay no taxes, but the local poor are the people who pay the taxes, and that is because they have no income and no capital gains tax. The tax is on food. Some years ago, a notorious New York tax delinquent

who was convicted in the Federal court observed, "It is only the little people who pay taxes." We cannot afford to allow that cynical view of the tax system to become accepted wisdom of this country.

Tax havens which rely on bank and corporate secrecy are knowingly assisting customers to commit tax fraud. Lawful tax shelters do not need to be kept secret. I am not advocating the indiscriminate disclosure of financial discrimination on a wholesale basis, but rather the disclosure of specified information to appropriate tax and prosecuting authorities where they have reason to request on the same basis on which disclosure of bank information is made to tax authorities and criminal investigations in the United States.

Let me emphasize the unfairness of allowing some citizens to avoid paying their fair share of taxes—it erodes confidence in the tax system and the voluntary compliance in which the system is based. In a democracy, you have to have voluntary compliance by virtually everybody. You cannot have a system where people are running around checking up on every taxpayer, and you are not going to have voluntary compliance unless people believe the system is fair. There is a lot of work to be done here. I wish I could say that I thought things were getting better. I do not think that they are. Some steps have been taken in the right direction, but the fact that offshore deposits in the Cayman Islands have gone up by $120 billion in the last year indicates that some people have not gotten the message yet.

So I think that everybody has to work together to solve this problem. We have to work with the Justice Department and we will do that. I met with Secretary O'Neill this morning, and we are going to work with the Treasury Department. We are going to work with the Federal Reserve. We will work with this Committee, and it is only by everybody working together that we can solve this very complicated, huge, difficult problem—but not intractable if everybody cooperates.

Thank you for the opportunity of testifying.

Senator LEVIN. Thank you, Mr. Morgenthau.

Mr. Chertoff.

TESTIMONY OF HON. MICHAEL CHERTOFF,[1] ASSISTANT ATTORNEY GENERAL FOR THE CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. CHERTOFF. Thank you, Mr. Chairman, and again let me thank you for that kind introduction. Also, I just want to express my pleasure at the opportunity to sit with Bob Morgenthau on this panel. Back some years when I was the U.S. Attorney in New Jersey and an assistant in the Southern District, we worked together on cases. He has really been a role model for prosecutors in the New York metropolitan area and throughout the country and the world, in his tenacious pursuit of very complicated international criminal cases.

I am very pleased, Mr. Chairman, to be invited here to testify before the Subcommittee in support of Secretary O'Neill's position in favor of international cooperation and transparency with respect to tax havens. We are dealing with the same entities in the money

[1] The prepared statement of Mr. Chertoff appears in the Appendix on page 68.

laundering context, the area with which I tend to deal in my current job. Also, if I can just take the opportunity to request that my written statement be included in the record, and I will briefly address some of the points here.

Senator LEVIN. Both of the statements will be included in the record in full, as all other statements will.

Mr. CHERTOFF. Obviously, I am not here as a tax expert or a tax lawyer. I am neither. I am here as a prosecutor looking at the issue of money laundering, which is clearly emerging as one of the most important global criminal issues that we face. Before I talk very briefly about the challenge in dealing with money laundering, I want to make a comment that arises from some of the discussion with Secretary O'Neill related to the issue of cooperation. Because I think in this area, certainly as much as in any other and maybe more than in most, the key to successful enforcement is cooperation between agencies, Federal, State and local officials, as well as internationally.

I can tell you, for example, that although we do not work tax cases in the Criminal Division, as soon as she is confirmed, I intend to sit down with the new head of the Tax Division and talk to her about ways in which we can cooperate in mutual cases of criminal investigation. Likewise, one of the things I did very early on in my still-brief tenure was to sit down with Jimmy Gurule, whom I have known for years, and talk about how we can approach and work together on the issue of money laundering from both a Treasury and the Justice perspective. Finally, I am looking forward to the opportunity to work with Mr. Morgenthau and others in a variety of jurisdictions to pursue these cases.

We need to look at good-quality cases, cases that are not only well put together in terms of proof, but deal with the institutional structures that promote money laundering. This way we will not only deal with the low-level money launderers, but with those entities that allow money laundering to progress on an ongoing basis. I know the Members of the Subcommittee are aware that money laundering has become one of the biggest threats to our national and financial security, with hundreds of millions of dollars in criminal proceeds moving through our financial system in and out of the United States and abroad.

I do not know if there is a definitive figure on the volume of illegal proceeds, but I have heard estimates that range from 2 to 5 percent of global GDP, which would put the figure between $800 billion and $2 trillion per year. In this country, obviously, we have addressed part of the problem with the Bank Secrecy Act. We are also working through the G–7 Financial Action Task Force to try to bring the rest of the world up to a standard that allows us to work cooperatively on money laundering. Generally this has been a very successful effort and a good example of how multilateral processes can work to motivate countries to address these deficiencies.

The critical thing about money laundering is this: Contrary to the public perception that money laundering simply consists of drug dealers moving money back and forth in and out of the country, though it certainly includes that, money laundering is actually a part of all kinds of international criminal activity, whether it be

international business fraud or international political corruption. In cases like Ferdinand Marcos or Noriega, Lazarenko or Montecinos, the ability to follow the proceeds of the crime has been a critical element in identifying criminal perpetrators and holding them accountable for their actions.

So, where are we today with money laundering? Our ability to detect, investigate, and prosecute these kinds of international and domestic financial crimes, is only as strong as our anti-money laundering laws and regulations and enforcement efforts. When these laws were first passed years ago, the United States led the world in adopting and implementing an anti-money laundering regime. To their credit, other nations, building upon our experience, have recently enacted and implemented their own laws and regulations, in some ways surpassing what we have in our own body of laws. In particular, other countries have adopted a more inclusive understanding of what constitutes a predicate offense to trigger money laundering under their domestic and foreign law. Some countries have adopted mandatory reporting by a wider array of reporting entities than we have in the United States.

So our money laundering laws, which were certainly cutting edge in the 1970's and 1980's need to be revisited. When we first enacted them in the mid-1980's, I think they were designed to primarily address the domestic narcotics problem. Since that time, technological developments and the globalization of commerce have overtaken those laws, and we need to look at how we can keep pace and move ahead. We can only now begin to envision now how important it is going to be to identify and halt the looming convergence of international organized crime, international corruption and cyber technology. We in law-enforcement, whether it be Federal, State or local, have to be ready for today's and tomorrow's threats to our national and financial security.

With that, I want to say that I look forward to working with the Subcommittee and with Bob Morgenthau and others in trying to put together a package of tools and authorities that will allow us to strike at the 21st Century of money laundering. Thank you again for the privilege of appearing, and I look forward to answering your questions.

Senator LEVIN. Thank you very much, Mr. Chertoff. While we are focusing on tax evasion today and the offshore tax havens which help assist its occurrence and its frequency, tax evasion is not always just about nonpayment of tax. As we saw and some of us remember either reading or hearing about the Al Capone conviction, as someone who was convicted of tax evasion, but who had been suspected of murder, extortion and a bunch of other violent crimes. But this is an example of how tax crimes can be used to stop other, more violent crimes. Do U.S. law enforcement personnel still use tax violations to put violent, dangerous criminals behind bars?

Mr. CHERTOFF. Absolutely. I can tell you from my personal experience that we often marry a substantive case involving violent crime, organized crime, or narcotics trafficking with tax counts, because the tax counts do give you an extra punch in law enforcement.

Senator LEVIN. Mr. Morgenthau.

Mr. MORGENTHAU. We use narcotics laws to put away a lot of murderers. It is easier to get a narcotics conviction when making an undercover buy than it is to prove a murder. So those kinds of things are still done and done effectively.

Senator LEVIN. Including using tax laws for that purpose?

Mr. MORGENTHAU. Well, we do not have as strong tax laws as the Federal Government does, but——

Senator LEVIN. So you are using that as an analogy?

Mr. MORGENTHAU. We do it from time to time.

Senator LEVIN. Both of you have offered powerful testimony about misconduct and offshore tax havens and why it is in the national interest of the United States to convince those jurisdictions to cooperate with U.S. law enforcement efforts. Given your experience, will the hard-core tax havens on the OECD list be likely to agree to cooperate unless they believe that we are willing to impose sanctions?

Mr. CHERTOFF. Well, I do not think I can identify the location of many of these places on the list. Based on my own experience, there was a time 10 or 15 years ago when we could not have envisioned getting even the cooperation we are getting now. I think the Cayman Islands is a very good example. I think carrot is great; sometimes stick is important, too.

Mr. MORGENTHAU. I think it varies. The Channel Islands, the Isle of Man, Guernsey and Jersey are now very cooperative, but they are the only ones that I can look at and say that there has been a significant change. There has been talk from the Caymans, but I am still from Missouri as far as the Caymans. We have not seen any tangible evidence they are going to be helpful. They are moving the players around a little bit, and I am hopeful, but the amount of dollars going down there is not going down. It is increasing.

Senator LEVIN. On the Caymans issue, the Caymans avoided going on the list of OECD tax havens, and so it does not show up on the chart, which is Exhibit 7 in your book.[1] You have pointed out, Mr. Morgenthau, that the amount of money in the Caymans has gone up. It is almost $1 trillion, it sounds like now. The disclosure agreement that the Caymans have made takes effect in the year 2003. So that will be the year when we will begin to get the information about U.S. taxpayers' money that is placed in the Cayman Islands. That is what we have fought so hard to get with these other jurisdictions—disclosure and transparency, so that upon request, when a law-enforcement person asks the Caymans for information about an account in one of those banks, that you will then be able to get it.

Mr. MORGENTHAU. Let me just say this, kind of the reverse of time is money, even where, under the Mutual Assistance Treaty, a country like Switzerland says we will disclose, but they may take a couple of years to do it, and by that time the horse is not only stolen, but the barn has burned down. I am reading a book by one of the lawyers who says how the rich grow richer. He said you can set up an asset protection trust and if somebody goes after you, then you move it to another jurisdiction. So just the fact that they

[1] See Exhibit 7, which appears in the Appendix on page 93.

are going to disclose is important, but it is important that it be done promptly.

Senator LEVIN. Right, I think that is a really significant point. There were less than 1,000 taxpayers of the United States that disclosed that they have an account in the Cayman Islands, and yet your data is that there is how much American money?

Mr. MORGENTHAU. $800 billion.

Senator LEVIN. Almost $1 trillion.

Mr. MORGENTHAU. Yes, and growing at the rate of about $120 billion a year in the last several years.

Senator LEVIN. If you look now on Chart 7, given the amount of money that we know is in the Caymans that is American money and the relatively few taxpayers who admit it on their income tax forms, 999, to be precise, in the year 2000, there sure seems to be a similar disconnect with some of these other tax havens. Do you have Chart 7 in the book in front of you there? Look at the taxpayer filings, for instance, Isle of Jersey, which has 868 taxpayers saying they have an account, and there are 20,000 offshore companies. We do not know how many of those are American, by the way, and we will not know that until we get disclosure.

Mr. MORGENTHAU. I know. Well, we know quite a few of those are British; quite a few of them are Russian. We have indicted two British lawyers, one of them a magistrate and a Canadian lawyer, for setting up Jersey companies. Some of this was used to facilitate the moving of money out of Russia.

Senator LEVIN. In Antigua, you have 87 U.S. taxpayers saying on their returns that they have accounts in Antigua of $10,000 or more, and yet we have 12,000 companies. There is nobody who is going to tell us how many of those are American companies and how many of those are deposits until we get disclosure, if we ever do. But just looking down this disconnect between the relatively few disclosures that we have and the incredible number of offshore companies that have been opened up—Bahamas, we have a total of 786 U.S. taxpayers saying that they have accounts there of $10,000 or more. We have 100,000 offshore companies in the Bahamas.

From your experience in law enforcement, would you expect that there would be a larger number than 786 taxpayers from the United States in the Bahamas when there is 100,000 offshore companies there, Mr. Morgenthau?

Mr. MORGENTHAU. In the case that we have now, we know of 980 Americans who have accounts there.

Senator LEVIN. In one bank or one person who opened it?

Mr. MORGENTHAU. With one investment called Evergreen. They will regret that now, because Evergreen is in bankruptcy, and the 2,000 investors in Evergreen have lost $212 million. So they are paying.

Senator LEVIN. That was one investment.

Mr. MORGENTHAU. One enterprise, yes.

Senator LEVIN. With that many American investors, equal to the total of all the American investors.

Mr. MORGENTHAU. They set up a separate trust for each one, so I think there was something like 900 trusts set up in the Bahamas.

Senator LEVIN. And that is just with one person setting up one investment for that many Americans.

Mr. MORGENTHAU. The company said each one of you has your own trust——

Senator LEVIN. But one company.

Mr. MORGENTHAU [continuing]. To their regret. Because they have been wiped out.

Senator LEVIN. Right. I understand that, but with one company.

Mr. MORGENTHAU. One company.

Senator LEVIN. They may regret it, because they have been wiped out, but they have to disclose it, whether they are wiped out or not or whether it is a good investment or bad, they have to disclose that investment.

Mr. MORGENTHAU. Of course, one of the attractions to these poor suckers was the, "You will not pay any American taxes."

Senator LEVIN. And that it will be hidden; is that correct?

Mr. MORGENTHAU. Yes.

Senator LEVIN. Do you have anything to add on that, Mr. Chertoff?

Mr. CHERTOFF. I do not know that I am in a position to speculate about the number of accounts, but I do think something that Mr. Morgenthau pointed out is worth noting in terms of money laundering. We are dealing not only with the issue of Americans who put money in these banks, we are talking about foreign criminals who put money in these banks and then move the funds into the United States.

Senator LEVIN. This international tax haven project, which we have made reference to this afternoon, is asking offshore tax havens to agree to cooperate with both criminal and civil tax inquiries, with criminal tax inquiries by the year 2003 and with civil tax inquiries by the year 2005. That is what this OECD project is asking the tax havens to do. What is the difference between the two? How do you know which one to ask for at the outset of a tax investigation?

Mr. CHERTOFF. Well, again, I do not want to get outside my expertise as that is a Tax Division matter. I can just tell you from my experience back when I was U.S. Attorney, that if you are dealing with a "naked tax case," a tax case not a part of an organized crime or drug case, the IRS and the Tax Division have sets of procedures that they use to evaluate whether a case ought to be treated as civil or criminal. I do not know that, in my experience, there was a precise line. It has the character of, "I know it when I see it." But there are generally a set of characteristics that define whether a case is serious enough in terms of mental state and pattern to warrant criminal prosecution.

Mr. MORGENTHAU. We have no civil jurisdiction, so we would only be interested in criminal tax investigations.

Senator LEVIN. The tax haven project has succeeded in obtaining written commitments from 10 jurisdictions, including Bermuda and the Caymans, to begin cooperating with civil and criminal tax investigations. So there is an agreement to cooperate there. What impact do you believe those commitments are going to have on law enforcement? Are you familiar with the details?

Mr. MORGENTHAU. I hope they are going to be helpful, but I think the proof of the pudding is in the eating. We are going to have to wait and see.

Senator LEVIN. Would you take a look at those commitments for us and give us your critique or your commentary or your reaction to the commitments, so you could tell us where we should look for loopholes?

Mr. MORGENTHAU. I would be glad to.

Senator LEVIN. That would be very helpful. Mr. Chertoff, if you would do the same, we would appreciate that.

Mr. CHERTOFF. Yes.

Mr. MORGENTHAU. If I may say one thing.

Senator LEVIN. Please.

Mr. MORGENTHAU. In the past, where there has been a mutual legal assistance treaty in effect, like in the Caymans, for instance, they have taken the position that we will give this information only to the Justice Department, and the Justice Department is not permitted to give it to State prosecutors. So that is something you have to be on the lookout for, also.

Senator LEVIN. All right. We are going to get you both the copies of those commitments, so you can tell us where you believe they are strong and where you believe that they are weak. Some opponents of the international tax haven project want to require the United States law enforcement to have to establish probable cause that a tax violation has taken place before asking a tax haven to provide information to the U.S. Government. Now, as I understand it, that would be a reversal of a long-standing policy and a U.S. Supreme Court decision which has held that you can obtain information for a tax investigation, provided the investigation is for a "legitimate purpose," without a prior establishing of "probable cause."

Mr. MORGENTHAU. What we would want to see would be the same standard for getting records offshore as apply in the United States. In other words, the same reasonable basis, but not probable cause.

Senator LEVIN. Do you have anything to add to that, Mr. Chertoff?

Mr. CHERTOFF. I have nothing in particular.

Senator LEVIN. Mr. Chertoff, finally, with your reference to the money laundering laws and the efforts to strengthen them, we are going to be introducing bipartisan legislation, again to strengthen our hand against money laundering, and we would very much like to work with you on that legislation, and I hope we can get your support, get your commentary, and get something passed in this Congress.

Mr. CHERTOFF. I would very much like to work on that, too, Mr. Chairman.

Senator LEVIN. I guess there is one final one that we would like to ask, and this is also for you, Mr. Chertoff. The Treasury Department is conducting an internal review of money laundering programs to ensure that the American people are getting the best possible return on the investment. When that is applied to money laundering investigations and prosecutions in the Justice Department, the question arises as to how do you evaluate the costs and

benefits of law-enforcement efforts? How do you evaluate the benefits, for instance, of law-enforcement efforts?

Mr. CHERTOFF. I cannot speak to what Treasury is doing, obviously. I can just tell you that generally in my own experience it is always worth asking yourself the question of what is effective. In my experience, we have looked at a large number of factors, both quantitive and qualitative. A large case, which may involve only a certain number of defendants, but ones that may be high-ranking or pose a particularly serious danger, can have a much more positive effect than 5 or 15 or 25 lower-level cases. So basically we try to use our judgment. There is neither a magic number nor a magic rule. I think we try to use experience and judgment in evaluating the effectiveness of these programs.

Senator LEVIN. But how do you prove the return on that investment? How do you assess the benefits of a law-enforcement action?

Mr. CHERTOFF. All I can tell you, Mr. Chairman, is from my own experience years ago at the organized crime program that the Department of Justice runs. But in the period from 1980 to 1990, if you wanted to evaluate the success of that program, you would have looked at the fact that most of the organized crime families in this country had their leadership dismantled and sent to jail. You had numerous legitimate businesses taken out of the hands of organized crime. At the end of the day, someone could probably compute the millions of dollars saved for the American public through that effort. But, by evaluating, again, the people who were convicted, the entities which are freed from the grip of organized crime, and the number of victims whose crimes ultimately resulted in a successful prosecution, you can get a good picture of what an effective program is.

Mr. MORGENTHAU. If I may just say one thing.

Senator LEVIN. Sure. You also then would have to evaluate the benefits, look at the number of people who were not victimized because of what you did; would that be fair?

Mr. CHERTOFF. That would be fair. It is a little harder sometimes.

Senator LEVIN. It gets harder, but is that all necessary in terms of evaluating benefits?

Mr. CHERTOFF. Absolutely. It is a complicated process.

Senator LEVIN. Mr. Morgenthau.

Mr. MORGENTHAU. As you know, the FBI historically has put a great deal of emphasis on bank robberies, and it has been very effective, but how many bank robberies are prevented because bank robbers know that they are going to be investigated by the FBI? There is no way that you can really compute that cost/benefit. The fact that the FBI committed resources—will commit resources to any significant bank robbery—has got to be a major deterrent effect. So the fact that they do not prosecute a lot of cases does not mean that that money supporting the FBI's effort in bank robberies is not very significant.

Senator LEVIN. That is very helpful, both of you. We thank you for your testimony and very much appreciate your attendance here today.

Our third panel is also a very distinguished panel. First, Sheldon Cohen. Mr. Cohen served as Commissioner of the Internal Revenue

Service under President Lyndon Johnson and is a leading tax practitioner; and Donald Alexander served from 1973 to 1977 as Commissioner of the Internal Revenue Service under Presidents Nixon and Ford. Mr. Alexander is also a leading expert in the area of tax, and I believe it is the area of international tax where you have the most expertise, or in any event spend most of your time. It is another very distinguished panel. We look forward to hearing your views on the current state of our tax enforcement efforts, and like our other witnesses, I would ask you to stand and be sworn in. Do you swear that the testimony that you will give before the Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. COHEN. I do.

Mr. ALEXANDER. I do.

Senator LEVIN. Well, I guess we did not flip a coin, so we do not know who to call on first. I think we will go alphabetically.

Mr. Alexander.

TESTIMONY OF HON. DONALD ALEXANDER,[1] FORMER COMMISSIONER, INTERNAL REVENUE SERVICE (PRESIDENTS NIXON AND FORD)

Mr. ALEXANDER. Thank you, Mr. Chairman. I am glad to be here and I am glad to try to clear up something. I signed the letter that Sheldon wrote and I thought that it was a good letter.[2] Looking back on it, I probably should have raised an objection to one particular sentence, but it is not significant and I did not. I also signed a later letter to the Secretary that he mentioned today.[3] That letter had two aspects to it. The first was approval of the Secretary's concerns about part of the OECD effort, the part that your Subcommittee is not focusing on, that is dealing with harmful tax regimes. I was uncertain about whether the OECD should tell a country that its tax regime is harmful or tell a country that a particular aspect of its tax regime is harmful, and your Subcommittee is not focusing on that, and that is fine.

You are focusing on the tax-haven project and properly so. It is a very important and helpful project to try to make our tax laws work better, to try to make sure that the people who should be paying taxes are being called on to pay their fair share. I am glad you are looking into it and I am glad you are keeping Treasury's feet to the fire. I remember a lot of fires that my feet were kept to when I was back in IRS, and I was delighted to hear the commitment that the Secretary made. I think that will be very constructive.

In my statement, which is part of the record, as you pointed out, I make a number of specific suggestions and points. Given the lateness of the hour, I do not think I have anything more to add right now, Mr. Chairman.

Senator LEVIN. We welcome that. We will be asking you some questions, though, to try to bring some of that out.

Mr. Cohen.

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[1] The prepared statement of Mr. Alexander appears in the Appendix on page 77.
[2] See Exhibit 4, which appears in the Appendix on page 87.
[3] See Exhibit 23, which appears in the Appendix on page 120.

TESTIMONY OF SHELDON S. COHEN, FORMER COMMISSIONER, INTERNAL REVENUE SERVICE (PRESIDENT JOHNSON)

Mr. COHEN. Mr. Chairman, I am pleased to be before you today at your request. I should add that I appear in my individual capacity. I do not represent anybody other than myself. I have practiced tax law a long time in this city, 49 years to be exact, in the government, out of the government, teaching. I was fortunate to be the chair of the group of commissioners, seven of us, three former Republican commissioners, four Democrats, that wrote the letter to the Secretary to try to clarify his statement in the May issue of the *Washington Times.*

As our letter says in the very first sentence of the second paragraph, after the introduction, it says, "That statement," meaning the Secretary's statement in the May letter, suggests that the OECD project in its current form runs counter to the administration's efforts. We were addressing the inferences of what the Secretary said in his unfortunately inexact language he has now clarified. In his inexact language, he seemed to be backing off of the position that the United States has taken consistently for the last 12, 15 years, and probably, if you go back, 40 or 50 years.

So I am happy to hear that he did back off of that position. I should give you a few of my views on the OECD project. I have worked with Jeffrey Owens, who is the head of the OECD project's tax group on several international projects. He is one of the outstanding international civil servants doing a terrific job for all of us, because the United States is a member of OECD, in trying to bring the tax systems of the world in some kind of working order so they work, and that requires some pressure on countries that would have wild-cards, if you will. They will do what they will with the system.

We were talking about the Cayman Islands and other places like that. Many years ago, I had to open a bank account for a client who needed a transaction to occur abroad for entirely legitimate reasons, and which they intended to report on their U.S. return and did report on their U.S. return, but, for a variety of reasons, the account had to be abroad. I wrote an instrument. It was a trust instrument, and we opened the account in the trust's name in the Cayman Islands—in one of the British banks in the Cayman Islands, because I wanted a bank that I could trust.

The banker immediately asked me where was my "letter of instructions." That is the under-the-table instructions of what I really meant to do. I said, "No, I mean for you to do exactly what the trust says, no more and no less. That trust instrument will be attached to a tax return."

Now, a friend of mine opened an account in the Cayman Islands for a completely legitimate reason just a few months ago, and he told me that when he opened the account, the banker did not know him and the banker asked for a certification from the U.S. bank that this person was a real person. That is typically what a U.S. bank would do with a customer who came in to open a large deposit and they did not know him, under the money laundering rules. So somebody down there at some banks—I cannot say as to all of them—is paying attention to Jeffrey Owens and the inter-

national efforts to bring them into line with an organized, orderly system.

I have had experience with developing countries which negotiate tax treaties with the United States, and many of them want banking secrecy. They have banking secrecy or they have something like bank secrecy.

In each instance, you have to explain to the high officials of that government that the United States will not ratify a treaty that does not require mutual exchanges of information. In most of those instances, they will comply because they want the relationship with the United States. In a few instances, I have seen them delay and, in fact, in one country I know of, the delay was many years, until they realized in their country that many of their people were hiding money in New York banks or Miami banks, and they wanted an exchange of information and they ratified the treaty and we have a treaty with that country.

So this is a system that has been going on. The problem has existed for years. It has gotten better. It is not nearly as good as it ought to be.

I am pleased to hear that the Secretary is on board; that is, his statements were interpreted by people as being more radical than he intended them to be. If I were the Secretary's close personal friend, I would advise him to be more careful with his language, because the inference that one picks up from a statement is just as important as the actual words, and the inference that everybody picked up from the Secretary's statement, perhaps because of the juxtaposition of the lobbying effort by some groups to get the United States to abandon its OECD cooperation, and the Secretary's statement caused us all to have that inference. I do not blame the Secretary for that, but I do blame somebody on his staff for not calling that to his attention.

Senator LEVIN. Thank you. Mr. Cohen, I want to go to that letter, because there has been, as you say, inferences drawn from it, and this is Exhibit 4[1] in that book, which I believe you made reference to.

Mr. COHEN. I will take full blame for most of the letter. There were a number of my conferees did make substantial suggestions and substantial improvements. The first draft was mine.

Senator LEVIN. But what I am interested in is the inexact language that the Secretary used that led to the inference, could you go through that with us?

Mr. COHEN. Exhibit 4 is my letter to him.

Senator LEVIN. Yes, I think it also makes reference, I believe, in your letter, although I may be wrong, to the—I think it is Exhibit 2[2] is his statement that you made reference to, I believe, in your letter. But in any event, if you look at Exhibit 2, if you could share with us what do you believe in his statement is the inexact language?

Mr. COHEN. Partially, Senator, it was the fact that just days before his letter, there was published in the tax press and certainly in the general media, a lobbying effort by several groups to get the

[1] See Exhibit 4, which appears in the Appendix on page 87.
[2] See Exhibit 2, which appears in the Appendix on page 83.

Secretary to back—to get the U.S. Treasury to back out of its support for OECD.

Senator LEVIN. So the timing——

Mr. COHEN. The timing—that happening, then the next thing is the Secretary's statement of May 10, I think it was.

Mr. ALEXANDER. Mr. Chairman, if I could add a little to that, there was one item for which Secretary O'Neill is surely not responsible, and that was the headline that the *Washington Times* used, that confronting OECD's, "harmful," tax approach. Well, that headline is hardly a helpful or constructive one. Second, the particular part of the Secretary's statement to which we responded, that I was concerned about, is the last sentence in the last paragraph, "In its current form, the project," that is the OECD project, "is too broad and is not in line with this administration's tax and economic priorities."

I think that particular sentence was directed at the harmful tax regimes part of the project, but it did not say so. It said "the project." That was the reason, that very sentence, was the reason why I was willing to sign on to the letter drafted by former Commissioner Cohen.

Mr. COHEN. If the Secretary had said in his article what he attempted to say today, and then he tried to get too precise with his language, then he seems to be backing off.

Mr. ALEXANDER. I think the Secretary has got it just about squarely right now. I would be concerned about one thing, though. When we have these agreements, these exchange agreements with some of these tax-haven countries, I certainly hope that they do not all provide, as some of them do now, that the agreement will be subject to all the laws of the tax-haven country, because some of those laws of the tax-haven country exacerbate the very problem that you heard about this afternoon.

What we have to do if we are going to pursue tax evasion effectively under this new approach, and I surely hope we do, is make sure that some law in Antigua, a country that I like, except for the fact that they usually have at least three banks on every corner, does not limit Antigua's now new duty, if they cooperate with us, to share information with us. They may say, "Hey, we are going to give you the information we can legally give you, but we cannot legally tell you whether the particular tax evader you are talking about in the United States actually has an account with that bank."

Mr. COHEN. One of the things in our system is a treaty of the United States is a law of the United States, and all of these countries do not have quite the same rule.

Senator LEVIN. I think this is really very helpful. I think the bet that I had with the Secretary had to do with disclosure, not with whether he would just get agreements, but whether he would get agreements which would lead to, in fact, the sharing of information. I am going to go back and make sure that it was clear what the bet was that I had with him, on a 500-percent achievement rate within 1 year. But it is clear that the whole spirit of what this effort, this tax haven effort is, is that we want these tax havens to share the information requested of them relative to the owner-

ship of these accounts and the monies that flow through these accounts.

So if, in fact, as you say, Mr. Alexander, there is a tautology in here, a circle in here where the tax agreement is that they would do what is permitted by their laws, then that is absolutely nothing. That is not worth the paper it is written on, as far as I am concerned, if all they are going to do is agree to share whatever information their laws allow them to share, and their laws do not allow them to share any information. It is a wasted effort. So I am glad you point that out. It is a very valuable caution to just saying how many treaties will be signed. We want treaties that are relevant, worthwhile and effective.

Mr. Cohen.

Mr. COHEN. In one country, and because of diplomatic niceties, I ought not mention it, when I was commissioner we had an agreement with this country to share information. They agreed only to share information on criminal cases, not on civil cases. They had been very uncooperative in the past. They always said they would cooperate. Whenever you asked them for anything, it just never arrived. They never said, "No, we will not give it to you." It just never arrived. So I asked the staff to find the worst criminal case they could find in which there were no redeeming characteristics about the person, and we had pretty good proof, but the case could use some strengthening, and give me the facts of that case and we would test them on that. We were pretty sure this person had a bank account in that country. Bingo, no information. We waited for a year-and-a-half and nothing happened.

Senator LEVIN. You made reference to opponents of the tax-haven project of the OECD, and they continue to object to the information exchange very vehemently. The Center for Freedom and Prosperity, one of these organizations, has stated that "Information exchange for tax purposes, even when limited to specific cases, is inconsistent with sound tax policy, respect for privacy, and international comity."[1] So they flat-out oppose information exchange for tax purposes. Congressman DeLay has characterized the contemplated information exchange proposals as "assaults on financial privacy."[2]

So there are very strong opponents here and very vocal opponents against information exchange in order to counter tax evasion. What is your reaction, both of you, to the arguments that the sharing of information in response to a law-enforcement request in order to get to the tax evasion issue, that somehow or other is an assault on financial privacy and due process?

Mr. Cohen.

Mr. COHEN. Their fathers argued that when we introduced 1099s. I happened to be the draftsman of the section that provides for 1099s when I was a kid right out of law school. But we have had that kind of reporting. It is kept confidential in the United States. It is between the Internal Revenue Service and the taxpayers. It is a crime for anybody at the Internal Revenue Service level to disclose that information except as provided by law, in

[1] See Exhibit 14, which appears in the Appendix on page 108.
[2] See Exhibit 10, which appears in the Appendix on page 101.

which case if there is a court case, they have to, but otherwise they do not reveal it. It is what makes our system work.

The first year we put in computers, you remember we did not introduce the Social Security number as the identifying number until the early 1960's—the first year we put in computers, dividends reporting went up 26 percent. I think interest went up 40-some percent in 1 year.

That did not happen because there was a gigantic jump in the economy. It happened because people who had not been reporting were suddenly reminded, if you will, that they better report because the Internal Revenue Service had the information.

There is an old Yiddish adage which, converted to English, says, "He thinks he is an honest man who is not given the opportunity to steal." When you think about it, it is why we put locks on our doors and windows. We keep locks on our doors and windows to keep amateurs from becoming thieves. A real thief can get in anyway. And that is why we build all these systems to keep all of us—me, you, all the rest of us—honest, and that is the way we deal with each other, and therefore we ought to be square, and the only way we can be square is if the government has some way to check us if we are not. If the government has no way to check us, then it is a license to steal. That is what is happening in these tax havens. It is a license to steal.

Senator LEVIN. Mr. Alexander, would you want to comment on that?

Mr. ALEXANDER. Yes, building on what my distinguished colleague had to say, first as to computers. When we required Social Security numbers for children down to the age of five, we discovered that we had 6 million fewer children in this country than we had the year before, and I am not totally sure we had a plague in that particular year. But this notion that there is an overriding right of privacy is something that I frankly do not understand. I think there is a duty on the part of every American, as you mentioned in your opening statement, Mr. Chairman, to pay his or her taxes, and that duty overrides any notion that the payment is an exaction forbidden by the Constitution or that the duty to pay taxes is overridden by the notion that one's privacy is invaded, one, by the payment of taxes and, two, by Internal Revenue's investigation of the nonpayment of taxes.

There is no constitutional right of privacy that states that tax evasion through an offshore account is somehow permitted because one's privacy as to that account would be invaded by the intrusive IRS if, indeed, the Cayman Islands were to have to tell the IRS in response to a lawful and reasonable question whether a U.S. citizen had an account like those thousands and thousands of companies and accounts that were in your chart.

Senator LEVIN. That chart is Exhibit 7, by the way. It indicates how many taxpayers have admitted in the year 2000 to having an account in one of the 35 tax havens identified by the OECD, and then we have looked at how many offshore banks and offshore companies were in those tax havens in the year 2000, giving a rough indicator of the extent of offshore activity in that country.

It shows 1.1 million corporations, but less than 6,000 taxpayers in the United States, acknowledging having a financial account in

one of those 35 tax havens. Does that give you a feeling of the scope of this problem, Mr. Cohen?

Mr. COHEN. Certainly if you just look at economic activity worldwide, the United States' percentage of that economic activity is greater than that. You cannot say for sure. I think the Secretary said that. But we surely can draw pretty good inferences and we ought to be curious and pursue our inferences, and indeed Mr. Morgenthau did indicate several instances where he knew of specific instances where there were—he could prove almost the numbers here—well, he did not know of every case. So it is clear that they are vastly under-reported.

Senator LEVIN. I am doing some quick math here. Did you want to comment to any further on that chart, Mr. Alexander?

Mr. ALEXANDER. Yes, I would. I would have to make two qualifications. First, I am very skeptical about the accuracy of the reporting anyway on the question in Schedule B—I think that is where it is now—on foreign bank accounts. When I was working for IRS, I discovered that people generally ignored that particular question and that if the IRS obtained information based on that question, IRS totally disregarded the information. So I worried about the question.

Second, while I do not think the question was probably answered accurately, I am not sure about the relationship of an accurate answer to the number of offshore companies, as opposed to offshore deposits and offshore trusts of the kind that Mr. Cohen mentioned.

Senator LEVIN. The total number of offshore companies that we have in these jurisdictions is 1,126,000, and I want to see if I understand your answer. The total number of U.S. taxpayer filings acknowledging accounts is 6,000.

Mr. ALEXANDER. Right, but an account may not be a company.

Senator LEVIN. We have the companies, as well.

Mr. ALEXANDER. So that was my concern. I agree with you that the gross disparity between the tiny number on one hand and the enormous number on the other, and what Mr. Morgenthau testified to, shows that there are a lot more offshore accounts than are reported by taxpayers.

Senator LEVIN. Finally, I want to ask you both about sanctions. You have seen tax havens from several perspectives, as tax regulators, tax advisers, taxpayers, and I may have left off one of your hats, but I think I got them all. You heard the discussion about the possibility of sanctions and the OECD saying that we need to have sanctions that will apply to those tax havens, that will not cooperate in this venture. Do you feel the OECD is correct in saying that the threat of sanctions is necessary to achieve the openness and the disclosure which is so essential if we are going to get at the tax evasions that we are trying to get at, so that honest taxpayers are not losing their taxes to people who refuse to pay those that are honestly owned? Mr. Cohen.

Mr. COHEN. I have always said before a number of congressional committees "law is that which you will enforce." It is not that which is written on the books, it is that which you are willing to enforce. So the same thing is true here. If the international community wants some rule of reason, that is, everybody has to meet these minimum standards, then you have to set some target date

and then you have to set some sanctions if you do not meet that target date.

That is a question of judgment and feel and touch and taste as to whether you set that target date as a year from now or 2 years or 3 years from now, but you cannot set it so far in advance that it becomes meaningless, and you cannot keep deferring it, because if you keep deferring it, you lose any push that you have got. As soon as they see that you are willing to back off for a year or 2, they are willing to come at you again to find another reason to have you back off a year or 2.

Mr. ALEXANDER. I think that the threat of actual and effective sanctions is necessary to the achievement of this goal.

Senator LEVIN. Well, we thank you for your testimony, and it is based on a very important experience that you have both had, and actually, as I said, it is not just as commissioners, but also as taxpayers and advisers. You are very practical. You, I think, know human nature from all sides of the various desks that you have sat on, and your appearance here today is going to be very helpful to us in trying to close down these tax havens, if they do not comply with reasonable disclosure requirements.

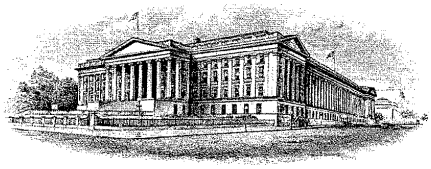
They have been a threat to the international community for many decades. They become magnets for drug trafficking, for government corruption, for financial fraud, for other crime, in addition to the tax evasion that they have fostered. The last three administrations, from President Reagan to President Bush Senior to President Clinton, and the administrations, as you know from personal knowledge, before them, have devoted resources to addressing the offshore problem and have been bedeviled by that problem and have been determined, along with many other countries now, to band together to try to convince uncooperative tax havens to change their ways. And we were seeing some results.

We saw results in the Cayman Islands after 15 years of refusal, to the fact that a total now of 10 jurisdictions have agreed to change, and many more are apparently on the brink of change. The initial appearance of this administration to throw some cold water on that OECD project was disappointing. I think it allowed its critics to characterize or mischaracterize what the project did, and sanctions have now been delayed for 2 years. However, Mr. O'Neill's testimony here today suggests that the United States seems to be back in alignment or moving back in alignment with our allies and colleagues in the OECD, and that is where we should be.

As I think both of you have just stated, these offshore tax havens are not going to change their ways if they think they can keep the status quo. Change does not come easily. But if we do not obtain change in this area, the American taxpayer is going to continue to be cheated of huge amounts of tax revenues, which in fairness should be paid by people who owe those taxes and not by the honest taxpayers of the United States. So we will be working with both the Treasury and the Justice Departments on this. We value your testimony greatly. We value your service to this Nation, and we will stand adjourned.

[Whereupon, at 4:52 p.m., the Subcommittee was adjourned.]

APPENDIX



DEPARTMENT OF THE TREASURY

Embargoed until 2:00pm
Wednesday, July 18, 2001

STATEMENT OF PAUL H. O'NEILL
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OECD HARMFUL TAX PRACTICES INITIATIVE

JULY 18, 2001

Mr. Chairman, Senator Collins, and members of the Subcommittee, I appreciate this opportunity to discuss the position of the United States with respect to the OECD harmful tax practices initiative. This detailed statement will cover all the specific issues regarding the OECD initiative that Chairman Levin asked me to address in his June 29th letter.

As I have stated previously, when I took my oath of office as Secretary in January, I pledged faithfully to execute the laws of the United States. We have an obligation to enforce our tax laws because failing to do so undermines the confidence of honest taxpaying Americans in the fairness of our tax system. At the same time, we should not presume to interfere with the internal tax policy decisions of sovereign nations. Based on these two fundamental principles, I have concluded that the United States should attempt to refocus the OECD project on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to prevent noncompliance with their tax laws.

Extent of tax evasion through use of offshore accounts or entities

It is impossible to quantify precisely the extent to which U.S. taxpayers are using offshore entities or secret bank accounts – the facilities of tax haven jurisdictions – to evade their U.S. tax obligations. Such taxpayers obviously do not report the extent of their noncompliance with U.S. tax laws, and it is difficult to obtain anything other than anecdotal information with respect to such activity.

However, based on this anecdotal information, I believe that the potential for such evasion is significant. For example, the cases involving a bank in the Cayman Islands run by John Mathewson highlight the opportunities available to U.S. taxpayers to evade their U.S. tax obligations through the use of offshore bank accounts. According to Mr. Mathewson, over 95 percent of the more than 1,000 depositors in his bank were U.S. citizens, and the bank had over $150 million in its accounts when it was shut down in 1995. The IRS has to-date obtained tax evasion convictions on, and collected substantial back taxes from, over 20 of Mr. Mathewson's clients. The IRS was able to demonstrate this evasion only because of Mr. Mathewson's extraordinary cooperation. Without it – and because we do not have an information exchange agreement with the Cayman Islands – this large-scale tax evasion would have gone unpunished.

I should note that the United States and the Cayman Islands have been discussing new legal mechanisms to provide for effective exchange of information, and that the Cayman Islands is one of the jurisdictions that has made a commitment to implement effective information exchange procedures in connection with the OECD harmful tax practices initiative.

The use of offshore entities or accounts by U.S. taxpayers to evade their tax obligations is likely to increase because of trends that are unlikely to be reversed, including the increasing solicitation of U.S. taxpayers by offshore banks through the Internet and the ease of access to offshore funds through electronic banking and account-linked credit cards, which may allow significant fund transfers that do not create a paper trail. The primary obstacle to enforcement of our tax laws in these cases remains the unwillingness of jurisdictions to enter into effective information exchange agreements with the United States that would provide us with access to critically important information in cases involving suspected tax cheats.

For example, in connection with a recent tax investigation, IRS examiners suspected that an offshore International Business Corporation (IBC) and its offshore bank account were being used by a U.S. taxpayer to evade the taxpayer's U.S. tax obligations. The IRS could not obtain the shareholder and bank account information needed to prove this because there was no treaty or agreement in place that allowed the exchange of taxpayer information with the jurisdiction in which the IBC was established. Put simply, jurisdictions with strict bank secrecy rules and a resistance to cooperate in tax matters facilitate the evasion of U.S. tax.

U.S. efforts to address tax evasion

The United States employs a multi-prong strategy to enforce our tax laws. First and foremost, we undertake significant unilateral efforts to combat tax evasion. For example, we presently are engaged in a multifaceted effort to address the problem of fraudulent tax schemes, many of which employ offshore entities or secret bank accounts. The IRS estimates that there are thousands of Internet sites with information relating to methods for evading U.S. tax obligations. Our approach is to educate the general public to avoid these scams and to take civil and criminal enforcement action against those who use them and those who promote them.

While we do everything we can ourselves to address tax evasion, we can be more effective with the cooperation of other countries. When the United States suspects that a particular taxpayer is evading

U.S. tax laws through the use of offshore entities or secret bank accounts, we sometimes need information from another country to address that situation. The United States has been more successful than any other country in negotiating and implementing tax information exchange agreements. Our tax information exchange agreement program was initiated in 1983 to encourage the entry into these agreements by jurisdictions with which we would not conclude comprehensive income tax treaties – typically low or no tax jurisdictions for which the provisions in a comprehensive treaty addressing issues of double taxation are not necessary. The United States has tax information exchange agreements with five of the jurisdictions identified as tax havens by the OECD in June 2000, as well as with another jurisdiction that made a commitment with respect to the OECD initiative and was not included in the June 2000 list. Most other OECD countries do not have information exchange relationships with any of the identified jurisdictions.

At present, the United States has over 60 bilateral tax treaties and agreements that provide for information exchange. The information exchange provisions in these agreements are consistent with, and have served as a significant resource in the development of, international standards with respect to information exchange. The United States frequently is able to prosecute taxpayers for tax evasion because of information obtained from other countries. Further, the fact that the United States may be able to obtain information from a foreign country when we have reason to suspect noncompliance helps to deter taxpayers from attempting to evade tax through entities or accounts in that country.

The United States, however, has been unable to develop information exchange relationships with some jurisdictions that are significant financial centers. Some jurisdictions simply are not interested in cooperating in this regard. Other jurisdictions are wary of agreeing to effective tax information exchange with the United States unless competing offshore financial centers enter into similar agreements. Working with the OECD and other OECD member countries on the development of a framework for reaching information exchange agreements with these jurisdictions may indeed prove fruitful.

In order to effectively enforce our own tax laws, it is critical that we are able to obtain the cooperation we need from other countries. The OECD initiative has the potential to advance the interests of the United States in this regard. This objective is too important to allow the OECD project to stray into other areas that could distract from or hinder success in this objective. In my view, the OECD initiative has the greatest chance of enhancing the ability of the United States to enforce our tax laws if it is focused on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to prevent noncompliance with their tax laws.

History of the OECD project

The OECD harmful tax practices initiative began in 1998 with the publication by the OECD of a report that set out criteria to attempt to identify so-called "harmful tax practices" and provided a framework for future work to address such practices. Part of that framework was the establishment of a subsidiary OECD body called the Forum on Harmful Tax Practices, which was co-chaired by the United States from October 1998 until October 2000. The United States also has been one of

four members of the Forum's steering group, called the Bureau to the Forum, from October 1998 up to and including the present.

The 1998 OECD Report, and a follow-up report issued in June 2000, contained rhetoric that implicated fundamental internal tax policy decisions of countries within and outside the OECD, including decisions regarding tax rates. The Reports enumerated the harms potentially caused by "tax havens or harmful preferential regimes that drive the effective tax rate levied on income from the mobile activities significantly below rates in other countries." Tax systems that "redirect capital and financial flows and the corresponding revenue from" other countries were condemned as "poaching" the rightful tax base of the other countries, even though such systems may simply provide a more attractive investment climate without facilitating noncompliance with the tax laws of any other country.

The two OECD reports take a notably condemnatory tone with respect to the issues addressed, and the advocacy of internationally coordinated action against targeted countries represents an approach that is more aggressive than is typical for the OECD.

The OECD's technical work on harmful tax practices has proceeded on three tracks since 1998:

- The identification and elimination of harmful tax practices within OECD member countries;
- The elimination of such practices in identified tax haven jurisdictions; and
- Outreach to other non-OECD jurisdictions, with the goal that such jurisdictions eventually eliminate their own harmful tax practices.

The 2000 OECD Report identified 35 so-called "tax haven" jurisdictions. Under the criteria established in the 1998 OECD Report, a tax haven is a jurisdiction that imposes no or nominal direct taxes on financial or other mobile services income *and* also meets one of three other criteria: (1) its regimes lack transparency; (2) it does not engage in effective information exchange; or (3) its regimes facilitate the establishment of entities with no substantial activities. The 2000 Report also identified 47 "potentially" harmful preferential tax regimes in OECD member countries. A harmful preferential regime is a regime that provides for low or no taxation of financial or other mobile services income *and* also meets one of three other criteria: (1) the regime lacks transparency; (2) the country does not engage in effective information exchange with respect to taxpayers utilizing the regime; or (3) the regime is "ring fenced" (as described below).

The 2000 Report provided a one-year period for the identified tax havens to enter into commitments to eliminate (by the end of 2005) their harmful tax practices. The 2000 Report also provided that jurisdictions that do not make such commitments will be included on a list of "uncooperative" tax haven jurisdictions to be published in July 2001. The report anticipated that the OECD would recommend that OECD member countries implement a coordinated framework of "defensive measures" against the jurisdictions that are listed as "uncooperative."

Concerns about the OECD project

On February 17th, following a meeting of G7 Finance Ministers in Palermo, I indicated that certain aspects of the OECD project were under review by the Administration. I was troubled by the notion that any country, or group of countries, should interfere in any other country's decisions about how to structure its own tax system. I felt that it was not in the interest of the United States to stifle tax competition that forces governments – like businesses – to create efficiencies. I also was concerned about the potentially unfair treatment of some non-OECD countries, with regard to both the deadlines to which they were being subjected and the uncertainty created by the lack of clarity with respect to the application of the "no substantial activities" criterion. This perceived unfairness seemed to be contributing to the difficulty in obtaining commitments from most of the identified jurisdictions. I was particularly troubled because these aspects of the project did not relate to what appeared to be a critical – and attainable – objective of the OECD' s work: the establishment of a framework for reaching information exchange agreements with countries that have shown little interest in cooperating with other countries on tax matters in the past. Indeed, these aspects distracted from and interfered with the achievement of that objective.

Our review of the OECD project has been guided by two fundamental principles. First, we must do everything that we can to enforce our own tax laws, including working to obtain needed information that is in the hands of other countries. Second, we will not interfere in the internal tax policy decisions of other countries. These principles led me to conclude that the United States should attempt to refocus the OECD initiative on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to prevent noncompliance with their tax laws.

Recent developments with respect to the OECD tax haven work

I am happy to report that, together with other OECD member countries, we have made substantial progress in focusing the initiative on its core element of effective information exchange and in addressing aspects of the initiative that seemed unfair to non-OECD countries.

Treasury representatives have worked with their counterparts from other OECD countries through the OECD process and have been able to obtain agreement to significant modifications to the work with respect to tax haven jurisdictions. The recent discussions regarding the OECD project focused on the portion of the work relating to tax haven jurisdictions because that work was facing immediate decision points and deadlines. The modifications recently agreed to at the OECD were noted in the July 7th report by the G7 Finance Ministers on Fighting the Abuses of the Global Financial System.

I would like to summarize three significant modifications to the OECD tax haven work, each of which I will describe in greater detail below.

- First, coordinated defensive measures would not apply to "uncooperative" tax haven jurisdictions any earlier than they would apply to similarly-situated OECD member countries.

- Second, the "no substantial activities" criterion will no longer be applied to determine whether or not a jurisdiction is considered to be an "uncooperative" jurisdiction.

- Third, the time for tax haven jurisdictions to make a commitment to transparency and information exchange has been extended from July 31st to November 30th.

The United States argued for each of these modifications within the OECD, and strongly supports them. It is important to note that the United States was not alone within the OECD in advocating these modifications, and that agreement within the OECD would not have been possible without the support of other countries. In my view, these modifications constructively focus and clarify the OECD tax haven work, and therefore increase the likelihood that it can achieve its critical objective.

Parity of timeline for application of defensive measures. In order for the OECD initiative to have the legitimacy it needs to succeed, jurisdictions outside the OECD must be treated no more severely than similarly-situated OECD member countries. The 2000 OECD Report anticipated the coordination and application of defensive measures by OECD member countries against "uncooperative" tax haven jurisdictions as of July 31, 2001. Such measures, however, would not be applicable to similarly-situated OECD member countries – including OECD member countries with substandard transparency or information exchange practices which they have not yet made commitments to improve – until April 2003 at the earliest. That disparity in treatment would not have been fair. It is not surprising that there was unanimous support among G7 countries to address this inequity.

Accordingly, the OECD has now agreed that defensive measures would not be applicable to non-OECD jurisdictions any earlier than they would be applicable to similarly-situated OECD member countries. Each OECD member country, of course, reserves the right to take or refrain from taking any measure as appropriate, whether within the coordinated framework established by the OECD or outside of that framework. Tax haven jurisdictions will be able to observe whether OECD member countries with significant financial centers make the changes necessary to meet the standards that the jurisdictions are being asked to meet. OECD member countries should hold themselves to standards and timelines at least as rigorous as those to which they hold jurisdictions that are not part of the OECD.

Removal of the no substantial activities criterion. Under the provisions of the 1998 and 2000 OECD Reports, a jurisdiction that meets international standards of transparency and information exchange could nevertheless be considered an "uncooperative" tax haven jurisdiction potentially subject to defensive measures if it has regimes that facilitate the establishment of entities with "no substantial activities." Application of the "no substantial activities" criterion proved difficult, and the OECD sought to apply a ring-fencing criterion to the tax haven jurisdictions as a proxy. Under the 1998 OECD Report, which addresses ring fencing in the context of identifying harmful preferential regimes within OECD member countries, a tax regime is ring fenced if it available only to non-resident investors or if the activities of entities formed under the regime are limited to international transactions.

The ring-fencing criterion is problematic because it does not provide an adequate basis to distinguish regimes that facilitate tax evasion from regimes that are designed to encourage foreign investment but that have nothing to do with evasion of any other country's tax law. Countries may have good reason to provide different levels of taxation to income earned by nonresidents or to income earned by residents from foreign activities, such as to provide investment incentives or to improve access to capital markets. If such policies are not coupled with a lack of transparency or a refusal to exchange information and otherwise do not interfere with the enforcement by other countries of their tax laws, they should not be targeted by the OECD initiative.

As a practical matter, the OECD has struggled to articulate the application of the "no substantial activities" criterion, or the ring-fencing criterion as its proxy, to the tax haven jurisdictions. Moreover, this criterion necessarily would have uneven application to the tax haven jurisdictions as it would have potential application only to those jurisdictions that have an income tax system and would have no application whatsoever to those jurisdictions that have no income tax system. This lack of clarity in definition and uneven application are particularly troubling because the criterion potentially implicates fundamental tax and economic policy decisions of the jurisdictions.

Accordingly, the OECD has now agreed that neither the "ring-fencing" criterion nor the "no substantial activities" criterion will be used to determine whether a jurisdiction would be listed as "uncooperative" and would be subject to potential defensive measures.

Extending the time for commitment. In light of the recent modifications to the OECD initiative and the number of jurisdictions that have yet to complete discussions with the OECD with respect to commitments to improve their practices, it made good sense to reconsider the anticipated July 31st date for listing "uncooperative" tax haven jurisdictions. The OECD is in active discussions with many of these jurisdictions, and these discussions have proved to be quite time-consuming. Maintaining the July 31st deadline almost certainly would have caused many jurisdictions that are engaged in ongoing, good-faith discussions with the OECD regarding the commitment process to be included in the list of "uncooperative" tax haven jurisdictions. It would have been counterproductive to so label jurisdictions merely because the OECD and the jurisdiction were unable to conclude their discussions by July 31st. In order to avoid this inappropriate result, the time for jurisdictions to make commitments to improve transparency and information exchange practices, and therefore avoid being considered an "uncooperative" tax haven, is being extended from July 31st to November 30th.

Any jurisdiction that makes a commitment to meet international standards of transparency and effective exchange of information will not be listed as "uncooperative" and will not be subject to potential application of coordinated defensive measures. The United States fully supports efforts to improve the information exchange and transparency practices of countries within and outside the OECD which are necessary to enable other countries effectively to enforce their own tax laws.

Information exchange standards. International standards with respect to exchange of tax information have been developed through the work on the relevant provisions of the OECD Model income tax treaty and other instruments. These standards have been strongly influenced by developments regarding the U.S. Model income tax treaty and the standards set out in the Internal Revenue Code with respect to tax information exchange agreements. The ten jurisdictions that have committed to the OECD initiative thus far have been participating with OECD member countries, including the United States, in developing an exchange of tax information instrument based on these U.S. and international standards. It is anticipated that this instrument could be used in meeting the jurisdictions' commitments to engage in effective tax information exchange.

In the context of the OECD initiative, effective information exchange means that governmental authorities will provide information upon specific request if necessary for the conduct of a specific criminal tax investigation or civil tax examination. In general, information exchange can be effective only if bank secrecy, bearer shares, and other practices do not impede such exchange. Requests for information that are in the nature of a "fishing expedition" are not within the scope of standard information exchange relationships.

United States tax authorities may directly exchange tax information with authorities of foreign countries only pursuant to bilateral tax treaties or tax information exchange agreements, and the United States currently has over 60 such treaties and agreements. These treaties and agreements provide that the information cannot be used for non-tax purposes or disclosed without authorization, thus protecting the confidentiality of such information. The OECD project contemplates that confidentiality standards will be included in the model exchange of information agreement being developed by the joint group of OECD and non-OECD countries, and the United States will continue to insist on these important protections in any agreement to which it is a party.

Transparency standards. International standards with respect to transparency have been developed at the OECD as part of the harmful tax practices initiative. In this context, transparency means two things: (1) the absence of non-public tax practices, such as the secret negotiation, or waiver, of public tax laws and tax administration rules; and (2) the absence of obstacles, such as strict bank secrecy or the use of bearer shares, to obtaining financial or beneficial ownership information within a jurisdiction. The United States supports efforts to improve transparency as critical to establishing and maintaining an effective information exchange relationship; a jurisdiction that could not obtain basic financial or beneficial ownership information from residents or financial institutions within its jurisdiction could not satisfy its information exchange obligations in a meaningful way. Efforts to improve transparency should prevent the establishment of barriers to effective information exchange.

Possible application of defensive measures. The OECD initiative can reach its core objective of improving the ability of countries to enforce their own tax laws only if the significant financial centers within and outside the OECD are persuaded to meet international standards for transparency and effective information exchange. Drafting lists and devising defensive measures ultimately will not help countries curb noncompliance with their tax laws. Accordingly, it is the hope of the United States and other OECD member countries that we will never have to consider the implementation of coordinated defensive measures with respect to uncooperative jurisdictions.

It is important to note two things with respect to defensive measures in connection with the OECD harmful tax practices project. First, the threat of such measures by a group of 30 large, developed countries is by its nature highly coercive and accordingly should be reserved only for jurisdictions acting in bad faith whose practices demonstrably facilitate the noncompliance by taxpayers with the tax laws of other countries. In this context, such measures must truly be measures of last resort.

Second, while the work in the OECD project to refine the identification of appropriate potential defensive measures is still in an early stage, it is important to recognize that several of the defensive measures that have been identified thus far by the OECD have been part of the international tax policy of the United States and other OECD member countries for many years. For example, the Internal Revenue Service has a practice of enhanced audit and enforcement activities with respect to transactions and activities in jurisdictions which, in its experience, are used by U.S. taxpayers to evade their U.S. tax obligations. These jurisdictions invariably do not have effective information exchange agreements with us or other countries, and in fact most were identified as tax havens by the OECD. In addition, since the mid-1980s, the United States has had a policy of not entering into comprehensive tax treaties with no-tax jurisdictions because such treaties would not serve a principal purpose of our bilateral tax treaties – the elimination of double taxation on cross-border activities and investment flows – and because such jurisdictions traditionally have not had effective information exchange practices. Consistent with that policy, the United States has terminated several tax treaties in the last 20 years with no or low-tax jurisdictions, many of which were identified as tax havens by the OECD.

More generally, however, the aspects of our international tax laws designed to prevent noncompliance do not target lists of countries because, as the experience with the OECD initiative shows, such lists are difficult to draw up and maintain and can become the subject of controversy. Thus, most aspects of our international tax laws apply without regard to the particular foreign jurisdiction in which the activity or taxpayer is located. For example, our tax law includes a comprehensive controlled foreign corporation regime, as well as other complementary anti-deferral regimes, that provides for the immediate taxation of certain categories of foreign income earned by foreign corporations controlled by U.S. taxpayers. These rules are not limited to corporations located in particular jurisdictions.

The United States, like other OECD member countries, would strongly prefer working cooperatively with jurisdictions rather than contemplating the imposition of coordinated defensive measures. It would be premature for me to speculate as to what measures, if any, the United States or other countries might consider applying in two years if it were to come to that. I will note at this time, however, that many of the defensive measures identified by the OECD would require legislation and therefore would require action by Congress.

Concluding thoughts on the OECD project

I am heartened by the significant progress we have made with our OECD counterparts in focusing the OECD's work with respect to tax haven jurisdictions on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to enforce their own tax laws. It is clear from the recent developments with respect to the OECD initiative that this important objective can be achieved without stifling tax competition. These developments also reflect a fairer and more constructive approach to the dialogue with non-OECD countries, whose cooperation ultimately is necessary to the success of the OECD initiative. We look forward to ongoing discussion with countries both within and outside the OECD aimed at establishing effective transparency and other mechanisms for the provision of tax information upon specific request while protecting against unauthorized use and disclosure of such information.

Additional comments on money laundering work

I would also like to make a few points about our work to combat money laundering, something that I know has been of interest to this Subcommittee. First of all, this Administration is committed to aggressive enforcement of the money laundering and asset forfeiture laws. To that end, the President has nominated, with my full support, Jimmy Gurulé, a former Federal prosecutor and expert on money laundering enforcement, to be the Under Secretary for Enforcement at Treasury. President Bush has also tapped Judge Robert Bonner, a former U.S. Attorney and Administrator of the Drug Enforcement Administration, to head the Customs Service, which plays a crucial role in our efforts to root out international money laundering. Professor Gurulé, with my full support, has announced his intention to make enforcement of the money laundering laws his top priority during his tenure at the Treasury. Assistant Attorney General Chertoff has told us that money laundering enforcement is also one of his top priorities for the Justice Department's Criminal Division. Though neither Professor Gurulé nor Judge Bonner is yet confirmed, they have both been advising me on this issue. With their expert assistance, and with the support of our colleagues at the Department of Justice, I am comfortable that our internal review of our money laundering programs will put us in a position to ensure that the American people are getting the best possible return on their investment in this area.

The previous Administration published a spread sheet that indicated that we spent about a billion dollars each year combating money laundering. Since becoming Secretary I have learned that that number was significantly in error, and I have asked the Treasury staff a series of tough questions about the nature of our actual expenditures and what exactly we get in return for our efforts. I'm still not satisfied that we have good answers to all of these questions, but I assure you that, as we move forward, I will continue to push the staff to answer them. I believe this approach is the best way to

ensure effective public policy, regardless of the subject area. It is clear to me that money laundering control is an important component of our overall effort to combat crime and to protect the integrity of our financial institutions and markets. But it is also clear to me that we can do a much better job in making ourselves accountable to the American people.

We will circulate shortly for interagency review a draft of the 2001 National Money Laundering Strategy. I expect we will be in a position to publish a final strategy in the coming weeks. That strategy will articulate a number of specific steps across a range of different activities, all designed to ensure effective law enforcement. The three main pillars of the strategy will be, first, to focus our limited federal resources to investigate and prosecute money laundering on high impact major cases; second, to protect the integrity of the U.S. financial system; and third, to significantly improve the Government's capacity to measure the results of its efforts, so that we can be fully accountable to the American taxpayers.

Thank you.

Testimony
of
Robert M. Morgenthau
before the
United States Senate
Permanent Subcommittee on Investigations
July 18, 2001

Mr. Chairman, members of the Committee, I am grateful for the opportunity to testify on a subject that has long been of interest to me and is becoming more important every day.

Increasingly, off-shore tax havens are serving as powerful magnets for U.S.dollars. Deposits of U.S. dollars in the Cayman Islands have been increasing by about $120 billion a year; according to the Federal Reserve Bank of New York, there are now more than $800 billion U.S. dollars on deposit in Grand Cayman. That is more than twice the amount on deposit in all the banks in New York City and the equivalent of nearly 20% of all the dollar deposits in the United States. It amounts to almost $3000 for every man, woman and child counted in the last U.S. census. It is about what the federal government now spends on Social Security, Medicare and Medicaid combined in a year.

It also amounts to approximately $20 million for every resident of the Cayman Islands. Obviously, this huge cache of U.S. money does not reflect any real economic activity in the Caymans. In fact, of the nearly 600 banks and trust companies licensed in the Caymans -- which include 47 of the world's largest 50 banks -- only 100 or so have a physical presence there. According to the website of the Cayman Islands Monetary Authority, only 31 banks are currently licensed to do business with Cayman residents. Similarly, there are some 45,000 companies registered in the Caymans whose only business is outside the country. Notably, Long Term Capital, the giant hedge fund that almost collapsed 3 years ago, was chartered in the Caymans, but managed out of offices in Greenwich, Connecticut.

Though the Caymans have proven particularly attractive to U.S. residents, they do not stand alone as an off-shore haven for U.S. dollars. There are countless others: Antigua, the British Virgin Islands, the Cook Islands, Nassau, Belize, Cyprus, to name just a few. And the list is growing all the time.

What is all this money doing off-shore? It is not there because of the sunshine and the beaches. To be blunt, it is there because those who put it there want a free ride -- depositors, investors, banks and businessmen want to avoid or evade laws, regulations and taxes in their home countries, including the U.S. Some of this avoidance is legal under present law, but much of it is not. And whether legal or not, the presence of $800 billion in a single off-shore jurisdiction -- hidden from the scrutiny of bank supervisors, securities regulators, tax collectors and law enforcement -- is a huge problem.

A few examples from the cases prosecuted by the Manhattan District Attorney's Office illustrate just how attractive tax havens and off-shore jurisdictions offering strict bank and corporate secrecy have become for tax cheats and other white-collar criminals. When you consider that we only come across a small fraction of the illegal activities in these jurisdictions and are successful in prosecuting only a small number of the crimes we discover, the dimensions of the problem may become clearer.

It is becoming increasingly commonplace to find an off-shore connection to security frauds and other major sophisticated white-collar crimes. For example, in 1997 and 1998, my office convicted A.R. Baron & Co. and 13 of its former officers and employees for running an organized criminal enterprise. Baron was what is commonly known as a "boiler room" or "bucket shop," pushing questionable stocks and specializing in market manipulation, unauthorized trading in customers accounts and countless other methods of taking advantage of innocent investors. Baron's illegal activities over 5 years cost investors more than $75 million.

The lead defendant in the Baron case used Liberian shell companies and accounts in the Isle of Jersey to trade in the stock the firm was underwriting, a violation of U.S. securities laws. He also sheltered his illegal profits -- from tax authorities, creditors and the Bankruptcy Court -- in a Cook

Islands trust. The Cook Islands are a New Zealand protectorate in the South Pacific.

A New York lawyer drew up the papers for Mid-Ocean Trust Co. in Rarotonga, the Cook Islands, to act as the trustee. The affairs of the trust were, however, managed here in New York by the so-called "protector" of the trust, the lead defendant's father. Mid-Ocean Trust did business in New York through one of the largest banks in Australia, which had branches in Rarotonga and New York, and which refused to honor a New York subpoena on the grounds that to do so would violate Cook Islands bank secrecy laws.

In another securities fraud case, which is still ongoing, we have thus far convicted the company, Meyers Pollock, and 37 individual defendants for enterprise corruption and securities fraud. In this case, we again came across shell companies and off-shore bank accounts. Promoters used these off-shore vehicles to trade illegally in their own stocks, to "paint the tape" -- that is to generate fictitious trades to drive up prices -- and, of course, to cheat on their taxes.

Securities fraud is not the only area where we have found tax havens used for criminal purposes. In 1996, my office concluded a case involving the bribery of bank officers in U.S. and foreign banks in connection with sales of emerging markets debt, transactions which earned millions for the corrupt bankers and their co-conspirators. In this case, a private debt trader in Westchester County, New York, formerly a vice president of a major U.S. bank, set up shell companies in Antigua with the help of one of the "big five" accounting firms; employees of the accounting firm served as nominee managers and directors.

The payments arranged by the accounting firm on behalf of the crooked debt trader included bribes paid to a New York banker in the name of a British Virgin Islands company, into a Swiss bank account; bribes to two bankers in Florida in the name of another British Virgin Islands corporation; and bribes to a banker in Amsterdam into a numbered Swiss account. Because nearly all the profits in this scheme were realized in the name of the off-shore corporations or off-shore accounts, almost no taxes were paid.

A year ago, in a very different sort of case, a Manhattan jury convicted Sante and Kenneth Kimes, a mother-son team of so-called "grifters," for murdering an elderly Manhattan widow to gain control of her expensive townhouse. In our investigation of the case, we found that to arrange for the payment of filing fees and taxes on a forged deed to the townhouse, the pair drew on funds held in a brokerage account in Bermuda in the name of The Atlantis Group, a shell company. The money, which was part of the proceeds of a separate fraud committed in Las Vegas, came to Bermuda by way of an account established by the defendants at Swiss American Bank in Antigua. It was Swiss American (a bank that was neither Swiss nor American) that helped the Kimes' set up the Atlantis Group shell company in Antigua.

For the defendants in these cases, the principal attraction of doing business in off-shore havens was not the low or non-existent tax rates. They sought to take advantage of other benefits that are almost invariably provided in tax haven jurisdictions: strict bank and corporate secrecy, lack of transparency in financial dealings and the lack of any meaningful law enforcement or supervision in the financial area. For white-collar criminals, the lack of transparency and the code of strict secrecy is particularly useful because it prevents law enforcement from "following the money;" it breaks the trail of dirty money, often leaving investigators at a dead end.

The obstacles created for law enforcement take many forms. In some cases the laws in off-shore jurisdictions do not require adequate records, as when the ownership of an off-shore corporation is evidenced only by bearer shares or off-shore trust documents reveal the identity of the trustee or the protector, but not the beneficial owners.

Secrecy laws and the culture of secrecy may be impediments to disclosure even where legal mechanisms ostensibly permit disclosure to responsible authorities abroad. In the case of the Bank of Credit and Commerce International (BCCI), which was involved with drug money laundering, the illegal shipment of arms, and bribery of government officials, the majority of money

transfers went through BCCI Overseas, chartered in Grand Cayman. When my office sought to subpoena BCCI bank records from the Caymans, we met a stone wall. A BCCI official in New York to whom a grand jury subpoena was issued refused to produce any records, claiming Cayman bank secrecy.

We were told we had to invoke the Mutual Law Enforcement Assistance treaty between the U.S. and Grand Cayman. We did just that and were then told by the Caymans Attorney General that the records would be produced to the Department of Justice but only on the condition that they not be made available by the U.S. government to state and local prosecutors -- including, of course, the New York County District Attorney's Office, which had sought them in the first place. I note that more than 98% of all criminal prosecutions in the United States are brought by state and local prosecutors.

In the end, we did make some headway, after our relations with the British Serious Frauds Office improved, and the Attorney General of Grand Cayman, a lawyer from the Midlands in England, appointed by Her Majesty's Government, came to my office in New York. As a result of this personal diplomacy, we got some, but not all, of the records we sought.

Sometimes the problems continue even after U.S. authorities get their hands on the evidence. In 1996, the U.S. Department of Justice came into possession of a tape containing computerized records of a defunct Caymans bank, Guardian Bank and Trust Company. The bank was set up by an American and used to launder money for its depositors, 95% of whom were U.S. residents. The official Cayman liquidators of the bank -- two partners in another major world-wide accounting firm -- brought suit in U.S. District Court in New Jersey seeking the return of the computer tape to the Caymans. In their brief, the liquidators argued that disclosure of the contents of the records to, among others, the U.S. Internal Revenue Service would:

> Have a significant negative impact on the integrity, confidentiality, and stability of the financial services industry of the Cayman Islands. ... The confidence of the offshore financial community in the privacy afforded to legitimate account holders of Cayman Islands offshore banks

> is at the heart of the Territory's financial services industry and economy, as a whole. ... Thus, not only would the Bank be irreparably injured by the government's retention of the Tape, but the international bank and Eurocurrency industries
> of the Cayman Islands (and, indeed, the economy of the Territory), could suffer irreparable injury as well.

After decoding the tape -- without the help of the Caymans government -- authorities discovered that the Guardian Bank's U.S. depositors had $300 million offshore, hidden from tax authorities, litigants and creditors.

Access to off-shore accounts, shell companies and even private banks in tax haven jurisdictions is no longer limited to a small number of sophisticated professional criminals. John Mathewson, who set up Guardian Bank in the Caymans, started out in the construction and home remodeling business in Illinois. Years after opening a numbered Swiss bank account while vacationing in the Caymans, he was persuaded by a Caymans banker to open his own bank. According to Mathewson, his application for a bank license asked for little more than his name, address and previous work history.

In another investigation, my office obtained indictments earlier this year charging a British solicitor and magistrate and a Canadian lawyer, a Queen's Counsel, with establishing a network of shell corporations and bank accounts in bank-secrecy jurisdictions, including Liberia and Belize, to assist their clients in violating securities, banking and tax laws in the jurisdictions where they lived. The defendants paid a Liberian diplomat, among others, to serve as nominal owners of the companies and to sign blank documents used in the fraud. Among the clients of this enterprise was a New York plastic surgeon, who, when one of his patients died on the operating table, decided to put his assets off-shore to render himself judgment-proof.

In the debt trading case I spoke about, we found there was a virtual cottage industry in New York and elsewhere in the United States of accountants and lawyers willing to assist in setting up companies in tax haven and secrecy jurisdictions, and willing to

serve as agents for the companies or to provide references where required. Similar services are also available through an assortment of financial advisers and financial services companies that advertise in airline magazines and the International Herald Tribune and the Financial Times.

A popular paperback guide by a leading trusts and estates lawyer on how to "die richer" touts the advantages of off-shore Asset Protection Trusts. According to the book, APTs, as they are known, are structured to permit a foreign trustee to ignore U.S. court orders and to simply transfer the trust to another jurisdiction in the face of legal action threatening the trust's assets.

Countless internet sites solicit applications to open bank accounts, purchase shell companies or even establish personal banks off-shore; many take applications by e-mail. According to one web page, a personal bank may be formed in Montenegro "by any natural person or company worldwide with no tiresome background checks." With the bank, the site promises a correspondent account at the Bank of Montenegro and access to the Bank of Montenegro's correspondent network, including Citibank, Commerzbank and Union Bank of Switzerland. While this website may be in need of updating, it illustrates how easy it is today to take advantage of off-shore venues.

Sadly, Mutual Law Enforcement Assistance Treaties (MLATs), where they exist, have not proved to be an answer to the problems associated with off-shore tax and secrecy havens.

As in the BCCI case, countries sometimes withhold meaningful compliance despite the existence of a treaty. In some cases, the existence of an MLAT is even used as a shield to obstruct normal cooperation with law enforcement. In one recent case a financial institution with offices in New York and Switzerland transferred accounts from New York to Switzerland, to conceal the distribution of funds. When we issued a subpoena for the records, the institution insisted that we proceed by way of Treaty.

Where there is compliance under an MLAT, the process is often much too slow to be helpful. It routinely takes a year and often much longer to obtain critical bank records and other evidence. This is a significant problem, especially where funds, as they often are, have been funneled through companies and bank accounts in several jurisdictions, requiring MLAT applications to several jurisdictions to trace a single transaction. As time passes, leads dry up, suspects and witnesses disappear and statutes of limitations continue to run.

Finally, the treaties themselves are often inadequate, as when they do not provide for the exchange of information for all tax crimes. As the cases I have cited illustrate, tax crimes are often intertwined with other serious offenses such as securities fraud and bribery. Furthermore, in the early stages of an investigation, when bank records and other documentary evidence may be all we have to go on, it is often impossible to tell exactly what crimes have been committed. For that reason, treaties which exclude significant offenses, such as tax evasion, can prevent an investigation of serious crimes from ever getting underway.

In part because of the inadequacy of the MLAT procedures, we have had only very limited success in making criminal cases involving tax havens and secrecy jurisdictions. In some cases, like BCCI, we have succeeded by virtue of personal diplomacy, in other cases by fortuitous contact with a sympathetic off-shore official.

But all too often, we just have to get lucky. For example, in the Brazilian debt case, a key witness who had managed the shell companies in Antigua was willing to cooperate because he had relocated to England. We also discovered computer records when we searched the defendant's house. In the Kimes murder case, the defendants happened to keep wire transfers and other bank records in their Lincoln Town Car, which was seized by the police. But law enforcement should not have to rely on diplomacy, a fortuitous personal connection or good luck to make these cases.

There have been signs in some recent cases of real progress toward cooperation in a few formerly uncooperative off-shore jurisdictions. One such case involved Robert Brennan of First Jersey Securities, whom federal law enforcement officials have been pursuing for 25 years for assorted financial crimes. These efforts were unsuccessful until Brennan filed for bankruptcy to avoid a civil judgment the Securities and Exchange Commission won against him in 1995. Brennan had several million dollars concealed in accounts on the Isle of Man which he did not disclose to the bankruptcy court. He also had $22 million in three asset protection trusts, one of which, the Cardinal Trust, he directed to be moved, first to Mauritius and then to the island of Nevis during the course of the bankruptcy proceedings.

In 1999 my office started to deal with authorities on the Isle of Man, to gather evidence in connection with several securities fraud cases we were working on. The Manx authorities were quite helpful, and using available legal processes we were able to obtain evidence against several people, including Brennan. By the spring of 2000, we obtained court orders on the Isle of Man directing one Peter Bond, who managed Brennan's off-shore companies and served as director of one of the corporate trustees, to give evidence; Mr. Bond then agreed to come to the United States and testify. The United States Attorney's Office in New Jersey, using that evidence and other proof convicted Brennan, who is scheduled to be sentenced next week.

The Manx cooperation, like that of Jersey and Guernsey officials in other cases, has been invaluable in bringing criminal charges against American swindlers stealing from Americans. More such cooperation is needed.

But progress in this area has been much too slow; we may even be going backwards. As one off-shore jurisdiction attempts to reform, the bad guys simply look for another -- and they are all too easy to find. Just last week, my office secured indictments in a $6 million fraud in the export of meat products from the United States to Russia, in which a Russian-owned company incorporated in the Island of Niue played an important role. Niue, for those, like me, who are unfamiliar with it, is a tiny Polynesian atoll with a population of 1800; it is described

in the internet literature as a "self-governing territory in free association with New Zealand."

Obviously, there is much work to be done to get the off-shore genie back in the bottle.

I have long maintained that you cannot fight "crime in the streets" without also fighting "crime in the suites," which is to say white-collar crime. To be credible the law must be enforced without fear or favor. To do so, in today's interconnected world, law enforcement in the United States, including state and local prosecutors, needs access to critical evidence wherever it may be physically located. There must be a legal mechanism to require the production of off-shore records on a reasonable and timely basis for all serious crimes, including tax crimes.

Make no mistake about it, tax fraud and evasion are serious crimes. As Justice Oliver Wendell Holmes said, "Taxes are what we pay for a civilized society." We must see to it that everyone pays his or her fair share of the taxes mandated by federal and state legislation. In a democracy such as ours, where we rely largely on voluntary compliance with the tax laws, the tax system must not only be fair, it must be perceived as fair.

Only two days ago, the Financial Times reported a complaint by the deputy speaker of the assembly in the Caymans that, "It's the poor who pay taxes in this country." In the Caymans there are no income, capital gains, corporations, inheritance or sales taxes, but most food is taxed at 20 percent. In a more cynical vein, a notorious New York tax delinquent once observed that "only the little people pay taxes." We cannot afford to allow that cynical view to become accepted wisdom in this country.

Tax havens which rely on bank and corporate secrecy are knowingly assisting customers of theirs to commit tax fraud; lawful tax shelters do not need to be kept secret. We need to make certain that there is a free exchange of accurate information between these nations and the U.S. I am not

advocating the indiscriminate disclosure of financial information on a wholesale basis, but rather the disclosure of specified information to appropriate tax and prosecuting authorities where they have reason to request it. That is the same basis on which disclosure of bank information is made to tax authorities and criminal investigators in the U.S.

Of course, it is not only enforcement of the tax laws that requires access to information from abroad. Last year, New York enacted a strong money laundering statute. We need access to off-shore records to make this law effective against the money brokers that service drug dealers and their foreign suppliers and generate cash to bribe Wall Street stockbrokers.

What is at stake here is not just the ability of the police and prosecutors to make a few more criminal cases. Criminal conduct can have far-reaching consequences. In the early 1990's, Venezuelan bankers used as many as 3500 off-shore corporations, in Aruba, Curacao and elsewhere, to loot banks in Venezuela, resulting in the collapse of one-half of the banks in that country, with predictably disastrous effects for the nation's economy.

The unfairness of allowing some citizens to avoid paying their fair share of taxes erodes confidence in the tax system and the voluntary compliance on which the system is based. In addition, permitting some businesses to gain unfair tax advantages in off-shore venues destroys the level playing field on which our system of free enterprise depends.

The absence of responsible supervision in off-shore jurisdictions also encourages players in the financial markets to engage in reckless behavior which, as the near-collapse of Long Term Capital taught us, will likely have disastrous consequences for our domestic financial institutions and the economy if we do not do something to control such activities. The recent failure of just two such funds, Manhattan Capital and Evergreen Security, Ltd., has cost investors
$500 million.

Finally, and perhaps most important, the obvious inequity of a system that allows certain individuals and

companies to hide their financial affairs in off-shore havens undermines respect for government and the rule of law.

This is too important a matter to be left to the desultory ways of authorities in these off-shore jurisdictions. The United States, in cooperation with other OECD countries, must explore and implement effective measures to break down the culture of secrecy and obstruction that prevails in the tax havens. Legislation or regulations that made doing business in off-shore jurisdictions less attractive and profitable for U.S. taxpayers might have salutary effects, as would stricter oversight of financial institutions that do business with off-shore entities. In extreme cases, we should consider denying U.S. correspondent banking services to financial institutions in intransigent off-shore jurisdictions.

Certainly, more aggressive enforcement of the tax laws against off-shore hedge funds and limited partnerships would be a sound first step to restoring confidence in the fairness of the American tax system. It might even bring some of that $800 billion in the Caymans back to our shores.

Department of Justice

STATEMENT

OF

MICHAEL CHERTOFF
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE THE

PERMANENT SELECT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

CONCERNING

FOREIGN TAX HAVENS AND MONEY LAUNDERING:
LAW ENFORCEMENT PERSPECTIVE

PRESENTED ON

JULY 18, 2001

Testimony of Michael Chertoff
Assistant Attorney General, Criminal Division
United States Department of Justice
on July 18, 2001

Before the Permanent Subcommittee on Investigations
of the
Committee on Governmental Affairs
United States Senate

Chairman Levin, Ranking Minority Senator Collins, members of the Subcommittee, I am pleased and honored to appear before the Permanent Subcommittee on Investigations in support of Secretary O'Neill's strong focus on international cooperation and transparency in the OECD tax haven process as these same principles apply to the important related and vital issue of money laundering. I am not here as a tax expert, but rather as a representative of law enforcement. In my position as Assistant Attorney General of the Criminal Division, and from my perspective as a long-time federal prosecutor, I appreciate the opportunity afforded by this Subcommittee to provide some thoughts and insights on Justice and Treasury's fight against money laundering from the law enforcement perspective.

As the members of this Subcommittee are well aware and, indeed, have played a significant role in publicizing, money laundering constitutes a threat to the safety of our communities, to the integrity of our financial institutions and to our national security. The members of this Senate Subcommittee are to be credited for having done much to bring this critical issue before the public. In order to address this serious threat, we must apply and coordinate all the efforts and available resources of the federal government, along with those of our state and local authorities, as well as our foreign counterparts, if we are to be effective in our campaign against domestic and international money launderers. For this reason, I am pleased to

appear with Secretary O'Neill to demonstrate the commitment of this Administration to fighting this battle. The Department of Justice is fully committed to using our money laundering statutes to the fullest extent possible to identify, investigate, and prosecute those who would launder the illegal proceeds of drug traffickers, fraud perpetrators, organized crime groups, international terrorists and other criminals, and to seize and forfeit their ill-gotten assets.

Threats Posed by the Globalization of Crime

When the money laundering laws were first enacted in 1986, they were designed to address what was primarily a domestic problem. Since 1986, money laundering increasingly has become a global problem, involving international financial transactions, the smuggling of currency across borders, and the laundering in one country of the proceeds of crimes committed in another country. Currency, monetary instruments and electronic funds flow easily across international borders allowing criminals in foreign countries to hide their money in the United States, and allowing criminals in this country to conceal their illicit funds in any one of hundreds of countries around the world with scant concern that their activities will be detected by law enforcement.

These new opportunities for international money laundering have been seized upon by international organized criminal groups based in Russia, China, Italy, Nigeria and Japan, among other countries, who look upon globalization as an invitation to vastly expand the size and scope of their criminal activities – whether these organized criminal groups engage in narcotics trafficking, securities fraud, bank fraud and other white collar crimes, trafficking in people, as well as more traditional violent crime offenses, such as extortion and murders. With their expanded power and reach, international organized criminals seek to corrupt police and public

officials in countries around the world to protect their criminal enterprises and enhance their money-making opportunities. Foreign organized crime groups today threaten Americans, their businesses, and their property, as these groups work to expand their influence into this country.

The advent of new computer technology also offers new opportunities for criminal exploitation in the area of cybercrime. One area of particular concern is the emergence of Internet gambling businesses. Because the Internet allows instantaneous and anonymous communications that are difficult to trace to a particular individual or organization, the medium is attractive to organized crime and other bad actors. Criminals wanting to launder illegally-received profits can do so through the anonymity of Internet casinos, which typically exercise little control over money movement through their facilities, and make it difficult to identify and locate exactly which jurisdiction has authority over their activities. In addition, cybercriminals may also launder money through the use of "e-cash" and "smart card" manipulations that allow transactions on Internet gambling, as well as on other websites. Given the anonymous nature of these operations, law enforcement officials are severely hampered in their efforts to detect and prevent crimes being committed by unknown and untraceable persons.

In this kind of environment, law enforcement is challenged to the utmost. The criminals hold the advantage in almost every respect. Criminals are able to adapt to changing circumstances quickly. They pay no heed to the requirements of laws and regulations and recognize no sovereign's borders. Further, these criminal groups have learned to be adaptable and innovative and as we succeed in a new enforcement effort or implement a new regulatory regime, they quickly alter their methods and modes of operation to adapt to the new circumstances.

The Money Laundering Statutes

The challenges facing law enforcement in this environment make it necessary that our investigators and prosecutors have all of the legal and regulatory tools, as well as international legal assistance mechanisms they need to keep up with and ahead of those who launder the proceeds of crime. Consequently, the message I wish to convey today is that we need, and are committed to using, all of the legal and regulatory tools we have at our disposal today as we seek to keep up with this challenge. Moreover, some of these tools, such as our money laundering statutes themselves, need to be updated in order to keep pace with the globalization of commerce and crime. I look forward to working with you during my term in office to update those laws, especially with respect to how they operate in the international money laundering arena.

The money laundering statutes which Congress has provided for us, both in the Bank Secrecy Act and the Criminal Code, are major weapons in our war against the laundering of proceeds of drug trafficking and other serious crimes. Over the past five years, the Department of Justice has prosecuted more than 2,000 defendants each year for violations of those statutes. Approximately 50 percent of these cases involve the proceeds of drug trafficking. The remainder involve the proceeds of white collar crimes, such as health care fraud and telemarketing fraud, as well as the proceeds of organized crime activity such as prostitution, gambling and extortion. These money laundering statutes carry substantial sentences and also include forfeiture provisions that are used to forfeit the profits made and property traceable to this criminal activity.

The Importance of Regulatory and Reporting Requirements

Merely criminalizing financial crimes and money laundering, however, is not enough. Any nation serious about detecting, investigating, targeting and prosecuting these crimes, and

seizing and forfeiting the proceeds and instrumentalities of such criminal conduct, must establish a record keeping and reporting regime, commensurate with the nature of that nation's financial crimes and money laundering activities, to ensure that financial information revealing suspected criminal abuse of financial systems is made available in a timely manner to law enforcement and regulators.

The recording and reporting are triggered by the would-be criminal's activities, and serve the purpose not only to alert federal, as well as state and local law enforcement to these potentially criminal activities, but also to protect the safety and soundness of the reporting institutions themselves. No legitimate financial institution wants to facilitate the receipt or movement of illicit proceeds.

Large value reporting such as the $10,000 Currency Transaction Report (CTR) and the Currency and Monetary Instruments Reports (CMIR) drive cash-based money launderers to "smurf" their illicit currency in amounts below the reporting requirements and to smuggle the currency in every conceivable conveyance and product. Utilizing these CTRs and CMIRs, law enforcement has targeted illicit cash that moves directly into the U.S. financial system.

Money laundering schemes are successful as long as they go undetected. Without Suspicious Activity Reporting, which is used for reporting suspected currency transactions and suspected financial crime, a substantial amount of financial crime and money laundering would not come to the attention of law enforcement. Suspicious Activity Reports (SARs) are filed for individual suspicious financial transactions, but following the leads provided in SARs allows law enforcement to identify both abuse of financial institutions to launder money and eventually the underlying criminal activity. Without those leads, much of that activity would continue

unchecked. Whatever the nature of the underlying criminal activity, the entities in the best position to enable law enforcement to "notice" this criminal activity are the financial institutions with whom the money launderers are forced to deal. These SARs have become an invaluable tool for our law enforcement agencies to target criminals and uncover money laundering schemes, and we are getting better every day, especially with enhanced computer capabilities, in making effective use of these SARs. Examples of law enforcement's successful use of SARs can be found in FinCEN's two editions of the "Review of the Suspicious Activity Reporting System."

The Importance of International Cooperation in Fighting Money Laundering

Of course, all of our efforts in the United States to detect and prevent money laundering are rendered moot if criminals can simply smuggle their illegal proceeds in bulk into another country and deposit the proceeds into the banking system of that country, and thereby into the international financial system, with impunity. That is why there must be no break in the chain of effective anti-money laundering regimes around the world. It is therefore critical that the United States work on the bilateral and multilateral levels to promote effective anti-money laundering regimes in other countries. All these regimes must include the criminalization of money laundering and an effective regulatory and reporting regime with effective bank supervision. They must also provide for the timely exchange of financial information between countries. We must work to ensure that there are no safe havens for dirty money and that communication and cooperation among law enforcement authorities around the world work easily and well.

The Criminal Division works extensively to provide assistance to countries intent on improving their money laundering and asset forfeiture laws and enhancing their enforcement programs. Nevertheless, while many jurisdictions do not have the proper anti-money laundering

statutes and regulations in place, the U.S. Government, on its own, cannot compel the necessary changes. It is by working in concert with our international partners that together we are able to promote greater and greater compliance and thus, in the end, will be able to disrupt the flow of criminal proceeds around the globe and deprive criminal organizations of their accumulated wealth.

In order to promote this international mandate, the Department of Justice joins with the Departments of the Treasury and State to play a leading role in the G-7 Financial Action Task Force against Money Laundering (FATF). In addition to adopting and promoting the 40 Recommendations on Money Laundering, which have become the global standard for an effective anti-money laundering regime, the FATF last year implemented its initiative on "Non-Cooperative Countries and Territories" (NCCT), in order to spotlight publicly those jurisdictions with the highest levels of money laundering and the weakest anti-money laundering legal and regulatory framework. Last year, the FATF identified 15 jurisdictions[1] as being "noncooperative" in money laundering matters. At that time, the Department worked with the Treasury Department and other federal regulators on the drafting of FinCEN Advisory warnings explaining in detail the shortcomings relating to these 15 jurisdictions. Last month, the FATF removed four countries (the Bahamas, the Cayman Islands, Liechtenstein and Panama) from the list because of the substantial steps they have taken to improve their anti-money laundering regimes. But, at the same time, six new countries (Burma. Egypt, Guatemala, Hungary, Indonesia and Nigeria) were added to the list.

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[1] The fifteen jurisdictions were the Bahamas, the Cayman Islands, the Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, the Marshall Islands, Nauru, Nieu, Panama, the Philippines, Russia, St. Kitts and Nevis, and St. Vincent and the Grenadines.

This multilateral effort has proven to be successful in focusing the world's attention on countries that do not have adequate standards in anti-money laundering enforcement and inspiring named countries to address their shortcomings in this area. In fact, the NCCT exercise has been uniquely successful and the most important international anti-money laundering development since the promulgation of the 40 Recommendations and the beginning of the FATF's mutual evaluation program ten years ago. This effort has changed the way the world fights money laundering - eleven countries changed some or all of their laws in response to the NCCT list in less than a year - and it will continue to have the same impact as we go through the second round. The Department is proud to play a significant role in this and other FATF endeavors.

Conclusion

I would like to conclude by expressing the gratitude of the Department of Justice for the continuing support that this Subcommittee has demonstrated for our anti-money laundering activities. The Department believes that we must continue to strengthen our anti-money laundering laws, not only to fight drug trafficking but also to fight terrorism, white collar crime and all forms of criminal activity which generate or utilize illegal proceeds. Again, we in the Department of Justice look forward to working alongside our Treasury colleagues with this Subcommittee and with your colleagues in the Senate and the House in making our shared vision of anti-money laundering a strong and effective reality.

I would welcome any questions you may have at this time.

STATEMENT
OF
DONALD C. ALEXANDER
BEFORE
THE UNITED STATES SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
JULY 18, 2001

As a former IRS Commissioner, I am here to express my personal views about the U.S. position on the tax haven project of the Organization for Economic Cooperation and Development (OECD).

As I understand it, the OECD created the Forum on Harmful Tax Competition in 1998. Part of the OECD initiative was directed at "harmful preferential tax regimes" and the other part at tax havens. As to the first segment, OECD would assist governments to cope with regimes engaging in practices that "attract investment or savings originating elsewhere and when they facilitate the residents legally escaping tax in their home country." The Forum evaluated these preferential tax regimes and determined whether they would be considered "harmful preferential tax regimes" based on some combination of the following characteristics: (a) no or only nominal effective tax rates, (b) lack of effective exchange of information, (c) lack of transparency, and (d) absence of a requirement of substantial activities. Regimes fitting these criteria might become the target of economic sanctions by the OECD if they did not agree to cooperate.

The OECD's June, 2000 report of its progress in countering harmful tax regimes and tax havens stated specifically that its project "is not primarily about collecting taxes and is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates." This seems to be a good place to draw the line. The OECD should not dictate to any country what type of tax system the country should have (*e.g.*, income tax, value added tax, retail sales tax,

property tax) nor what the tax rates should be. If Country A chooses to impose a heavy burden of taxation upon its citizens, it should have no right, nor should the OECD attempt to assert any such right, to insist that Country B's citizens should be subjected to a similar burden. As Secretary O'Neill stated: "And we will not interfere in other people's tax systems." (*Business Week*, June 25, 2001, at 39.)

Nevertheless, the OECD's year 2000 report, like its description of the 1998 Forum, did not limit its concerns to havens and harmful tax practices, but instead expressed detailed concerns about certain features of tax laws considered to have the potential to constitute "harmful tax competition". One of the listed features was the foreign sales corporations provisions of the U.S. Internal Revenue Code. Concerns like this can be appropriately viewed as interfering with a particular country's structure of taxation; "harmful tax competition" might be viewed by a high-tax country as any system that produces a lesser burden than its own. The OECD should be slow to condemn Country A's tax policies that promote investment and economic growth, even though Country A's laws are less burdensome than those of competing Country B.

Having said that, I strongly support OECD's efforts to cope with the serious threat that tax havens pose to effective enforcement of U.S. tax laws. I am glad that the OECD has made meaningful progress in dealing with harmful tax practices of tax haven countries. A number of countries have made commitments to cooperate and to change their practices and, if necessary, their privacy laws, to help OECD members and the United States curb evasion through offshore accounts and money laundering. Secretary O'Neill is right. "We will do everything to collect every dollar owed under our tax laws by working in cooperation with other countries. . . . We want all the information that's necessary to ensure that our tax laws are fully enforced." (*Business Week*, June 25, 2001, at 39) We should advocate, not impede, the OECD tax havens project.

If a tax haven country's practices or laws should prevent the United States from obtaining the information necessary to ensure that U.S. laws are fully enforced, such practices or laws should be changed to remove this obstacle. Frankly, I have difficulty understanding apparent views to the contrary that seem to have been expressed by certain Members of Congress. Should a tax evader's "right of privacy" prevail over the duty of all U.S. citizens to comply with U.S. tax laws? Should secreting money in a tax haven country give more protection to a would-be U.S. tax evader than hiding the money under the mattress? As a former U.S. tax collector and a long-time U.S. taxpayer, I don't think so.

The Chairman's June 29, 2001, letter raised a number of specific questions. My brief responses are as follows:

1. In my experience, the United States has long encountered great difficulties in attempting to enforce the U.S. tax laws when offshore tax havens are involved. The U.S. has long pushed for tax treaties and agreements providing for exchange of necessary information, and it should continue and strengthen its efforts in this respect. It badly needs the cooperation of tax haven countries, particularly those in the Caribbean, and sporadic enforcement efforts by using informants and sting operations were troublesome and ineffective years ago and, I believe, remain troublesome and ineffective.

2. As stated above, I think the OECD tax haven project has made meaningful progress and should continue to do so. This part of the OECD overall initiative serves our national interest and should be endorsed and supported.

3. While, as stated above, I can understand concerns about the OECD's "harmful tax competition" initiative, I do not think that the recent criticism of the OECD tax haven project itself is well founded. It seems to be based upon extreme libertarian notions founded in anti-government

bias, and it even seems to claim that the United States tax system is territorial (or should be territorial) when it is not. Since 1913 U.S. citizens have been taxed on their worldwide income, and unless and until this tax system is abandoned, it should be enforced.

4. I am sorry to see delays in the OECD tax haven project, particularly the long delay in implementing sanctions. I hope there are no further delays.

5. a. I think the United States should continue to support requiring offshore tax havens to exchange information for civil and criminal tax enforcement purposes, and I believe that our current exchange of information agreements provide a generally useful framework.

b. I think the United States should continue to support requiring offshore tax havens to improve transparency, having in mind the current debate about transparency when offshore funds are placed in the United States. It is hard for us to ask more of others than we are willing to grant them.

c. As to defensive measures against uncooperative offshore tax havens, I think we want to move carefully. Again, I do not think we should undermine OECD efforts and we should be supportive of firm, but not harsh, measures.

Senate Permanent Subcommittee
On Investigations
EXHIBIT # 1

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

June 7, 2001

Dear Colleagues:

It was a pleasure to see you at the G-7 Ministerial at the Blair House in April. I felt that we were able to build further on the solid foundation for productive dialogue and cooperation that we established in Palermo. Since our last meeting, I have completed a thorough re-evaluation of the OECD initiative to address harmful tax practices and have stated publicly my views on that project. Therefore, I wanted to write to you directly to convey my thoughts on this important matter.

As I expressed in my recent public statement regarding the OECD initiative, it is critical that we enforce our tax laws as written because failing to do so undermines the confidence of honest taxpayers in the fairness of our tax system. With respect to the United States, where a taxpayer is suspected of evading the U.S. tax laws through the use of offshore entities or secret bank accounts, we sometimes need information from another country to address that situation. The same is true for other countries. In this regard, the development of a framework for reaching information exchange agreements with countries that have shown little interest in cooperating in this regard in the past will be valuable. The proposals by the OECD to promote adequate record keeping and legal mechanisms for effective information exchange when necessary in specific cases contribute to the development of such a framework.

Other aspects of the OECD initiative, however, go beyond what is necessary to enforce our respective tax laws. The OECD initiative implicates low-tax regimes that may be designed to encourage foreign investment but that have nothing to do with evasion of any other country's tax law. Countries must be free to adopt tax policies that encourage investment and promote economic growth. We should not interfere in any other country's decision about how to structure its own tax system when that system does not serve as an obstacle to enforcing our own tax laws.

As my public statement indicates, I want to refocus the OECD initiative on its core element: the need for countries to be able to obtain specific information from other countries upon request in order to enforce their respective tax laws. Representatives of the United States expressed these concerns regarding the need to refocus the project to your representatives at a technical-level OECD meeting in early May, and plan to continue discussions regarding this objective at technical-level OECD meetings later this month.

As a result of these discussions, I hope that a refocused OECD initiative could emerge and proceed with the same spirit of cooperation and common purpose that characterizes other G7 initiatives, such as our anti-money laundering efforts. We strongly support the ongoing work of the FATF and look forward to continued progress in the fight against money laundering.

I look forward to discussing with you the progress of these discussions, and a variety of other issues, at our meeting in Rome in July.

Sincerely,

Paul H. O'Neill

To: Ministers Brown, Eichel, Fabius, Martin, Shiokawa, and Visco

Senate Permanent Subcommittee
On Investigations
EXHIBIT #_____2_____

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
May 10,2001
PO-366

TREASURY SECRETARY O'NEILL STATEMENT ON OECD TAX HAVENS

Treasury Secretary Paul O'Neill made the following statement on OECD tax havens:

Recently, I have had cause to re-evaluate the United States' participation in the Organization for Economic Cooperation and Development's working group that targets 'harmful tax practices.' Following up on the thoughts I shared with my G7 counterparts at recent meetings, I want to make clear what is important to the United States and what is not.

Although the OECD has accomplished many great things over the years, I share many of the serious concerns that have been expressed recently about the direction of the OECD initiative. I am troubled by the underlying premise that low tax rates are somehow suspect and by the notion that any country, or group of countries, should interfere in any other country's decision about how to structure its own tax system. I also am concerned about the potentially unfair treatment of some non-OECD countries. The United States does not support efforts to dictate to any country what its own tax rates or tax system should be, and will not participate in any initiative to harmonize world tax systems. The United States simply has no interest in stifling the competition that forces governments - like businesses - to create efficiencies.

In fact, the Administration is actively working to lower tax rates for all Americans. After reducing our tax burden, we will turn our attention toward reforming our system to make it simpler and more efficient. On these principles the United States remains firm.

When I took my oath of office as Secretary in January, I pledged faithfully to execute the laws of the United States. In its current form as established by Congress, the U.S. tax code generally taxes income on a worldwide basis. We have an obligation to enforce our tax laws as written because failing to do so undermines the confidence of honest taxpaying Americans in the fairness of our tax system. We cannot turn a blind eye toward tax cheating in any form.

That means pursuing those who illegally evade taxes by hiding income in offshore accounts. In today's world of instant information on the Internet, offshore bank accounts are no longer an obscure perk of the very rich. Just type in "offshore brokerage account" in any Internet search engine. The number of sites offering easy, affordable, secret offshore brokerage accounts for investing in U.S. stocks is astonishing.

As one Internet site advertising offshore brokerage accounts in Dominica boasts, "U.S. stocks, bonds, options, currencies and mutual funds are frequently bought through offshore companies because they are

not liable to U.S. capital gains taxes." Consider just how unfair this is to law abiding U.S. investors who invest in U.S. stocks and pay taxes. The tax evading U.S. investor, investing in the very same U.S. stocks through a secret offshore account, does not.

Anyone who doubts that the U.S. needs information from offshore tax havens in order to prosecute tax evaders need look no further than the case of John Mathewson. Mathewson ran a bank in the Cayman Islands. When shut down in 1995, Mathewson had over 1,000 customers and, according to Mathewson, 95% of his customers were U.S. citizens. With Mathewson's cooperation, the IRS obtained tax evasion convictions on, and collected substantial back taxes from, over 20 of Mathewson's clients. These cases were made possible because of Mathewson's extraordinary cooperation. Without it - and without any tax information exchange agreement with the Cayman Islands - this large-scale illegal tax evasion would have gone unpunished.

To enforce our tax laws, we must have a multi-prong strategy. If the United States believes that a particular U.S. taxpayer is illegally evading the U.S. tax laws through the use of offshore entities or secret bank accounts, the United States must make every effort on our own to obtain the necessary information to enforce the U.S. tax laws. In addition, the United States has negotiated individual treaties or agreements with over 60 countries so it can obtain needed information in cases of tax evasion. Finally, in appropriate circumstances, organizations like the OECD can be used to build a framework for exchanging specific and limited information necessary for the prosecution of illegal activity. We do - and will - guard against over-broad information exchanges in which foreign governments seek information for improper purposes or without proper safeguards. We cannot tolerate those who cheat on their U.S. taxes by hiding behind a cloak of secrecy.

Where we share common goals, we will continue to work with our G7 partners to achieve these goals. The work of this particular OECD initiative, however, must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information from other countries upon request in order to prevent the illegal evasion of their tax laws by the dishonest few. In its current form, the project is too broad and it is not in line with this Administration's tax and economic priorities.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #____3____

TREASURY NEWS

FROM THE OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
February 17, 2001
PO-40

**STATEMENT BY TREASURY SECRETARY PAUL H. O'NEILL
AT THE POST G-7 PRESS CONFERENCE**

Good evening. I want to begin by noting how much I have enjoyed meeting my colleagues and how much I appreciate the productive and thought-provoking discussions we have had today. Coming together to share ideas and discuss key issues that we all face is indeed an important and useful opportunity. We live in a global economy in which developments in one country affect others, and thus it is important to work closely together - in the G-7 in particular - to promote common goals.

Although world growth has slowed somewhat, we agreed that the fundamentals for sustained growth remain in place and that macroeconomic and structural policies need to focus on supporting growth. My colleagues were particularly interested in hearing about the U.S. economy and our policies. We noted that policies in Europe need to focus on enhancing growth potential, and we shared concern about remaining downside risks in Japan.

On exchange rates, let me repeat for you what we said together:

- "We discussed developments in our exchange and financial markets. We reiterated our view that exchange rates among major currencies should reflect economic fundamentals. We will continue to monitor developments closely and to cooperate in exchange markets as appropriate."

Finance Minister Kudrin and Central Bank Governor Gerashenko joined us to discuss Russia's economic policy priorities. Together, the G-7 urged the Russian authorities to step up the process of economic reform and meet in full their financial obligations. As they face the task of reform, we underscored the importance of creating the policy, regulatory and legal infrastructure necessary to make market economies work. We also urged Russia to move quickly to take action against money laundering, as outlined by the Financial Action Task Force (FATF) in June 2000.

We took note of recent progress under the HIPC debt initiative and indicated the importance of a broader approach to poverty reduction - an issue that we will focus our attention on as we prepare for the Genoa Summit. We also recognized progress and looked forward to further steps to strengthen the international financial architecture, including the need to do a better job in anticipating and preventing crises. In particular, we discussed the key priorities for reform of the multilateral development banks - greater selectivity, sharper focus on the needs of the poorest countries, more effective and transparent internal governance and enhanced development impact. This issue will be a key focus when we next meet in Washington in April.

Finally, we reviewed developments in our shared effort to fight financial abuse. We look forward to

continued steps by identified jurisdictions to undertake needed reforms and urged the IMF and World Bank to help countries implement relevant anti-money laundering standards. At the same time, we reiterated our commitment to implement coordinated countermeasures in cases in of ongoing non-cooperation, based on recommendations by FATF. We also reaffirmed our support for efforts to address harmful tax practices. While I indicated to my colleagues that certain aspects of these efforts are under review by the new Administration, I support the priority placed on transparency and cooperation to facilitate effective tax information exchange. At the same time, it is critical to clarify that this project is not about dictating to any country what should be the appropriate level of tax rates.

Again, I found today's discussion very useful, and I look forward to working closely with all my G-7 colleagues.

Attachment:

Statement of G7 Finance Ministers and Central Bank Governors

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___4___

1800 M Street, N.W.
Washington, D.C. 20036-5869
202.467.7000
Fax: 202.467.7176

Morgan, Lewis
& Bockius LLP
COUNSELORS AT LAW

Sheldon S. Cohen
202.467.7300
sscohen@morganlewis.com

June 7, 2001

The Honorable Paul H. O'Neill
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary O'Neill:

On behalf of a number of former Commissioners of Internal Revenue, I am forwarding the attached letter regarding your recent statement on tax havens in the May 10 issue of *The Washington Times*.

Sincerely,

Sheldon S. Cohen

SSC/bsj
Enclosure

June 7, 2001

The Honorable Paul H. O'Neill
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary O'Neill:

As former Commissioners of Internal Revenue, we are writing to express concerns about the possible impact on tax administration of your statement as reported by the Washington Times on May 10.

That statement suggests that the OECD project in its current form runs counter to the Administration's efforts to lower U.S. tax rates and that it might be a concealed attempt to harmonize world tax systems. The statement also indicates a belief that the project improperly dictates to tax havens how they should structure their tax systems. The statement expresses support for exchange of information "necessary for the prosecution of illegal activity," but finds the OECD project to be "over-broad."

There is nothing in the OECD publications on the project that suggests any intention to harmonize or raise tax rates. In fact, the OECD's own report on the project issued in June 2000 explicitly agrees with much of your statement. The executive summary states that the project is "not intended to promote the harmonization of income taxes or tax structures generally within or outside the OECD nor is it about dictating to any country what should be the appropriate level of tax rates."

The reality of existing tax structures within OECD makes clear that these words are not just empty rhetoric. Tax structures in OECD member countries are far too diverse to assume some hidden agenda of raising or harmonizing tax rates. Germany, for instance, completely exempts its citizens from tax on most capital gains. The Netherlands has just introduced a new tax on investment income that is based on an imputed return of 4 percent on net assets. On the corporate tax side, rates range from 40.17% in Belgium to 20% in Ireland and 18% percent in Hungary. The average EU tax rate is about 6% lower than the typical combined U.S. Federal and state tax rate.

It is true that the OECD project has sought to end practices by some tax havens to advertise specific non-regulated and tax-free offshore regimes that can only be used by foreigners and that are carefully separated from the local economy (referred to as "ring fencing"). As a practical matter, however, for most tax havens this might not be much of an issue. For instance, numerous tax havens have no income tax at all and for that reason do not (and do not need to) ring fence their offshore regimes. If this is the only substantive U.S. concern, it can surely be resolved in consultation with our trading partners.

As you rightly state, effective enforcement of our tax laws requires access to information, and particularly to information reflecting tax evasion. Exchange of information has wide bipartisan support. While the reported statement has been presented as a reversal of the position endorsed by the Clinton Treasury, it is worth recalling that the Reagan administration first initiated efforts to sign up some of the same tax havens in the Caribbean for an exchange of information similar to the exchange of information of the current OECD project. The statement in the Washington Times hardly helps in achieving this goal:

- Decision-makers in the nine tax havens that have already made a commitment to the OECD project have been embarrassed and might come under intense political pressure to withdraw from the project.

- With wavering U.S. support for the project and an uncertain response from the other OECD member states, tax havens that were close to making a commitment will stay put. This is especially true where White House officials are reported in the press as saying that there was "no purpose" in pursuing the project at all.

Ultimately, we believe that there is a much better chance persuading tax havens to agree to exchange of information if we stick with our trading partners. Since 1984 one Democratic and two Republican administrations have attempted to get countries in the Caribbean and elsewhere to agree to exchange of information. Despite intense political pressure and various carrots and sticks most of the key countries have refused to sign up. Some of the countries (e.g., Cayman Islands) that for more than 15 years resisted the efforts have, within the last year, agreed to co-operate with the OECD.

The Caribbean is in a region where the U.S. holds most sway. With increasing globalization and the use of internet, U.S. taxpayers seeking to evade U.S. taxes will have an increasing ability to transfer assets to tax havens further afield. These tax havens are even less likely to bend to U.S. unilateral pressure. Conversely, they may well co-operate where 30 OECD countries, some of which have close historical ties in addition to geographical proximity, act in concert.

We need to resolve our differences with our trading partners. We need to find a solution that is acceptable to both the United States and the other OECD countries involved. The reported comments have been misread to evidence a greater substantive divide than in fact exists. We have never been closer to cracking down on tax abuse through the use of tax havens and that

is especially important to the United States. Therefore, we urge you to engage in constructive dialogue with our trading partners. We need this project for one very simple reason: our own tax and economic interest.

Should you or your staff wish to consult with us on these matters, we would be pleased to do so.

Sincerely,

Sheldon S. Cohen
Donald C. Alexander
Mortimer M. Caplin
Jerome Kurtz
Margaret M. Richardson
Randolph W. Thrower
Johnnie M. Walters

c: The Honorable Mark Weinberger
The Honorable Charles O. Rossotti

Senate Permanent Subcommit
On Investigations
EXHIBIT # 5

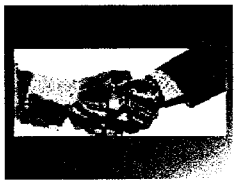
2000 OECD List of Offshore Tax Havens

- Andorra
- Anguilla
- Antigua and Barbuda
- Aruba*
- Bahamas
- Bahrain
- Barbados
- Belize
- British Virgin Islands
- Cook Islands
- Dominica
- Gibralter
- Guernsey
- Grenada
- Isle of Man*
- Jersey
- Liberia
- Liechtenstein
- Maldives
- Marshall Islands
- Monaco
- Montserrat
- Nauru
- Netherlands Antilles*
- Niue
- Panama
- Samoa
- Seychelles*
- St. Christopher & Nevis
- St. Lucia
- St. Vincent and the Grenadines
- Tonga
- Turks & Caicos
- US Virgin Islands
- Vanuatu

*Has signed commitment letter to cooperate with tax inquiries, as have Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino, and is not expected to be included in the 2001 OECD List of Uncooperative Tax Havens.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #____6____

COMMITMENTS SOUGHT FROM TAX HAVENS



(1) Answer criminal tax inquiries by 2003

(2) Answer civil tax inquiries by 2005

(3) Improve transparency

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___7___

Number of U.S. Taxpayers Reporting Foreign Accounts and
Number of Offshore Banks and Companies in
35 OECD Tax Havens

Country	U.S. Taxpayer Filings of Foreign Accounts Totaling $10,000 or more*						Number of **	
							Offshore Banks	Offshore Companies
	Corporate	Fiduciary	Individual	Partnership	Unknown	Total		
Andorra			17	2	1	20	NA	NA
Anguilla	3		5			8	2	1,988
Antigua & Barbuda	6	2	70	6	3	87	26	12,000
Aruba	13		22		2	37	2	7,400
Bahrain	12		51	2	9	74	48	NA
Barbados	123	2	128	16	14	283	51	3,855
Belize	4	4	63	3	7	81	2	16,000
British Virgin Islands	35	1	129	8	12	185	13	360,000
Dominica			8		2	10	6	6,596
Bahamas	70	42	584	45	45	786	413	100,000
Cook Islands	1	18	22		1	42	25	1,230
Gibraltar	5	2	50		1	58	21	8,300
Grenada	4	3	77	2	5	91	16	2,200

*Source: U.S. Taxpayer Report of Foreign Bank and Financial Accounts, TDF 90-22.1, fiscal year 2000 data provided by the Internal Revenue Service.

** Source: U.S. Department of State, Bureau for International Narcotics and Law Enforcement Affairs, International Narcotics Control Strategy Report, March 2001

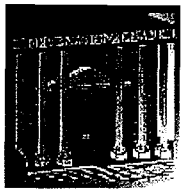
NA= Not Available

Prepared by U.S. Senate Permanent Subcommittee on Investigations, July 2001

Country	U.S. Taxpayer Filings of Foreign Accounts Totaling $10,000 or more*						Number of * *	
	Corporate	Fiduciary	Individual	Partnership	Unknown	Total	Offshore Banks	Offshore Companies
Guernsey	7	15	232	4	19	277	79	15,905
Isle of Man	3	9	605	9	46	672	10	24,300
Jersey	22	13	741	17	75	868	NA	20,000
Liberia	1		10		2	13	NA	NA
Liechtenstein	8	3	143	8	4	166	15	75,000
Maldives	1					1	NA	NA
Marshall Islands	4		6		2	12	0	4,000
Monaco	10	1	147	1	14	173	0	NA
Montserrat			12		1	13	15	22
Nauru	1	4	2			7	400	NA
Netherlands Antilles	42	1	232	10	18	303	42	20,919
Niue	4		21		1	26	5	5,500
Panama	40	1	267	3	31	342	34	372,667
Seychelles			2			2	NA	4,808
St. Christopher & Nevis	2	1	25	4	1	33	1	19,500

Country	U.S. Taxpayer Filings of Foreign Accounts Totaling $10,000 or more*						Number of **	
	Corporate	Fiduciary	Individual	Partnership	Unknown	Total	Offshore Banks	Offshore Companies
St. Lucia			12		2	14	1	100
St. Vincent & the Grenadines	1		7	2		10	28	11,000
Tonga			1			1	NA	NA
Turks & Caicos	11	1	30	3	1	46	8	27,000
U.S. Virgin Islands	88	15	602	12	92	809	NA	NA
Samoa (American & Western)	12		344	4	31	391	10	4,085
Vanuatu			7			7	55	2,500
Totals	533	138	4674	161	442	5,948	1,328	1,126,875

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___8_



Out of approximately 2000 accounts open in 1985, 95% of Guardian Bank's clients were U.S. citizens and virtually 100% were engaged in tax evasion.

–Testimony of John Mathewson, former owner of Guardian Bank & Trust Ltd. in the Cayman Islands, 3/1/01 hearing before U.S. Senate Permanent Subcommittee on Investigations

Senate Permanent Subcommittee
On Investigations
EXHIBIT # 9

Republic of Seychelles
Office of the Vice President

13th February 2001

Mr David Johnston
Secretary General
OECD
2 Rue André Pascal
75775 Paris Cedex 16
FRANCE

Dear Mr Johnston

COMMITMENT OF THE REPUBLIC OF SEYCHELLES

I am writing in connection with the OECD's project on Harmful tax Competition and the OECD's reports 'Harmful Tax Competition' and 'Towards Global Tax Co-operation' of 1998 and 2000.

In view of the above, I am pleased hereby to inform you that the Republic of Seychelles is committed to the elimination of harmful tax practices as determined by the Forum on Harmful Tax Competition.

We commit ourselves, in particular, to a programme of effective exchange of information in tax matters, transparency, and the elimination of ring-fencing of the regimes for financial and other services as outlined in the attachment to this letter. Our plan to achieve these international standards will be agreed with the Forum by 31st December 2001.

We understand that the OECD is prepared to assist us in establishing, improving, or maintaining such practices and procedures as are necessary to comply with this commitment.

The Government of the Republic of the Seychelles intends to release the substance of this letter and the attachment to financial and business press and other contacts and expect the OECD to publish them on the OECD's internet site.

Yours truly,

James A. Michel
VICE PRESIDENT

State House Avenue, P. O. Box1303, Telephone 225509, Telefax: 224985,
E-Mail:jmichel@seychelles.net

Republic of the Seychelles

Annex

This attachment outlines the measures that the Republic of the Seychelles will take on a phased basis by 31 December 2005. It describes as well stand-still, collateral and termination issues with respect to the commitment.

Terms & Timetable:

(A) By 31 December 2001:

Plan to achieve international standards: The Republic of the Seychelles will adopt a detailed plan indicating how, by 31 December 2005, it will achieve transparency and effective exchange of information for all tax matters, and eliminate any regimes that attract business without substantial business activity,

(B) By 31 December 2002:

Beneficial Ownership information available: The Republic of the Seychelles ensures that its regulatory or tax authorities have access to information regarding beneficial owners of companies, partnerships and other entities organised in its jurisdiction, including collective investment funds, and to information on the identity of the principal (as opposed to agent or nominee) of those establishing trusts (settlors) under their laws and those benefiting from trusts.

Financial Books & Records: The Republic of the Seychelles ensures that financial accounts will be drawn up in accordance with generally accepted accounting standards, and that such accounts will be either audited or filed for all entities (banks, insurance companies, collective investment funds and managers, trusts, foundations, etc.) organised or operating in the county (subject to de minimis exceptions for entities that are not engaged in offshore activities and do not have foreign ownership, beneficiaries, management, or other involvement). The Republic of the Seychelles ensures that there is access by its regulatory or tax authorities to such accounts.

(C) By 31 December 2003:

Effective Exchange of Information (Criminal tax matters): The Republic of the Seychelles will have in place a legal mechanism that allows information to be provided to the tax authorities of OECD countries upon request for the investigation and prosecution of criminal tax matters. This mechanism will include a means to ensure that information can be given to tax authorities of OECD countries in response to a request if the information may be relevant to the investigation of a criminal tax matter. The information eligible for exchange will include bank information and financial information as well as information on beneficial ownership.

In the case of information required for the investigation and prosecution of a criminal tax matter, the information will be provided without the requirement that the conduct being investigated would constitute a crime under the laws of the Republic of the Seychelles, if it occurred in the Republic of the Seychelles.

The Republic of the Seychelles will ensure that there is no impediment to the disclosure of any exchanged information to persons or authorities (including courts and administrative bodies) concerned with the enforcement or prosecution in respect of, or the determination of appeals in relation to, criminal tax matters.

Administrative practices will be in place so that the legal mechanism for exchange of information will function effectively and can be monitored. Personnel responsible to make sure that the requests for information are answered promptly and efficiently, and personnel trained or experienced in obtaining information will be at place.

Access to Bank Information: The Republic of the Seychelles will ensure that its regulatory or tax authorities have access to bank information that may be relevant for the investigation or prosecution of criminal tax matters.

Transparency of tax system: The Republic of the Seychelles will ensure that there are no non-transparent features of its tax systems, such as rules that depart from accepted laws and practices, secret rulings, or the ability of investors to "elect" or "negotiate" the rate of tax to be applied. To the extent rulings are given with respect to transfer pricing issues, such rulings will not deviate materially from the result under the OECD Transfer Pricing Guidelines.

Not attracting business without substantial domestic activity: The Republic of the Seychelles will remove any restrictions on the ability of entities qualifying for preferential tax treatment to do business in the domestic market.

(D) By 31 December 2005

Effective Exchange of Information (All tax matters): The Republic of the Seychelles will have in place a legal mechanism that allows information to be provided to the tax authorities of OECD countries upon request for the investigation and prosecution of criminal tax matters and for the determination, assessment, collection, and enforcement of all other tax matters (hereafter referred to as "civil tax matters"). This mechanism will include a means to ensure that information could be given to tax authorities of OECD countries in response to a request if the information may be relevant to a of a civil or criminal tax matter. The information eligible for exchange will have to include bank information, financial information, as well as information on beneficial ownership.

In the case of information requested for the investigation and prosecution of a criminal tax matter, the information will be provided without the requirement that the conduct being investigated would constitute a crime under the laws of the Republic of the Seychelles, if it occurred in the Republic of the Seychelles.

In the case of information requested in the context of a civil tax matter, the Republic of the Seychelles will provide the information without regard to whether or not the Seychelles has an interest in obtaining the information for its own domestic tax purposes.

The Seychelles will ensure that there is no impediment to the disclosure of any exchanged information to persons or authorities (including courts and administrative bodies) concerned with civil and criminal tax matters. Further, the information will have to be provided without regard to whether or not the Republic of the Seychelles has an interest in the information for its own tax purposes.

Administrative practices will be in place so that the legal mechanism for exchange of information will function effectively and can be monitored. Personnel responsible to make sure that the requests for information are answered promptly and efficiently and personnel that is trained or experienced in obtaining information will be at place.

Access to Bank Information: The Republic of the Seychelles will ensure that it's regulatory or tax authorities have access to bank information that may be relevant for civil and criminal tax matters.

Not attracting business without substantial domestic activity: For any preferential tax treatment accorded to financial and other services activities, the Republic of the Seychelles will remove any restrictions that deny the benefits of that preferential tax treatment to resident taxpayers, to entities owned by resident taxpayers, or to income derived from doing the same type of business in the domestic market.

(E) Stand-Still

The Republic of the Seychelles will refrain from

(i) introducing any new regime that would constitute a harmful tax practice under the OECD 1998 Report on Harmful Tax Competition;

(ii) with respect to any existing regime related to financial and other services that currently does not constitute a harmful tax practice under the OECD Report, modifying the regime in such a way that, after the modifications, it would constitute a harmful tax practice under the OECD Report; and

(iii) strengthening or extending the scope of any existing measure that currently constitutes a harmful tax practice under the OECD Report.

(F) Collateral Issues

List of Uncooperative Tax Havens: The OECD will refrain from including the name of the Republic of the Seychelles on any List of Uncooperative Jurisdictions, provided that the Republic of the Seychelles is proceeding in good faith to satisfy the terms and timetable of this Annex.

Defensive Measures: The OECD will refrain from recommending that any common framework of defensive measures (within the meaning of the 1998 Report) be implemented against the Republic of the Seychelles, provided that the Republic of the Seychelles is proceeding in good faith to satisfy the terms and timetable of this Annex.

Invitation to the Global Forum: The Republic of the Seychelles is invited to participate in the OECD's Global Forum on Taxation, which is developing a framework for a legal mechanism for exchange of information, provided that the Republic of the Seychelles is proceeding in good faith to satisfy the terms and timetable of this Annex.

(G) Termination prior to 31 December 2005

The Republic of the Seychelles shall have the annual option by advance written notice to the Chairman of the OECD's Committee on Fiscal Affairs to terminate the implementation of its commitment as outlined in this Annex as of 31 December of the given year.

Letter to Secretary O'Neill from Majority Whip Tom DeLay

Senate Permanent Subcommittee
On Investigations
EXHIBIT #10

MAJORITY WHIP TOM DELAY

Center for Freedom and Prosperity

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[PDF Version]

June 20, 2001

The Honorable Paul O'Neill
Secretary of the Treasury
Department of Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Dear Secretary O'Neill,

I am strongly opposed to the "information exchange" tax initiatives being promoted by the European Union (EU) and the Organization for Economic Cooperation and Development (OECD). These assaults on financial privacy and due process legal protection are driven by a desire to thwart international tax competition. But since the United States is the world's biggest beneficiary of tax competition, it makes no sense for America to participate in an endeavor that will undermine our competitive advantage in the global economy.

Tax competition promotes economic freedom by pressuring governments to implement lower tax rates -- much like what happened when President Reagan's tax rate reductions in the 1980s led to a global shift toward lower rates. Nations should have the right to maintain high tax rates, of course, but they also should bear the consequences. Under no circumstance, however, should they be permitted to interfere with the sovereign right of other nations to adopt attractive tax and privacy laws.

I intend to follow this issue closely, and plan to examine during the appropriations process whether Congress should continue to fund international organization that push policies that are contrary to America's national interests. I also will closely review whether various departments are misallocating resources by lending support to misguided initiatives sponsored by international bureaucracies.

I applaud you for your opposition to the OECD's so-called "harmful tax competition" initiative and I hope you will logically extend that opposition to the anti-privacy information exchange schemes being advocated by the OECD and EU. I look forward to hearing how we can work together to advance the cause of economic freedom.

Sincerely,

Tom DeLay
Majority Whip

2001-SE-005672

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___11___

The Prosperity Institute

THE PROSPERITY INSTITUTE
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ALEXANDRIA, VA 22314
(703)548-5868 VOICE
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INFO@PROSPERITY-INSTITUTE.ORG

FACSIMILE TRANSMITTAL SHEET

TO: ATTN: LINDA FIGURA	FROM: Dan R. Mastromarco
COMPANY: OFFICE OF HONORABLE PAUL O'NEILL	DATE: June 28, 2001
FAX NUMBER: 202.622.1800	TOTAL NO. OF PAGES 3
PHONE NUMBER: 202.622.0733	SENDER'S REFERENCE NUMBER: 001
RE: MEETING	YOUR REFERENCE NUMBER:

☐ URGENT ✓☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

Linda, members of the group who will be in attendance (especially Richard Rahn, David Burton and Larry Hunter) have met already with Larry Lindsey and Glenn Hubbard, who recommended we meet with Secretary O'Neill. We have also been having discussions with Mark Weinberger, who is aware of the formation of the task force outlined in the note. We will be inviting Mark to address the group soon.

Dan R. Mastromarco

MEMORANDUM

To: Linda Figura
Scheduler for Honorable Paul O'Neill
Secretary of the Treasury

From: Dan R. Mastromarco
President, The Prosperity Institute

Subject: Request for Meeting

Date: June 28th, 2001

What is Being Requested?:

We are requesting a meeting with Secretary O'Neill and others of his choosing. The Prosperity Institute has established a private sector task force in cooperation with several leading public policy organizations (Task Force on Information Exchange and Financial Privacy (TFIEFP)) to advise Treasury on a model information exchange mechanism. We wish to discuss that task force, and other information exchange policy positions now before Treasury.

Who Will Attend?:

Former Senator Mack Mattingly has agreed to Chair the Task Force. Other individuals who have agreed to serve include former Attorney General Ed Meese and Honorable Jack Kemp. Others who may attend the meeting include: David R. Burton (Executive Director, TFIEFP); Stephen J. Entin (Institute for Research on the Economics of Taxation), Dan R. Mastromarco (President, Prosperity Institute); Dan Mitchell (McKenna Senior Fellow in Political Economy, Heritage Foundation); Andrew Quinlan (Center for Freedom and Prosperity) and Richard W. Rahn (Senior Fellow, Discovery Institute).

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Purpose of the Meeting:

The purpose of the meeting is (1) to brief Secretary O'Neill on our serious concerns relating to the information exchange provisions in the OECD harmful tax competition initiative, (2) to explain to him the work that the Task Force is undertaking to develop a workable solution that both respects financial privacy and meets the legitimate needs of law enforcement and tax administration, (3) to discuss continued dialog between Treasury and the Task Force as the solution is being developed and (4) to express support for the Secretary's position on the tax competition aspects of the OECD initiative.

Background:

Facts:
In 1998, the OECD Council issued a report entitled "Harmful Tax Competition: An Emerging Global Issue," wherein they outlined a series of sanctions on "tax havens" engaging in "unfair tax competition." A tax haven is a country with (1) low or zero income taxes, (2) which allows foreigners investing in the country to do so at favorable rates, and (3) which affords financial privacy to its investors or citizens. The OECD is demanding that the low tax countries sign a Memorandum of Understanding (MOU) by July 31, 2001, or face significant sanctions, including the termination of tax treaties, denial of income tax deductions for purchases made from a targeted countries businesses, imposition of withholding taxes, denial of the foreign tax credit and possible disruption of banking operations.

Treasury Public Position:
The Department of Treasury has made several public statements outlining concerns about the tax competition aspects of the OECD initiative. Most notably, in a Washington Times' article later by Secretary O'Neill, Secretary O'Neill stated "the work of this particular OECD imitative ... must be refocused on the core element that is our common goal: the need for countries to be able to obtain specific information ... upon request in order to prevent the illegal evasion of their tax laws." He continued, however, "in its current form, the [OECD] project is too broad and it is not in line with the administration's tax and economic priorities." In recent statements, Mr. Taylor, Undersecretary for International Trade, is reported to have expressed support for efforts to "redirect" the OECD initiative toward a focus on information-sharing issues.

Continuing Issues:
The Treasury Department has criticized the OECD initiative for stifling tax competition. However, the neither the OECD nor Treasury has acknowledged the important balance between due process and privacy concerns on the one hand, and law enforcement or tax administration efficiency on the other. The initiative requires systematic and transparent release of information without predicate to 30 OECD countries from 41 targeted countries. The manner in which that information is secured can either respect the notions of privacy or disregard them. OECD has shown no indication that financial privacy is of legitimate concern. OECD nations that want to impose high tax rates on extraterritorial activity should also respect the sovereign rights of jurisdictions that seek not to assist them.[1]

[1] This is particularly true when one considers (1) the havens attract capital as well from countries with territorial taxing jurisdictions, (2) are being required to enforce laws they do not have on their books, and (3) are being forced by Nations which themselves violate the OECD guidelines and yet do not have to comply.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #__12__

CFP SPECIAL ALERT, 06-15-01

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Center for Freedom and Prosperity Special Alert

As you can see, there have been important developments in the battle for tax competition, financial privacy, and fiscal sovereignty. On the positive side, it appears that we have achieved all of our short-term objectives. The blacklist and threat of sanctions likely will be delayed, and the tax harmonization aspect of the OECD campaign has been thwarted. On the negative side, it is still not clear whether we have stopped the assault on financial privacy. As mentioned in Dan Mitchell's memo earlier this week, information exchange is desirable in the fight against crime. It is not okay, however, when it is used in an indiscriminate fashion to enforce bad tax laws on an extra-territorial basis. In the coming months, we will be fighting to ensure the correct outcome.

We will make one quick prediction: The OECD is a master of the art of "spin control." As such, we expect that they will renew pressure on low-tax jurisdictions by claiming that the United States has decided to support the OECD view of information exchange. This is not the case, and we will be sending out a memo on this topic either later today or tomorrow morning. Low-tax jurisdictions should not allow themselves to be bullied or misled.

Below is a copy of Dan Mitchell's CFP strategic memo and some of the recent news articles.

Best regards,

Andrew Quinlan
Center for Freedom and Prosperity
President
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603-971-9137 (efax)
quinlan@freedomandprosperity.org
www.freedomandprosperity.org

CFP Strategic Memo on Information Exchange
http://www.freedomandprosperity.org/Papers/m06-11-01/m06-11-01.shtml

Wall Street Journal, June 15, 2001, By Michael M. Phillips, Economy: U.S., Allies To Ease Curbs On Offshore Tax Havens
http://www.freedomandprosperity.org/Articles/wsj06-15-01/wsj06-15-01.shtml

Tax-news.com, June 14, 2001: OECD May Delay Sanctions
http://www.tax-news.com/asp/story/story.asp?storyname=3993

Bloomberg News, June 12, 2001, By Michael Bleby, OECD Likely to Push Back Tax Haven Sanctions Deadline
http://www.freedomandprosperity.org/Articles/bb06-12-01/bb06-12-01.shtml

CFP News Summary (World Tax Daily), June 14, 2001, U.S. and OECD Inch Toward Tax Haven Deal
http://www.freedomandprosperity.org/Articles/sum06-14-01/sum06-14-01.shtml

Tax-News.com, June 13, 2001, by Mike Godfrey, CFP Warns Offshore Jurisdictions About Information Exchange
http://www.tax-news.com/asp/story/story.asp?storyname=3980

Senate Permanent Subcommittee
On Investigations
EXHIBIT #__13__

CFP STRATEGIC MEMO, JUNE 16, 2001

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Center for Freedom and Prosperity Strategic Memorandum

[PDF Version]

To: Leaders of Low-Tax Jurisdictions and Supporters of Tax Competition, Financial Privacy, and Fiscal Sovereignty

From: Dan Mitchell, Heritage Foundation

Date: June 16, 2001

Re: OECD Developments

We have gained another victory in the battle for individual liberty. The OECD has backed down in the face of U.S. opposition. The headlines tell the story:

- Lloyd's List, June 15, "Defiant offshore financial centres scent victory over sanctions threat."
- BNA, June 15, "Bush Administration Seeking New Focus to OECD Tax Competition Work, Official Says."
- Wall Street Journal, June 15, "U.S., Allies to Ease Curbs on Offshore Tax Havens."
- Tax-news.com, June 14, "OECD May Delay Sanctions."
- AFX News Service, June 13, "U.S. wants 'redirection' of OECD tax havens plan."
- Bloomberg, June 12, "OECD Likely to Push Back Tax Haven Sanctions Deadline."

But don't break open the champagne bottles. As we have indicated in previous memos and in yesterday's alert, we still have to win the second stage of the battle -- how to define when it is appropriate for governments to suspend financial privacy and to share data with other governments. If information exchange means cooperating in the fight against crime while respecting civil liberties and due process legal protections, we will have won. On the other hand, we will have lost if information exchange means that governments can indiscriminately obtain private financial data in order to enforce their tax laws on an extra-territorial basis.

The Center for Freedom and Prosperity and the Heritage Foundation, in cooperation with a growing list of allies, will be fighting very hard to ensure that information exchange is subject to appropriate safeguards. In particular, we look forward to working with our friends at Americans for Tax Reform, the Free Congress Foundation, the National Taxpayers Union, the Prosperity Institute, and others on this critical project.

At this stage, there are only two things that could lead to defeat. We could lose if the U.S. government acquiesces to the OECD definition of information exchange. Given the many statements from the Treasury Department – all of which indicate that information exchange should be on a case-by-case basis for criminal investigations, we think that is

unlikely. The other way we could lose is if a bunch of targeted jurisdictions suddenly and inexplicably decide to surrender to the OECD, giving the bureaucrats in Paris a fait accompli victory. Because of all the progress we have made, we strongly urge targeted jurisdictions to hold firm. As we have said many times before, if you had the courage to resist one year ago when it appeared that the OECD had a 99 percent chance of victory, then there is no need to give up now that the odds have shifted so dramatically. Indeed, we encourage jurisdictions that have capitulated to announce that they are re-evaluating their decision.

One bit of news that may help bolster resistance to the OECD is that the Center for Freedom and Prosperity has launched an aggressive grassroots campaign. The first stage of this campaign is an Internet advocacy promotion. This effort so far has generated about 10,000 e-mails to either members of Congress or the Treasury Secretary. The next stage of the campaign is a direct-mail crusade. The Center already has contracted to send out 100,000 pieces of mail to targeted citizens and will send many more based on how much money is raised for the project.

In conclusion, there is an "inside-outside" strategy to win the battle on information exchange. The Heritage Foundation's research and the Center's lobbying will ensure that policy makers in Washington have the right facts and figures to make the correct decision. The Center's grassroots advocacy campaign, meanwhile, will generate pressure on politicians from back home so that they will make the right decision even if they are not convinced by the compelling truth of our arguments.

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EXHIBIT #__14__

CFP PRESS STATEMENT, JUNE 28, 2001

Center for Freedom and Prosperity

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For Immediate Release
Thursday, June 28, 2001

OECD Forced to Make Major Concessions, But New Agreement Still Dangerously Flawed

The Center for Freedom and Prosperity released the following statements from Andrew Quinlan, president of the Center for Freedom and Prosperity and Dan Mitchell, senior fellow at the Heritage Foundation:

ANDREW QUINLAN:

"Thanks to U.S. leadership, the OECD has been forced to retreat. Deadlines have been pushed back. Threats of financial protectionism have been reduced. Indeed, the Paris-based bureaucracy has thrown in the towel on its tax harmonization agenda. Equally important, they have been forced to scale back their "information exchange" assault on financial privacy. That's the good news.

"The bad news is that the OECD is still demanding that other countries have an obligation to help enforce the oppressive tax laws of OECD member nations.

"The Center will be increasing its public education campaign in the coming months. Given all the developments in recent days, we will repel the OECD's fiscal imperialism. In the last 10 days alone, for instance, House Majority Whip Tom DeLay and two top House Committee chairmen, Rep. David Dreier of California and John Boehner of Ohio, have come out against the OECD's dangerous information exchange agenda. Leading grassroots groups like the Free Congress Foundation, Americans for Tax Reform and Citizens for a Sound Economy also have weighed in against the OECD's anti-privacy initiative.

"Tax competition, financial privacy and fiscal sovereignty should be celebrated, not persecuted."

DAN MITCHELL:

"The President's economic team thwarted the worst aspects of the OECD's anti-tax competition campaign, but the agreement still contains dangerous elements. Information exchange for tax purposes, even when limited to specific cases, is inconsistent with sound tax policy, respect for privacy, and international comity."

Senate Permanent Subcommittee
On Investigations
EXHIBIT # 15

CFP STRATEGIC MEMO, JULY 5, 2001

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Center for Freedom and Prosperity Strategic Memorandum

To: Public and Private Sector Leaders in Low-Tax Jurisdictions

From: Dan Mitchell, The Heritage Foundation

Date: July 5, 2001

Re: Latest Developments in Fight against OECD

There is good news and bad news. The good news is that the OECD has been forced to retreat. Indeed, one could even say they have suffered a humiliating defeat. Much to their chagrin, the bureaucrats in Paris have pushed back deadlines and scaled back demands. They have, for all intents and purposes, given up on their tax harmonization agenda. They have even substantially curtailed their call for information exchange.

The bad news is that the limited information exchange the OECD is seeking -- low-tax jurisdictions apparently will be expected to provide information on a case-by-case basis – is still an egregious assault on financial privacy. Nations have no right to demand that other jurisdictions act as vassal tax collectors. Information exchange is bad tax policy, bad privacy policy, and bad sovereignty policy.

The Center for Freedom and Prosperity and The Heritage Foundation will continue to aggressively fight against any information exchange for tax purposes. Along with many other groups that have become active in this battle, we will continue our campaign until we have achieved total victory. Some have asked up why we don't declare victory. After all, we have won 80 percent of the battle. Our answer is that there are important principles at stake. Any defeat – even if the other side only gets 20 percent of what they wanted – means that human freedom will be diminished.

There are several things that leaders from low-tax jurisdictions should think about as they contemplate how to react to these latest developments:

1. Do not acquiesce to the OECD's latest demands. Even though the OECD has been forced to curtail its agenda, they still are seeking to impose bad tax policy on non-member nations. Unfortunately, good tax policy has never been at issue in this fight. Instead, this is a case of over-taxed, uncompetitive nations trying to use their power to compel less-powerful jurisdictions into becoming fiscal colonies. Yet, as already has been demonstrated, the OECD can be defeated. As such, we offer low-tax jurisdictions the same advice we provided six months ago: Do not rush to capitulate. Even if you are tempted to surrender, you now have until November 30. Bide your time and see if we can win this last stage of the fight.

2. Demand that OECD nations comply with the same rules. This is especially important for jurisdictions that are tempted to capitulate. Every low-tax regime should state that they will not even consider making a "commitment" to the Paris-based bureaucracy until every OECD nation has made a similar commitment. That includes the United States, the United Kingdom, Switzerland, Luxembourg, and all the other tax havens in the rich man's club. Let's see how many OECD nations are willing to have their head-of-state or finance minister sign a humiliating "Memorandum of Understanding." As we say in America, "Sauce for the goose should be sauce for the gander."

3. Highlight human rights and civil liberties. The OECD wants to suspend due process legal protections and run roughshod over longstanding principles of international law. From news reports, it appears that the bureaucrats in Paris want to eliminate the "dual criminality" provision, which states that one country will not help another country enforce a law unless the so-called offense is a crime in both jurisdictions. Not only is this a traditional part of international law, but you can bet your last dollar that OECD nations will not give up their use of this important

principle. Does anyone really imagine, after all, that the United States will help China prosecute Tiananmen Square protesters – either by extradition or providing information? Does anyone really think that European nations will assist Asian and African nations enforce their laws? The dual criminality principle is just the tip of the iceberg. Does the OECD really intend to deny access to the courts? To do away with "probable cause" before violating privacy? These are just a few of the issues that must be addressed. But if the low-tax jurisdictions surrender before these questions are answered, rest assured that the OECD will unilaterally decide how these questions are resolved.

4. Ask for something in return. "Information exchange" is a very misleading term. In most cases, the OECD is seeking a one-way street. They get information and the low-tax jurisdiction gets nothing except the "privilege" of helping another nation enforce misguided tax laws. When the OECD sends a delegation, low-tax jurisdictions should have a list of demands. This list should include everything from minor requests such as the right to visa-free travel to major conditions such as open immigration (after all, if the OECD wants to impoverish smaller nations by decimating their financial service industries, why shouldn't OECD nations bear the consequences). The OECD will offer "technical assistance," but this is a Trojan Horse. Allowing a bunch of foreign bureaucrats to help change your internal procedures – and therefore turn your jurisdiction into a fiscal colony – is not exactly a gift.

In conclusion, we urge all persecuted jurisdictions to band together. Do not let the OECD play the old "divide-and-conquer" game. The last six-nine months have resulted in a series of setbacks and concessions for the OECD, but this is because the bureaucrats have not been able to bully jurisdictions and gain any momentum. In the last week, Aruba capitulated to the OECD, in large part because they were pressured by their Dutch overseers. It is our hope that other regimes – particularly sovereign nations – will not make the same mistake.

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Senate Permanent Subcommittee
On Investigations
EXHIBIT #___16___

The New York Times
Saturday, May 26, 2001
(A-12, Editorial Desk)

A Retreat on Tax Havens

From Antigua in the Caribbean to Nauru in the South Pacific, offshore tax havens leach billions of dollars every year in tax revenues from countries around the world. Unfortunately, the Bush administration is backing away from a three-year effort by the Organization for Economic Cooperation and Development to crack down on tax havens. The administration's decision to withdraw American support for essential elements of the effort undermines what had been a successful international campaign.

The Internal Revenue Service estimates that Caribbean tax havens alone drain away at least $70 billion a year in personal income tax revenue. The O.E.C.D. suspects the total worldwide to be in the hundreds of billions of dollars. The International Monetary Fund concluded in 1999 that offshore banking had played a sometimes "catalytic" role in Asian, Russian and Latin American financial crises by hiding losses in ways that regulators and auditors were unable to penetrate. The secrecy and lax regulatory environments that characterize many offshore tax havens also invite money-laundering.

The O.E.C.D. has sought greater transparency in tax and banking practices, better cooperation with law enforcement and tax authorities and an end to special tax breaks for foreign investors. Last June the O.E.C.D. published a blacklist of more than 30 offshore tax havens. Nine of them promptly agreed to the organization's requests. Others, including Antigua and Nauru, have resisted.

In withdrawing Washington's support for the O.E.C.D.'s effort to eliminate the tax breaks that lure foreign capital, Treasury Secretary Paul O'Neill has bowed to a lobbying campaign by anti-tax activists who have wrongly claimed that the O.E.C.D. wants to impose some sort of global regime of high taxes. But the practices the O.E.C.D. opposes are not competitive tax policies designed to benefit businesses in the countries where they apply. On the contrary, the most notorious tax havens do not even extend their minimal tax rates to their own citizens or domestic enterprises. Their primary aim is to encourage and profit from individuals and businesses seeking to evade taxes in their own countries.

Mr. O'Neill asserted that the United States did not want to participate in efforts to "harmonize world tax systems." But there is no harm in governments cooperating to prevent illegal activity by their citizens, including tax fraud.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #____17____

THE WALL STREET JOURNAL
February 22, 2001

Economy

U.S. Could Abandon Initiative To Crack Down on Tax Havens

By MICHAEL M. PHILLIPS
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON -- The Bush administration is considering backing away from an international campaign to crack down on tax havens such as Panama, Monaco and the Bahamas.

In internal discussions, Treasury Secretary Paul O'Neill has expressed skepticism about the Organization for Economic Cooperation and Development's three-year-old campaign to blacklist uncooperative tax-haven countries and territories -- currently 35 of them. Conservative lawmakers have been pushing to rein in the effort for some time.

Last weekend, at a meeting in Italy of the top economic officials of the Group of Seven major industrial powers, the U.S. warned privately that it intends to review the Clinton administration's decision to support the OECD initiative. And publicly, Mr. O'Neill sent up a cautionary flag about the effort to bring foreign tax laws in line with international standards. "It is critical to clarify that this project is not about dictating to any country what should be the appropriate level of tax rates," Mr. O'Neill said in a statement issued after the G-7 meeting.

Former Treasury Secretary Lawrence Summers viewed the anti-tax-haven effort as an important tool for combating tax evasion, particularly by U.S. companies that shift profits to secretive low-tax jurisdictions to cut their tax bills back home.

Mr. O'Neill hasn't yet decided whether he wants to abandon the effort. "He will respect the sovereignty of the various tax systems -- that's very important," a senior Treasury official said Wednesday. At the same time, this official said, Mr. O'Neill feels that tax rules should be clear and that foreign officials should share information.

The OECD, a grouping of the U.S., Britain, Japan and 27 other wealthy nations, aims to ensure that governments world-wide cut no secret tax deals with foreign individuals or corporations. In addition, the OECD has been pressing governments to treat foreign and local depositors the same, and to cooperate with foreign investigators in tax-evasion cases.

Robert S. McIntyre, director of Citizens for Tax Justice, a nonpartisan Washington research group, estimates that the Treasury loses tens of billions of dollars a year because American companies report profits as coming from low-tax jurisdictions. "It would be a shame if the Bush Treasury were to decide

that they're in league with the people who want to manipulate the tax laws," said Mr. McIntyre, whose group receives funding from labor unions.

The OECD says its efforts aren't intended to force countries to adopt a particular tax rate or method. But some conservatives like House Majority Leader Richard Armey (R., Texas) say the OECD stifles free-market competition by pushing up tax rates and forcing disclosure of private information. In a blunt letter last September, Mr. Armey told Mr. Summers that tax competition from overseas helps strengthen the case for tax cuts at home, and he asserted that the OECD wants to infringe on privacy rights.

"You really cannot dictate what a country's policies should be," said Joshua Sears, the Bahamian ambassador in Washington. Bahamian Prime Minister Hubert Ingram, whose nation is on the OECD list, wrote Mr. O'Neill recently asking him to reconsider the anti-tax-haven campaign.

Write to Michael M. Phillips at michael.phillips@wsj.com[3]

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___18___

Copyright 2001 Knight Ridder/Tribune News Service
Knight Ridder/Tribune News Service
The Miami Herald

May 11, 2001, Friday

SECTION: BUSINESS AND FINANCIAL NEWS

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HEADLINE: U.S. won't pressure offshore tax havens, O'Neill says

BYLINE: By **Gregg Fields**

BODY:
In a major policy reversal with deep ramifications for the Caribbean basin, Washington signaled that it won't go along with other major Western powers in their crackdown on offshore tax havens.

Treasury Secretary Paul O'Neill, in an official statement, said pressuring financial havens to turn over information on suspected tax evaders shows too little respect to the small countries where offshore financial services have thrived in recent years.

"The United States does not support efforts to dictate to any country what its own tax rates or tax system should be," said O'Neill, "and will not participate in any initiative to harmonize world tax systems."

O'Neill's highly anticipated policy statement threatens to drive a wedge between the United States and the rest of the Organization for Economic Cooperation and Development, whose members are the world's rich democracies.

The OECD has made the fight against offshore tax evasion a major policy initiative. And the Clinton administration vigorously supported the move, estimating that the Treasury loses $70 billion in annual revenue from Americans hiding income in offshore accounts, then failing to pay tax on it.

Evading taxes in such a manner is illegal, although the tax evaders aren't breaking local laws in the havens themselves.

More than 30 governments, primarily in the Caribbean, were placed on a blacklist by the OECD last summer for allegedly fostering both tax evasion and money laundering.

However, the OECD's threats _ including economic sanctions against those countries that refuse to go along with it _ sparked outrage in the developing world.

Public officials throughout the Caribbean regularly complained of the "re-colonization" of the region.

The United States was in the unenviable position of offending either its most important economic partners or its closest geographic neighbors.

Caribbean leaders seemed elated by O'Neill's statement.

"I fully share the views expressed," said Joshua Sears, the Bahamas' ambassador to the United States. "We always felt the initiative was biased. We think it undermines the rule of law and seriously impinges on a country's ability to manage its own fiscal affairs."

Offshore banking has boomed in recent years, with the Internet making it easier for U.S. citizens to

move money offshore. Frequently, the banks are little more than shell corporations, but by registering the assets offshore citizens can often evade U.S. taxation.

Caribbean countries covet the jobs that offshore banks create, and also earn income by levying a small tax or fee on the assets held there. It also provides a welcome economic diversification from tourism and agriculture.

"In the future, our citizens will be looking at more spreadsheets than bedsheets," said Lionel Hurst, ambassador from Antigua and Barbuda to Washington. He added: "We thought this was the appropriate American response to this European idea."

O'Neill's statement coincided with a meeting of the OECD's Forum of Harmful Tax Practices in Paris, and a terse statement from the organization suggested it was none too pleased with his stance.

"Member countries are engaged in a discussion of how to respond to these concerns in a constructive way," said Bruno Gibert, OECD co-chair.

A major OECD conference on offshore tax havens is scheduled for Paris next month.

Caribbean governments were particularly incensed by the OECD initiative because it linked the issues of tax evasion, which is viewed by Caribbean leaders as simple tax competition between countries, and money laundering by criminal syndicates such as drug cartels.

"They're different issues," said Sears, of the Bahamas. "As a small country, we felt it was an attempt to confuse the issue. We don't want" money launderers' cash, he said.

Although initially a non-partisan issue, the topic of tax havens has taken on a partisan tone in recent months. Most significantly, numerous conservative Congressional leaders, including Speaker of the House Dick Armey, criticized the OECD initiative.

He and other critics contend the OECD program threatens to create standardized _ and inevitably, higher _ tax rates around the world.

"I am troubled by the underlying premise that low tax rates are somehow suspect," O'Neill said Thursday.

Conversely, proponents counter that failing to support the OECD is, in effect, giving a green light to tax cheats.

"I cannot understand why the U.S. government would consider abandoning this policy when it reflects sound policy," Sen. Carl Levin, the ranking Democrat on the permanent subcommittee on investigations, wrote to O'Neill recently.

Levin's committee recently authored an extensive report criticizing offshore banks' financial practices.

"Harmful tax practices facilitate the development of tax havens for individuals and entities who wish to unlawfully evade the payment of taxes," he added.

O'Neill, however, said that enforcement of tax codes is still a priority

"We cannot turn a blind eye toward tax cheating in any form," O'Neill said. "That means pursuing those who illegally evade taxes by hiding income in offshore accounts."

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Washington Post Op-Ed
Sunday, April 29, 2001

Senate Permanent Subcommittee
On Investigations
EXHIBIT # 19

David Ignatius

The Tax Cheats' Friends

Conservatives in Washington have picked some bizarre targets over the years, but their new campaign against the Organization for Economic Cooperation and Development may take the cake.

Some on the right appear to see the "black helicopters" of global government in a recent attempt by the OECD to crack down on tax evasion and money laundering. Now, most reasonable people would surely regard an attempt to curb notorious tax havens in the Caribbean and elsewhere as doing the Lord's work. But as House GOP leader Dick Armey sees it, the Paris-based OECD is trying to create "a global network of tax police."

Joining the tirade, conservative columnist Robert Novak [op-ed, April 19] demanded to know whether the Bush administration would support the evil "bureaucrats in Paris" who want to curtail the tax havens. And in an April 23 article in the Washington Times, Paul Craig Roberts demonized the OECD as the equivalent of "Big Brother" in George Orwell's novel, "1984." An editorial this month in the Wall Street Journal even warned that the OECD effort was "The Next Kyoto"—as if that were some kind of curse.

Conservatives apparently regard tax dodging as some sort of inalienable right.

This is dangerous nonsense. Far from being some sort of sinister global policeman, the OECD is an innocuous organization that spends much of its time gathering economic statistics. Its experts dispense advice on such subjects as the most efficient way to regulate postal services and telecommunications.

Given the OECD's somewhat dry subject matter, it's almost comical to see it accused of being the center of a global tax conspiracy. What makes the conservative broadsides unfunny is that they may undermine the successful campaign that has emerged over the past year to curtail global money laundering and tax evasion.

Why conservatives have decided to become lobbyists for the world's tax evaders is beyond me. It's an example of the sort of perverse logic that emerges when cutting taxes becomes an end in itself, regardless of its effects on society. The conservatives apparently don't care if the principal beneficiaries of their campaign are tax-evading drug barons who want to stash their money in the Caribbean.

What the OECD is proposing is actually rather tame, given the red-hot rhetoric flung at the organization. The group's tax experts became concerned that some offshore entities were using bank secrecy to help people hide money from local tax authorities, or to create special loopholes to try to lure multinational business. They asked these offshore tax havens to agree to three simple things: more transparency about their tax and banking practices, better cooperation with law enforcement authorities and an end to special tax breaks for foreign investors.

Last June the OECD published a list of more than 30 offshore tax havens. Nine jurisdictions promptly agreed to meet the organization's requests. This honor list includes such notorious spots as the Cayman Islands, Bermuda, Cyprus, Netherlands Antilles and the Isle of Man. But a few havens have resisted the OECD effort, such as Antigua and Barbuda in the Caribbean and the atoll of Nauru in the South Pacific.

The anti-tax zealots have established a Web site, freedomandprosperity.org, which acts as a clearing- house for the anti-OECD campaign. The site notes that the group "is funded by individual and institutional donations from around the world"—presumably from folks that benefit from loose regulation of existing offshore tax havens. The organization adds that it doesn't accept contributions "from those who have acquired money through immoral means." Whew! That's a relief.

The conservatives apparently regard tax dodging as some sort of inalienable right. Roberts frets that this right might be abridged: "A Frenchman, for example, who parks some money in Switzerland or the Cayman Islands with retirement in mind, will find his bank there required to report his holdings to the French government."

That's not what the OECD is recommending. But even if it was, so what? Why shouldn't governments cooperate to prevent illegal activity by their citizens, including tax fraud? That hardly amounts to an effort "to confiscate wealth on a worldwide basis," as Roberts claims.

People have a right to privacy about their financial dealings, to be sure, but not when those activities violate the laws of their home countries. If the OECD were actually proposing a global tax police, that would be a bad idea. But it's not.

What the OECD's beleaguered bureaucrats want are a few new rules that will help law enforcement in what until recently has been a losing fight against Colombian drug lords, Russian oligarchs and tax dodgers from all over. The authorities in the Cayman Islands and Bermuda seem to see the wisdom of the OECD's recommendations. How odd that they have provoked intemperate rants from the Wall Street Journal and Dick Armey—and turned them into advocates for the world's tax cheats.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___20___

FINANCIAL TIMES

February 14, 2001

Avenue of the Americas: OECD meets the XFL

If the pointy-headed tax experts at the Organisation for Economic Co-operation and Development thought the countries they fingered as tax havens would simply roll over, they reckoned without the substantial figure of Andy Quinlan.

The 6ft, 250lb former amateur football player and inside-the-Beltway veteran is launching a counter-attack on those he calls "evil bureaucrats" with a team stuffed with his conservative buddies.

Quinlan, president of the Center for Freedom and Prosperity, told a cheering audience in Panama - among 35 countries termed tax havens by the OECD - that he would take on the cosy, Paris-based club. "To use a football term, we don't just need to tackle them, we need to knock them down, grind them into the ground and hurt them."

He and his more scholarly sidekick, Dan Mitchell, who acts as CEO of the Alexandria, Virginia, centre when not working at the conservative Heritage Foundation, told the Panamanians they would dog the OECD's every move. "We already got thrown out of their meeting in Barbados. We like to call ourselves the truth squad," said Quinlan, who is leading the centre's Coalition for Tax Competition.

As the lobbying intensifies to have the new Bush administration halt the Clintonian attack on tax havens, Quinlan will call on the reserves to accomplish his goal. "Conservative groups will act together with other groups, like the National Rifle Association and church groups. We will have a huge letter-writing campaign to congressmen. There is nothing a member of Congress hates more than being asked about something he knows nothing about."

Senate Permanent Subcommittee
On Investigations
EXHIBIT #21

Washington Post
April 19, 2001

Robert D. Novak

Global Tax Police

Sen. Don Nickles, the assistant majority leader, on Feb. 6 wrote Treasury Secretary Paul O'Neill requesting a reversal of Clinton administration support for a global offensive against "harmful tax competition." The answer, some two months later, was less than reassuring.

Nickles had expressed "deep concerns" that the anti-"tax haven" campaign against low-tax small countries by the Paris-based Organization for Economic Cooperation and Development (OECD) eventually will turn against the United States to "undermine our sovereign right to enact pro-growth tax policies." Signing the letter "Don," the senator added a handwritten note to O'Neill: "Thanks for your attention on this."

O'Neill turned the letter over to Mark Weinberger, a Washington tax lawyer who on March 6 was confirmed as assistant Treasury secretary for tax policy. In a March 26 response to Nickles, Weinberger gave lip service to President Bush's low-tax policies but then lapsed into bureaucratese:

"Countries generally should not engage in practices that make it easier for other countries' laws to be broken or frustrated ... [T]hose practices might include bank secrecy rules or an unwillingness to exchange tax information with us that would permit taxpayers more readily to evade our laws."

That sounded like a tentative endorsement of what House Majority Leader Dick Armey has labeled a "global network of tax police." The Bush administration's final judgment will decide which side this country shall take on the OECD's drive to close the world's tax havens.

The more basic question, contends Dan Mitchell of the Center for Freedom and Prosperity (created to fight the OECD initiative), is "whether the administration sides with French tax collectors or American taxpayers." A paper written last year by distinguished Swiss banking experts said "OECD's tax officials adopt views usually advocated by states with a history of strong central power, which do not value highly the respect of their citizens."

Weinberger met over breakfast Tuesday with free market activists and said pretty much what he had written to Nickles. He was pressed by Mitchell and two former chief economists for the U.S. Chamber of Commerce, Richard Rahn and Lawrence Hunter, to deny the OECD the American imprimatur that is needed for the Europeans to succeed.

According to sources present, Weinberger indicated the United States had no intention of joining the international organization and the high-tax Europeans in threatening sanctions against 35 small, low-tax countries, including many in the Caribbean. However, he insisted on joining with the OECD in sharing information.

The Treasury's institutional purpose is to prevent Americans from finding tax shelter in places like the Cayman Islands. But tax information sharing also would give the French government access to its citizens' investments in the United States. Worse, it would hand a West African dictatorship a weapon for repression of its subjects seeking economic freedom in America. The breakfast ended inconclusively, with Weinberger agreeing to further consultation with the free marketers.

The danger posed by the OECD transcends the Cayman Islands. "The assault against so-called tax havens is just the beginning," said a recent paper by the Center for Freedom and Prosperity. "If the OECD had applied its criteria fairly, many larger regimes—including the United States, Switzerland, Hong Kong, Luxembourg, Ireland, Singapore and the United Kingdom—would have been classified as 'tax havens.' Almost certainly, the politicians and bureaucrats will begin to target these jurisdictions if their efforts to bully the so-called tax havens succeed."

Surely, activists for financial privacy thought, the OECD would be foiled when George W. Bush replaced Bill Clinton. Lawrence Lindsey, Bush's national economic adviser, who long has been an advocate of financial privacy, recently advised opponents of the OECD campaign to get Secretary O'Neill to deliver a speech on behalf of tax competition.

But in his letter to Nickles, Weinberger claimed he was following O'Neill's closed-door remarks to the G-7 finance ministers at Palermo in February. The secretary had been on the job less than a month at that point and was influenced by Treasury civil servants, who like to bond with their fellow bureaucrats in Paris. Still to be determined is whether the conservative Republican administration will exalt the convenience of the state over the rights of the individual.

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COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___22___

July 17, 2001

The Honorable Carl Levin
Chairman, Permanent Subcommittee on Investigations
Committee on Governmental Affairs
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of July 16, 2001, asking whether U.S. taxpayers can reduce their U.S. tax liability by opening interest bearing bank accounts in a foreign jurisdiction as opposed to in the United States. The answer to your question is that using an offshore account does not reduce a U.S. taxpayer's U.S. tax liability.

U.S. individuals and corporations are subject to U.S. tax on their worldwide income. [I.R.C. §§ 1 (imposing a tax on the taxable income of individuals), 11 (imposing a tax on the taxable income of corporations), 63 (defining "taxable income" as gross income minus allowable deductions) and 61 (defining "gross income" as "all income from whatever source derived", including interest).] Interest paid with respect to the foreign bank account of a U.S. individual or corporation is thereby subject to U.S. tax to the same extent as interest paid with respect to the U.S. bank account of such persons. Therefore, U.S. taxpayers *cannot* reduce their U.S. tax liability by opening bank accounts in foreign jurisdictions.

I hope this information is useful. If you have any further questions, please feel free to contact me.

Sincerely,

Charles O. Rossotti

Charles O. Rossotti

Senate Permanent Subcommittee
On Investigations
EXHIBIT #__23__

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June 15, 2001

The Honorable Paul H. O'Neill
Secretary of the Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: *Tax Havens and Enforcement of Our Tax Laws*

Dear Mr. Secretary:

As you correctly pointed out in your interview of June 12 with *Business Week*, there are two principles, one of which is non-interference in other countries' decisions about their tax systems and the other is getting the information necessary to ensure that U.S. tax laws are fully enforced. You are squarely right. Thank you for what you said.

All best wishes,

Sincerely,

Donald C. Alexander

Senate Permanent Subcommittee
On Investigations
EXHIBIT #___24___

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

October 1, 2001

The Honorable Carl Levin
United States Senate
Washington, DC 20510-6520

Dear Senator Levin:

This letter is to respond to the follow-up questions regarding the OECD initiative on harmful tax practices and our policy on tax information exchange agreements set forth in your letter dated August 3, 2001. Each of your questions is reproduced below in italics and my response to each question follows.

(1) Please indicate whether the tax haven treaties to be negotiated by the United States over the next year would be based upon and seek to include relevant provisions from the U.S. model income tax convention, and, in particular, whether they would:

(a) require an exchange of information for both criminal and civil tax matters;

(b) require an exchange of information for criminal tax matters even if tax evasion is not a crime in the tax haven; and

(c) require the tax haven to provide information held by financial institutions, nominees, agents or fiduciaries regardless of any bank or corporate secrecy laws or practices in the tax haven that might otherwise prevent the exchange of such information.

Our intention is to enter into tax information exchange agreements that, consistent with long-standing U.S. policy, provide for exchange of information on specific request for both criminal and civil tax matters, and, in the case of criminal tax matters, provide for exchange of information regardless of whether tax evasion is a crime in the jurisdiction. Further, and also consistent with long-standing U.S. policy, we intend to enter into agreements that provide that information must be exchanged notwithstanding any local bank or corporate secrecy laws or practices that might otherwise prevent the exchange of such information. As you may be aware, with our insistence on the inclusion of these and other important provisions, the United States has for many years set the standard for effective information exchange with other countries. We are firmly committed to continuing to be the leader in this area even as we devote significant resources to expanding the number of jurisdictions with which we have effective information exchange agreements.

(2) You testified that you would be willing to dedicate resources to analyzing the data in Hearing Exhibit 7 comparing the number of Foreign Bank and Financial Accounts Reports ("FBARs") filed by U.S. taxpayers with the number of offshore corporations

and banks in the 35 tax havens designated by the OECD. Please provide the Department's analysis of this data. In addition, please describe what the Department currently does to detect taxpayer failure to file FBARs, the results of any past FBAR enforcement efforts, and your plans to improve taxpayer compliance with FBAR requirements.

As I have indicated, it is not possible to draw a meaningful comparison between the number of offshore corporations and banks in a jurisdiction listed in Hearing Exhibit 7 and the number of FBARs which are filed by U.S. taxpayers with respect to bank accounts in that jurisdiction. Many of the companies listed may be owned by non-U.S. persons, may be inactive, or may not hold any bank accounts in the jurisdiction in which they are located. Further, as noted in the State Department report from which the data on banks and offshore corporations in Hearing Exhibit 7 are obtained, "information regarding offshore financial centers can be difficult to obtain." Therefore, the information regarding the number of offshore corporations and banks may not be accurate in every case.

The anecdotal information available with respect to noncompliance with U.S. tax obligations through foreign financial accounts suggests that compliance with the FBAR filing requirement is not high. In fact, we are aware that there are some promoters that incorporate into financial arrangements certain elements in an attempt to avoid the FBAR filing requirement. Such arrangements are then promoted as ways to evade U.S. tax obligations without triggering the FBAR filing requirement. For example, promoters may represent that there is no obligation to file an FBAR with respect to a foreign bank account of an offshore company that is owned through a trust if that offshore company is under the nominal control of a foreign trustee. A 1999 analysis comparing the filers of foreign trust information returns to the filers of FBARs revealed significant discrepancies. The IRS has undertaken an effort to educate the general public to avoid these scams.

The FBAR filing requirement is important not only because of the information gathered from FBARs filed, but because a taxpayer's failure to comply with the FBAR filing requirement can be used as evidence of intent to violate tax and other laws in a criminal cases. It is the experience of the Internal Revenue Service that proof of a taxpayer's failure to comply with the FBAR filing requirement may be an element in the successful prosecution of cases involving tax evasion and other serious crimes, including money laundering. Indeed, the FBAR filing requirement was not intended solely as a tool for gathering information that would lead to uncovering noncompliance with U.S. tax laws. While the information provided by taxpayers in FBAR filings can be useful, noncompliant taxpayers do not report the extent of their noncompliance. Therefore, the FBAR filing requirement is not a substitute for the ability to get information about tax cheats from other sources.

Improving compliance with or prosecuting violations of the FBAR filing requirement, of course, are but a means to a larger end: the effective enforcement of our tax laws. In order to enforce our tax laws effectively, we need information necessary to examine or investigate taxpayers that we suspect are not complying with their obligations. The cooperation of other countries through effective tax information exchange agreements is important to this end. That is why we are devoting significant resources to expand the number of jurisdictions with which we have information exchange agreements, and why we have worked to ensure that the OECD

harmful tax practices project is focused on its core element of effective exchange of information upon request in order to prevent noncompliance.

(3) Some opponents of tax information exchange want to reverse U.S. v. Powell, *379 U.S. 48 (1964), and require the United States to establish "probable cause" before obtaining tax information about a U.S. taxpayer from a foreign country. Would the Department support this more restrictive standard or would it retain the existing Supreme Court standard which authorizes the United States to obtain tax information so long as it is being sought for a "legitimate purpose"?*

The question at issue in U.S. v. Powell related to enforcement of an IRS summons to obtain information from a U.S. taxpayer and thus did not directly concern the standard that applies for purposes of obtaining information about a U.S. taxpayer from a foreign country. As a matter of policy, however, the Internal Revenue Service will not attempt to obtain information from another country unless it believes the Powell standard is satisfied. Consistent with this policy, our existing tax information exchange agreements provide that requests for information should be based on the potential relevance of the information requested to tax administration and enforcement (and not on a requirement to demonstrate probable cause). We intend to use this standard in future tax information exchange agreements.

(4) Please describe what steps the United States plans to take over the next two years to ensure that, if necessary, it will be ready and able to impose tax haven sanctions by April 2003.

The OECD has identified a preliminary range of potential defensive measures against jurisdictions that do not agree to meet international standards of transparency and effective tax information exchange. However, the work at the OECD to refine the range of measures is still at an early stage. The OECD working group, of which the United States is a part, must refine this range of measures and then consider which of these measures, if any, it should recommend to OECD member countries. The OECD working group also will have to consider whether it should recommend that some measures be adopted before others, or whether there should be some priority in terms of the jurisdictions with respect to which measures are to be applied. Once the OECD working group has finalized its work, individual OECD member countries then will need to consider the advisability of adopting any such measures given other measures already in place and other policy considerations. For example, from the perspective of the Untied States, it is important that we study the potential efficacy of any proposed defensive measure and tailor potential measures so that they would trigger as little disruption of legitimate business transactions as possible.

The United States plans to continue to work on these issues with other countries within the OECD in the next year. The experience of other OECD member countries in this regard is valuable because many of the measures that have been identified thus far are part of the international tax policy of some OECD member countries.

(5) Please describe what steps the Department plans to take this year to advance enactment of the necessary legislation (and identify any specific bill) to enable the

United States to impose tax haven sanctions, including authorizing the United States to deny tax deductions or tax credits for transactions in uncooperative tax havens.

As I have indicated, the United States intends to work with other countries within the OECD in the next year to refine the preliminary range of potential defensive measures identified thus far by the OECD. We need to see the outcome of that work before we can assess the need for or desirability of any legislative proposal in this area.

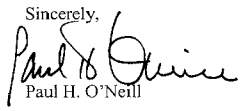
It is important to recognize that several of the potential defensive measures that have been identified thus far by the OECD have been part of the international tax policy of the United States for many years. For example, the Internal Revenue Service has a practice of enhanced audit and enforcement activities with respect to transactions and activities in jurisdictions which, in its experience, are used by U.S. taxpayers to evade their U.S. tax obligations. These jurisdictions invariably do not have effective information exchange agreements with us or other countries, and in fact most were identified as tax haven jurisdictions by the OECD. In addition, it is the long-standing policy of the United States not to enter into income tax treaties with jurisdictions that do not have effective information exchange practices.

(6) You testified that there is "collateral consideration" that must be given to the right of privacy when seeking information exchange from tax havens. Please explain the extent to which financial privacy requires consideration when tax evasion, money laundering or other crimes are at stake, and please describe the consideration you believe it deserves in this context.

The right of citizens to privacy is fundamental to a democratic system of government. My remarks concerning the right of privacy concerned two related but distinct principles. First, the Internal Revenue Service should not request information about a specific taxpayer from another country unless it believes that the information is or may be relevant to the administration and enforcement of U.S. tax laws. As I have already indicated, this is consistent with IRS policy and reflects the standard found in our existing tax information exchange agreements. Secondly, the Internal Revenue Service should scrupulously protect from unauthorized use or disclosure any taxpayer information it obtains. Maintaining the confidentiality of taxpayer information is vital to a tax system like ours, which depends heavily on voluntary compliance by taxpayers. For this reason, Section 6103 of the Internal Revenue Code contains strict safeguards relating to the confidentiality of taxpayer information. Also for this reason, every tax treaty and tax information exchange agreement entered into by the United States requires that information obtained by the United States from another country or provided by the United States to another country must be protected from unauthorized disclosure. We will continue to insist on these confidentiality protections in any future tax information exchange agreements we negotiate with other countries.

Thank you for your interest in this important issue.

Sincerely,



Paul H. O'Neill

Senate Permanent Subcommittee
On Investigations
EXHIBIT #25

Towards Global Tax Co-operation

REPORT TO THE
2000 MINISTERIAL COUNCIL MEETING
AND RECOMMENDATIONS
BY THE COMMITTEE
ON FISCAL AFFAIRS

Progress in Identifying and Eliminating Harmful Tax Practices

OECD
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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) and Korea (12th December 1996). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

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VERS UNE COOPÉRATION FISCALE GLOBALE
RAPPORT POUR LA RÉUNION DU CONSEIL AU NIVEAU DES MINISTRES DE 2000
ET RECOMMANDATIONS DU COMITÉ DES AFFAIRES FISCALES
PROGRÈS DANS L'IDENTIFICATION ET L'ÉLIMINATION DES PRATIQUES FISCALES DOMMAGEABLES

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EXECUTIVE SUMMARY

For a global economy to succeed, governments must intensify their co-operation and provide international frameworks for the effective management of global issues. Taxation is no exception. In this context, the OECD in 1998 established an international framework to counter the spread of harmful tax competition by adopting its Report, "*Harmful Tax Competition: An Emerging Global Issue*" (the "1998 Report").[1] Ministers in 1998 welcomed this Report and mandated OECD to pursue the work. The goal is to secure the integrity of tax systems by addressing the issues raised by practices with respect to mobile activities that unfairly erode the tax bases of other countries and distort the location of capital and services. Such practices can also cause undesired shifts of part of the tax burden to less mobile tax bases, such as labour, property, and consumption, and increase administrative costs and compliance burdens on tax authorities and taxpayers.

It is important to note at the outset that the project is not primarily about collecting taxes and is not intended to promote the harmonisation of income taxes or tax structures generally within or outside the OECD, nor is it about dictating to any country what should be the appropriate level of tax rates. Rather, the project is about ensuring that the burden of taxation is fairly shared and that tax should not be the dominant factor in making capital allocation decisions. The project is focused on the concerns of OECD and non-OECD countries, which are exposed to significant revenue losses as a result of harmful tax competition. Tax base erosion as a result of harmful tax practices can be a particularly serious threat to the economies of developing countries. The project will, by promoting a co-operative framework, support the effective fiscal sovereignty of countries over the design of their tax systems.

To counter harmful preferential tax regimes, the Recommendations adopted with the 1998 Report provide a set of Guidelines and a timetable for OECD member countries to identify, report, and eliminate the harmful features of their preferential regimes. They also provide for a dialogue with non-member economies on how they would apply the Guidelines. To counter the spread of tax havens, the Recommendations

1. The Report was approved by the OECD Council, with abstentions from Luxembourg and Switzerland, on 9 April 1998, and was presented to Ministers on 27/28 April 1998.

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provide for the Forum to identify jurisdictions that meet specified criteria for being tax havens. The 1998 Report also sets out a general framework for a common approach to defensive measures for restraining harmful tax competition.

This Report to Ministers outlines the results obtained up to date of the Forum's work in these areas. It includes, in particular:

a) an identification of potentially harmful preferential regimes in Member countries under the factors of the 1998 Report;

b) an identification of jurisdictions meeting the criteria for being tax havens under the factors of the 1998 Report; and

c) an update on work with non-member economies and proposals for taking this work forward.

The initial reaction to this project has been encouraging. A number of jurisdictions reviewed under the tax haven criteria and also a number of non-member economies have shown an interest in the project, resulting in an open dialogue. Accordingly, this reporting is not intended to be condemnatory or final, as the process is open and dynamic; it aims to move forward co-operatively so long as a co-operative approach bears fruit. Member countries are already working to eliminate harmful tax practices, and many jurisdictions meeting the tax haven criteria are actively considering taking a commitment within the next 12 months to eliminate harmful tax practices in accordance with the 1998 Report.

To take forward the work, this Report includes proposals by the Committee on Fiscal Affairs (the "Committee") on the follow-up for preferential regimes, for jurisdictions meeting the tax haven criteria, and for non-member economies.

With regard to the preferential tax regime work, the Committee has endorsed the development on a generic basis of guidance on applying the preferential regime criteria of the 1998 Report to the categories and types of preferential regimes that are represented among the regimes identified as potentially harmful. The Forum will work directly and where appropriate through other subsidiary bodies of the Committee in developing the guidance (application notes). The application notes will assist Member countries in determining which of their potentially harmful regimes are, or could be applied to be, actually harmful, and then in determining how to remove the harmful features of such harmful regimes. The application notes also will assist tax havens and other non-member economies in eliminating their harmful tax practices, and will assist the Forum in verifying that Member countries and co-operative jurisdictions have met their respective commitments to eliminate harmful tax practices within established timetables.

With regard to the tax haven work, the Committee has endorsed an approach to extend and to take forward co-operatively the dialogue with jurisdictions that meet the tax haven criteria. In particular, the Committee is now planning to develop

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a List of Uncooperative Jurisdictions that could be the subject of a co-ordinated approach to defensive measures, comprised of jurisdictions meeting the tax haven criteria that choose not to eliminate their harmful tax practices.

With regard to non-member economies, the Committee has endorsed a work programme to encourage these economies to associate themselves with the 1998 Report and also to encourage them to take positive steps to remove any harmful features of their preferential tax regimes.

The Committee accepts that the changes necessary for jurisdictions meeting the tax haven criteria that commit to remove their harmful tax practices may adversely affect the economies of some of those jurisdictions. The OECD will work with other interested international and national organisations to examine how best to assist co-operative jurisdictions in restructuring their economies.

The Committee has been engaged in a dialogue with the business community and civil society since the 1998 Report was issued, and this dialogue will be continuing during the period of implementation of the Report's recommendations.

The OECD's work through the Forum has evolved into a consensus-building, co-operative approach with interested parties who are willing to make positive change and contribute to emerging international principles of transparency, fairness, and disclosure. This evolution should be viewed in the context of other international efforts to encourage offshore financial centres to improve their regulatory environment. For example, the widespread financial crisis of the late 1990s has led to the creation of the Financial Stability Forum, the strengthening of the International Monetary and Finance Committee of the IMF, and other proposals to improve the transparency and operation of financial markets, including the functioning of offshore financial centres. Other institutions, such as the FATF and the UN Commission on Money Laundering, are addressing serious international criminal activities and money laundering in particular. The present Report represents the first stage in implementing the 1998 Report in a manner complementary to these other international efforts.

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I. Introduction

1. This Report responds to the mandate given by Ministers in April 1998 to counter the spread of harmful tax competition. The mandate is contained in the OECD Report: Harmful Tax Competition: An Emerging Global Issue (the "1998 Report").[2] The 1998 Report contains 19 recommendations (the "Recommendations") to counter harmful tax practices, with a scope aimed at geographically mobile financial and other service activities. The OECD created the Forum on Harmful Tax Practices to carry out the work.

2. To counter harmful preferential tax regimes, the Recommendations provide a set of Guidelines and a timetable for OECD member countries to identify, report, and eliminate the harmful features of their preferential regimes. They also provide for a dialogue with non-member economies on how they would apply the Guidelines. To counter the spread of tax havens, the Recommendations provide for the Forum to identify jurisdictions that meet specified criteria for being tax havens. The 1998 Report also sets out a general framework for a common approach to defensive measures for restraining harmful tax competition.

3. This Report to Ministers outlines the progress made to date of the Forum's work in these areas.

2. The Report was approved by the OECD Council, with abstentions from Luxembourg and Switzerland, on 9 April 1998, and was presented to Ministers on 27/28 April 1998.

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II. The Review Process

A. Process of Reviewing Member Country Regimes

4. As part of the 1998 Report, the Council adopted Guidelines for Dealing with Harmful Preferential Regimes in Member Countries. Under these Guidelines, which form an integral part of the Council Recommendation, the harmful features of preferential regimes in Member countries must be removed within 5 years (*i.e.* by April 2003). There is a limited "grandfather clause" for taxpayers benefiting from such regimes on 31 December 2000; these benefits are to be removed at the latest by 31 December 2005. The Guidelines include a "standstill" provision requiring that Member countries refrain from adopting new measures or extending the scope of existing measures that constitute harmful tax practices.

5. Part III(a) of the 1998 Report sets out "features of tax regimes which suggest that they have the potential to constitute harmful tax competition" (see paragraph 60 of the 1998 Report).[3] To carry out the work on identifying harmful preferential tax regimes, the Forum requested that each member country perform a self-review of its preferential regimes with regard to these features (hereinafter the "preferential regime criteria"). At the same time as the self-reviews were undertaken, cross-country reviews by Study Groups were carried out with respect to specific types of preferential regimes. The cross-country reviews were intended to be generic, *i.e.* the basic features of similar regimes were described without reference to country names. After the self-reviews were completed, a peer review process was undertaken for each reported preferential regime (for financial and other service activities) according to the preferential regime criteria. The peer review process involved the development of extensive questionnaires, containing both specific questions about regimes and generic questions about the preferential regime criteria, which

3. In brief, there are four main factors, similar to the tax haven criteria discussed in the next section: 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.

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were submitted to Member countries, answered in writing, and discussed at meetings of the Forum.

6. Three Working Groups were established within the Forum to review preferential tax regimes and these Working Groups and the Forum met and worked intensively between November 1999 and May 2000. The results of those reviews are described in Part III.A. below.

B. Process of Reviewing Jurisdictions under the Tax Haven Criteria

7. Part II(b) of the 1998 Report described its starting point for identifying a tax haven as whether the jurisdiction has no or nominal taxation on financial or other service income and offers or is perceived to offer itself as a place where non-residents can escape tax in their country of residence. Other key factors are used to confirm the existence of a tax haven (hereinafter referred to as the "tax haven criteria")[4] that focus on transparency, exchange of information, and local business activities of foreign enterprises. The fact that a jurisdiction may impose no or nominal tax on the relevant income is a necessary but not sufficient condition for the jurisdiction to be considered a tax haven. Whether a jurisdiction meets the tax haven criteria is determined based upon all the facts and circumstances, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

8. The evaluation of jurisdictions under the tax haven criteria was based on an in-depth factual review of such jurisdictions that appeared to have the potential for satisfying the criteria. Starting from published sources, the Forum identified an initial grouping of 47 such jurisdictions. These jurisdictions were asked to submit information pertinent to the application of the tax haven criteria in the context of their facts and circumstances. The Forum examined, discussed, and reviewed this information, using a series of bilateral contacts (under the auspices of small Study Groups comprised of Forum members) and through multilateral consultations with the Forum itself. The Study Groups prepared factual jurisdiction reports with input from, and in many cases agreement by, the jurisdictions as to the factual accuracy of the reports. In these contacts and consultations, the full participation of each jurisdiction was invited and encouraged.

4. The four key factors, similar to the preferential regime criteria discussed in the preceding section: 1) there is no or nominal tax on the relevant income (from geographically mobile financial and other service activities); 2) there is no effective exchange of information with respect to the regime; 3) the jurisdiction's regimes lack 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) the jurisdiction facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy.

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9. On the basis of the information submitted by the jurisdictions, the factual jurisdiction reports, the bilateral and multilateral contacts with the jurisdictions, and the Forum's discussions, the Forum in November 1999 made technical evaluations of which jurisdictions met the tax haven criteria. Each technical evaluation was undertaken on the facts and circumstances of the particular jurisdiction under review specifically with regard only to the criteria of the report.The Forum's conclusions reflect only those criteria, notwithstanding that among the jurisdictions meeting the criteria there is a wide range of circumstances both in relation to these criteria (*e.g.* some jurisdictions meet higher standards of transparency, openness, and exchange of information than others) as well as in relation to other important standards (*e.g.* the quality of their internal financial regulation and willingness to co-operate internationally in tackling money laundering and other financial crime). The results of those evaluations are described in Part III.B. below.

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III. Evaluations and Follow-Up Work

A. Member Country Preferential Regimes

10. From among the preferential tax regimes reviewed as discussed above, the Forum has identified below preferential tax regimes as potentially harmful, consistent with paragraphs 59 and 60 of the 1998 Report. In order to be as comprehensive as possible, a preferential tax regime is identified as potentially harmful if it has features that suggest that the regime has the potential to constitute a harmful tax practice, even though there has not yet been an overall assessment of all the relevant factors to determine whether regimes are actually harmful. Further, economic effects as described in paragraphs 80 to 84, as informed by paragraph 27, of the 1998 Report have not been assessed. Accordingly, the potentially harmful regimes include, *e.g.* regimes where the question of actual harm depends on the regime's application in specific circumstances, and regimes that have features of concern to the Forum under the preferential regime criteria but that have not been determined at this stage to be actually harmful or not actually harmful. Further work will assist Member countries in determining which of their potentially harmful regimes are, or could be applied to be, actually harmful, and in determining how to remove the harmful features of such harmful regimes, as described in paragraphs 13-15.

11. The preferential tax regimes identified as potentially harmful are:[5]

Country	Regimes[6]
Insurance	
Australia	Offshore Banking Units
Belgium	Co-ordination Centres

5. It is recognised that there may be additional regimes which will be examined as part of the future work of the Forum. See paragraph 25.
6. The preferential tax regimes are listed category-by-category. Certain regimes allow investors to carry out many different types of activities. Forty-seven preferential regimes are identified, but some are included in more than one category of the listing.

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Finland	Åland Captive Insurance Regime
Italy	Trieste Financial Services and Insurance Centre[7]
Ireland	International Financial Services Centre
Portugal	Madeira International Business Centre
Luxembourg	Provisions for Fluctuations in Re-Insurance Companies
Sweden	Foreign Non-life Insurance Companies
Financing and Leasing	
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[8]
Luxembourg	Finance Branch
Netherlands	Risk Reserves for International Group Financing
Netherlands	Intra-group Finance Activities
Netherlands	Finance Branch
Spain	Basque Country and Navarra Co-ordination Centres
Switzerland	Administrative Companies
Fund Managers[9]	
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)]
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[8]
Korea	Offshore Activities of Foreign Exchange Banks
Portugal	External Branches in the Madeira International Business Centre
Turkey	Istanbul Offshore Banking Regime

7. Non-operational.
8. Non-operational.
9. The taxation of fund managers is complex, given the various legal forms that can be used to structure fund management advice. These issues will be studied further in connection with the development of the application notes described in paragraph 13 in order to ensure that all similar regimes are treated the same.

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Headquarters regimes	
Belgium	Co-ordination Centres
France	Headquarters Centres
Germany	Monitoring and Co-ordinating Offices
Greece	Offices of Foreign Companies
Netherlands	Cost-plus Ruling
Portugal	Madeira International Business Centre
Spain	Basque Country and Navarra Co-ordination Centres
Switzerland	Administrative Companies
Switzerland	Service Companies
Distribution Centre Regimes	
Belgium	Distribution Centres
France	Logistics Centres
Netherlands	Cost-plus/Resale Minus Ruling
Turkey	Turkish Free Zones
Service Centre Regimes	
Belgium	Service Centres
Netherlands	Cost-plus Ruling
Shipping[10]	
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
Miscellaneous Activities	
Belgium	Ruling on Informal Capital
Belgium	Ruling on Foreign Sales Corporation Activities
Canada	Non-resident Owned Investment Corporations
Netherlands	Ruling on Informal Capital
Netherlands	Ruling on Foreign Sales Corporation Activities
United States	Foreign Sales Corporations[11]

10. The analysis of shipping is complex given the particularities of the activity. The criteria must be developed so as to take into account and be consistent with those particularities and will be considered further in connection with the development of application notes as regards shipping. Also, such further consideration shall compare tax equivalence of alternative regimes and should aim to establish similar standards for all comparable regimes.

11. As is the case with all regimes, the foreign sales corporation regime is only within the scope of the Report to the extent that it applies to mobile financial and other service activities. It should be noted that the treatment of the foreign sales corporation regime or any other regime for purposes of this Report has no bearing on its classification or treatment in connection with trade disciplines.

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12. Holding company regimes and similar preferential tax regimes are not included above, although such regimes may constitute harmful tax competition. The Forum was presented with a number of holding company regimes and similar provisions, but in light of the complexities raised by such regimes, including their possible interaction with tax treaties and with generally applicable principles of domestic law, the Forum reached no conclusions concerning their status as potentially harmful preferential regimes. Continuing the work on holding company regimes and similar preferential regimes will be a high priority in the ongoing work of the Forum, with the aim of reaching firm proposals within the context of preparing application notes (see paragraph 13 below) by early 2001. Holding company regimes and similar preferential tax regimes in the following countries are being examined: Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg, Netherlands, Portugal, Spain, Switzerland.

13. More work is needed in interpreting the manner in which the criteria apply. In the next stage of the work, the Forum will develop guidance on applying the preferential regime criteria of the 1998 Report to the categories and types of preferential tax regimes that are represented among the regimes identified as potentially harmful. This guidance (application notes) would be provided on a generic basis (*i.e.* not referring to specific country regimes) and would be equally applicable to any regime of the category or type being addressed. The application notes will illustrate what features, generically, would be problematic for particular categories or types of regimes under the relevant factors of the 1998 Report. The application notes will build upon the cross-country reviews undertaken in the initial evaluation of preferential regimes.

14. The Forum will work directly and where appropriate through other subsidiary bodies of the Committee in developing the application notes. For example, the Forum has asked the Committee's Working Party on Taxation of Multinational Enterprises to work on developing guidance in the area of rulings systems and other transfer pricing issues, and the Forum has asked the Committee's Working Party on Tax Avoidance and Evasion to provide advice on effective exchange of information. The Committee's Working Party on Tax Policy Analysis and Statistics may also need to assist in particular cases to the extent that economic analysis is relevant.

15. Member countries will be assisted by the application notes in making the assessment whether potentially harmful regimes are, or could be applied to be, actually harmful, and then in determining how to remove the harmful features of such harmful preferential regimes, in order to meet their commitments to eliminate the harmful features of harmful preferential tax regimes by April 2003. In respect of taxpayers benefiting from such regimes on 31 December 2000, the benefits they derive are to be removed by 31 December 2005. The Forum will undertake a verification process to ascertain that OECD countries have met this commitment, and will report back to the OECD Council no later than June 2003 to list any preferential regimes that have been

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found to be actually harmful and whose harmful features remain in OECD Member countries at that time. The application notes will assist the Forum in verifying whether Member countries and co-operative jurisdictions (as described below) have met their respective commitments to remove harmful tax practices within established timetables. The application notes also are expected to assist co-operative jurisdictions and other non-member economies in eliminating their harmful tax practices.

16. Work on removing the harmful features of preferential tax regimes in OECD countries must continue in parallel with that on counteracting the effects of tax havens, as discussed below. The application of the deadline set in the 1998 Report for Member countries to remove the harmful features of any harmful preferential tax regime is not contingent on the Forum determining that the regime is harmful. If harmful features are not eliminated by the prescribed deadlines, other countries may wish to take defensive measures (as foreseen in paragraph 96 of the 1998 Report). Accordingly, the proposal to develop application notes described above is not intended to affect the timing of national efforts by countries to remove the harmful features of any of their harmful preferential tax regimes. Rather, the objective is to develop application notes simultaneously with those efforts. However, it will be a priority for the Committee to ensure sufficient progress is made by the Forum on the development of the application notes to allow for timely guidance to countries, and to facilitate consistency and fairness.

B. Tax Haven Work

17. A small number of the jurisdictions reviewed by the Forum have, in advance of this reporting, made a public political commitment at the highest level (an "advance commitment") to eliminate their harmful tax practices and to comply with the principles of the 1998 Report.[12] In recognition of this commitment, this

12. An advance commitment jurisdiction also agrees to a standstill, i.e. not to enhance existing regimes that the Forum finds constitute harmful tax practices, and not to introduce new regimes that would constitute harmful tax practices. An advance commitment jurisdiction will develop with the Forum an acceptable plan by 31 December 2000, describing the manner in which the jurisdiction intends to achieve its commitment, the timetable for so doing, and milestones to ensure steady progress, including the completion of a concrete and significant action during the first year of the commitment. All advance commitment jurisdictions must fulfil their commitments by the date on which Member countries must remove the benefits to taxpayers benefiting on 31 December 2000 from any harmful preferential regimes (31 December 2005, which is 2-½ years after the main deadline by which Member countries have committed to eliminate the harmful features of their harmful preferential regimes). The follow-up for advance commitment jurisdictions is discussed in Part IV below. An advance commitment is similar but not identical to the post-June "scheduled commitment" described in Part IV.

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Report does not include the names of jurisdictions that have made this advance commitment ("advance commitment jurisdictions") even if they presently meet the tax haven criteria.[13] Otherwise, the jurisdictions below were found to meet the tax haven criteria of the 1998 Report. These evaluations were presented to the Committee in January 2000, confirmed by the Committee in May 2000, and endorsed by the Council on 16 June 2000. This listing is intended to reflect the technical conclusions of the Committee only and is not intended to be used as the basis for possible co-ordinated defensive measures. Rather, as discussed below, a further list will be developed in the next 12 months for this purpose.

Andorra	The Republic of the Maldives
Anguilla – Overseas Territory of the United Kingdom	The Republic of the Marshall Islands
Antigua and Barbuda	The Principality of Monaco
Aruba – Kingdom of the Netherlands[a]	Montserrat – Overseas Territory of the United Kingdom
Commonwealth of the Bahamas	The Republic of Nauru
Bahrain	Netherlands Antilles – Kingdom of the Netherlands[a]
Barbados	Niue – New Zealand[b]
Belize	Panama
British Virgin Islands – Overseas Territory of the United Kingdom	Samoa
Cook Islands – New Zealand[b]	The Republic of the Seychelles
The Commonwealth of Dominica	St Lucia
Gibraltar – Overseas Territory of the United Kingdom	The Federation of St. Christopher & Nevis
Grenada	St. Vincent and the Grenadines
Guernsey/Sark/Alderney – Dependency of the British Crown	Tonga
Isle of Man – Dependency of the British Crown	Turks & Caicos – Overseas Territory of the United Kingdom
Jersey – Dependency of the British Crown	US Virgin Islands – External Territory of the United States
Liberia	The Republic of Vanuatu
The Principality of Liechtenstein	

a) The Netherlands, the Netherlands Antilles, and Aruba are the three countries of the Kingdom of the Netherlands.
b) Fully self-governing country in free association with New Zealand.

13. Ministers in their communiqué welcomed these highest-level commitments.

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i) Preparing a List of Uncooperative Tax Havens

18. During the process of consultations, a number of the jurisdictions under review indicated an interest in the possibility of co-operating with the OECD by committing to the elimination of harmful tax practices. The extent of the interest in co-operation was not fully foreseen at the time that the 1998 Report was presented to Ministers. In response to this development, the Committee believes that a process should be established to promote co-operation and positive changes to comply with the principles of the 1998 Report. Such a step would be in harmony with the Council Instruction of 9 April 1998 to make proposals for further improvements in the co-operation to counter harmful tax practices, and also in harmony with the 1998 Report itself, which provides that in implementing the Recommendations of the Report, account should be taken of the commitment which the jurisdictions involved make to the elimination of harmful tax practices.

19. To facilitate the taking forward of a co-operative process, the Committee has already invited jurisdictions to consider making commitments to the elimination of harmful tax practices, and the Council has in its 16 June 2000 Recommendation instructed the Committee to continue these efforts over the next 12 months. The Council also instructed the Committee to produce, from the list of jurisdictions meeting the tax haven criteria (*i.e.* the list in paragraph 17 as it may be amended in the future) an OECD List of Uncooperative Tax Havens. This List is to be completed by 31 July 2001. Any jurisdiction listed in paragraph 17 above that by this deadline does not make the commitment to eliminating harmful tax practices in the manner and substance as described in *ii)* below would automatically be included in the List of Uncooperative Tax Havens.[14]

20. To recognise the ongoing efforts being made by some of the jurisdictions to continue the dialogue, and to encourage jurisdictions to make commitments to the tax competition work, the Committee recommended and the Council agreed that the co-ordination of a common approach to defensive measures should not be undertaken with respect to jurisdictions that have committed to the tax competition work, as discussed below (*i.e.* those jurisdictions not appearing on the List of Uncooperative Tax Havens). Accordingly, the co-ordination of defensive measures foreseen in the 1998 Report, as described in Part IV below will not be implemented prior to 31 July 2001.

14. A jurisdiction making an advance commitment (pre-June 2000) also would not appear on the List of Uncooperative Tax Havens and would not be subject to co-ordinated defensive measures. There will be an annual review by the Forum to determine whether the established milestones and timetables are being met. If the milestones and timetables are not met and there is at any time evidence that the jurisdiction's commitment to the tax competition work is no longer in good faith, the Committee will place the jurisdiction on the List of Uncooperative Tax Havens.

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ii) Commitment to Eliminating Harmful Tax Practices

21. The commitment necessary to avoid inclusion on the List of Uncooperative Tax Havens is a public political commitment by a jurisdiction to adopt a schedule of progressive changes to eliminate its harmful tax practices by 31 December 2005. This is the date set in the 1998 Report for Member countries to remove the benefits to taxpayers benefiting on 31 December 2000 from any harmful preferential regime (which is approximately 2-½ years after the main deadline by which Member countries have committed to remove the harmful features of their harmful preferential tax regimes). A jurisdiction making this commitment (a "scheduled commitment") will develop with the Forum an acceptable plan within 6 months of having made the commitment, describing the manner in which the jurisdiction (a "co-operative jurisdiction") intends to achieve its commitment, the timetable for so doing, and milestones to ensure steady progress, including the completion of a concrete and significant action during the first year of the commitment. The jurisdiction must also agree to a "standstill" during the period of the commitment, *i.e.*, not to enhance existing regimes that the Forum finds constitute harmful tax practices; not to introduce new regimes that would constitute harmful tax practices; and to engage in an annual review process with the Forum to determine the progress made in fulfilling its commitment and to assess the use being made of its existing regimes.

22. A co-operative jurisdiction, at the time of making its scheduled commitment, would not be included in the List of Uncooperative Tax Havens for an initial period of one-year from that time. A co-operative jurisdiction is eligible for successive renewals of its status by making a new public commitment to move to the next stage of the plan of progressive changes. However, a jurisdiction would be placed on the List of Uncooperative Tax Havens if any harmful aspects of its regimes remain after the deadline for their elimination. Also, if the milestones and timetable are not met and there is at any time evidence that the jurisdiction is not acting in good faith in accordance with its commitments, the Committee will place the jurisdiction on the List of Uncooperative Tax Havens.

23. The procedure for making a scheduled commitment is that a jurisdiction submits a written statement of the commitment of its government as described in paragraph 21 above. The statement is to be in the form of a letter to the Secretary-General of the OECD, and signed by an authorised official.[15] This letter is to be accompanied by an annex setting forth the specifications to which the jurisdiction is agreeing, as discussed with the Forum.

15. An authorised official would be an official having authority in regulatory and fiscal matters and appointed by the jurisdiction to represent the jurisdiction in dealing with the Forum.

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C. Dynamic Nature of the Evaluations of Preferential Regimes and Tax Havens

24. The evaluations given in this Report are dynamic for both potentially harmful preferential regimes and for jurisdictions meeting the tax haven criteria. Accordingly, the evaluations will be regularly updated as the work is taken forward. With regard to the tax haven work, jurisdictions that will appear on the List of Uncooperative Tax Havens remain eligible to make scheduled commitments at any time and thereby be removed from the List of Uncooperative Tax Havens. Further, a jurisdiction's name would be removed from the List of Uncooperative Tax Havens and no longer be identified as meeting the tax haven criteria if the jurisdiction were to eliminate its harmful tax practices, without regard to whether a scheduled commitment is made. The process of pursuing a scheduled commitment can be initiated by a listed tax haven by writing to OECD Secretariat or to the Chair of the Committee.

25. The OECD's work in this area must not only address existing tax havens and harmful tax practices, but it must be vigilant against adverse developments. Such developments could be new jurisdictions entering the field, the introduction of new harmful preferential regimes by jurisdictions/ countries that are already being evaluated, a change in posture as regards commitments to eliminate the harmful aspects of their regimes, or the discovery of other jurisdictions/regimes that constitute harmful tax practices. The dynamic nature of this work has resource implications for the OECD that must be addressed in the context of the Committee's priorities, as indicated in paragraph 39.

D. Extending the Dialogue with Co-operative Jurisdictions

26. The Committee intends to continue the dialogue with co-operative jurisdictions. Such work will include:

- The development of a model vehicle for exchange of information (*e.g.* an OECD Model Tax Information Exchange Agreement or a multilateral agreement).
- The creation of a multilateral framework under the Forum for consultation with co-operative jurisdictions, on exchange of information and other relevant issues pertaining to the elimination of harmful tax practices.
- An examination of the types of assistance that jurisdictions will need in the transition, recognising that an initial reduction in certain financial and other service activities may occur in some jurisdictions as a result of complying with the principles of the Report. OECD governments may consider:

20 – Examining how their bilateral assistance programmes can be re-targeted.

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- Encouraging international organisations to take into account the special needs of these jurisdictions in the design of multilateral assistance programmes.
- Offering under the auspices of the OECD and other organisations specific assistance in the design of their tax systems and in the strengthening of their tax administrations.

• Encouraging jurisdictions to initiate co-operative programmes to improve tax administration and enforcement by using existing organisations such as Intra-European Organisation of Tax Administrations (IOTA), Inter-American Centre of Tax Administrators (CIAT), Commonwealth Association of Tax Administrators (CATA), the Caribbean Community - (CARICOM), Centre de rencontres et d'études des dirigeants des administrations fiscales (CRE-DAF), and the Organization for Economic Cooperation (OEC).

27. The Committee accepts that the changes that will be necessary for jurisdictions meeting the tax haven criteria that commit to remove their harmful tax practices may adversely affect the economies of some of those jurisdictions. The OECD will work with other interested international and national organisations to examine how best to assist co-operative jurisdictions in restructuring their economies. A dialogue has already been launched with the OECD's Development Assistance Committee. Also, the Committee on Fiscal Affairs, by means of its CCNM-sponsored outreach programme, is prepared to assist jurisdictions in meeting the standards contemplated by the 1998 Report.

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IV. Involving Non-Member Economies

28. Harmful tax competition is by its very nature a global phenomenon and therefore its solution requires global endorsement and global participation. Countries outside the OECD must have a key role in this work since a number of them are either seriously affected by harmful tax practices or have potentially harmful regimes. Three regional seminars that brought together over 30 non-member countries were held prior to the finalisation of the 1998 Report: in Mexico (for the Latin American region); by the Asian Development Bank in Singapore (for the Asian region); in Turkey (for the NIS region). These three seminars have enabled the Committee to gain a better understanding of the concerns of countries outside the OECD area. Non-member economies should be invited to continue a dialogue with the OECD in relation to the work on tax competition.

29. Some non-member economies feature strongly in the global financial marketplace, with possibly major distortions being caused by the harmful tax practices they have put in place. There is a significant risk that a failure to address these practices in parallel with the work in relation to Member countries will cause a shift of the targeted activities to economies outside the OECD area, giving them an unwarranted competitive advantage and limiting the effectiveness of the whole exercise.

30. It is important to take forward the work of the Forum with regard to eliminating harmful tax practices on a global basis. To this end, the Committee will encourage non-member economies to associate themselves with the 1998 Report and to agree to its principles; and hold regional seminars that will encourage and assist non-member economies to remove features of their preferential regimes that are potentially harmful. This work programme should progress on a timetable that would facilitate the removal of harmful tax practices in non-member economies by 31 December 2005.

31. The Committee proposes that the Forum continue and intensify its dialogue to explore ways in which non-member economies that share the concerns of OECD members and that are prepared to accept the same obligations as OECD members could be more closely associated with the Forum. In this way, non-member economies can become partners in the development of an international framework

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appropriate in an era of liberalised financial markets. The Committee will initiate the dialogue regarding this approach on 29-30 June 2000 at a high-level meeting for non-member economies co-hosted by the Finance Minister of France.

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V. Framework for Implementing a Common Approach to Restraining Harmful Tax Practices

32. One objective of identifying harmful tax practices is to facilitate through co-ordination the OECD Member countries' actions against such practices, recognising the limitations on the effectiveness of unilateral actions.

33. The Committee recommends a general framework within which Member countries can implement a common approach to restraining harmful tax competition. This framework will facilitate the ability of countries to take defensive measures swiftly and effectively against jurisdictions that persist in their harmful tax practices. Defensive measures are important so that the adverse impacts from uncooperative jurisdictions can be addressed and so that these jurisdictions do not gain a competitive advantage over co-operative jurisdictions. In the application of the co-ordinated defensive measures, no distinction shall be made between jurisdictions that are dependencies of OECD countries and those that are not. These defensive measures would be at the discretion of countries and taken under their domestic legislation or under tax treaties. Moreover, each country may choose to enforce the defensive measures in a manner that is proportionate and prioritised according to the degree of harm that a particular jurisdiction has the potential to inflict, and taking into account the effectiveness of its existing defensive measures.

34. The 1998 Report suggested that defensive measures would be more effective if applied by a wide number of countries in a similar manner. A number of potential measures were identified for further study by the Forum. Paragraph 35 sets out these measures together with a number of other possible measures that the Forum believes might be able to form the framework of a common approach against harmful tax practices. The Committee on Fiscal Affairs will be working within the next six months to a year to consider these possible measures, finalise its recommendations, and adopt an implementation strategy and timetable. Those co-operating with the tax competition work will then be invited to adopt such of the measures recommended by the Committee to the extent possible and appropriate within their national systems, to be implemented against Uncooperative Tax Havens as of
24 31 July 2001. Countries may also take note of the defensive measures for purposes

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of combating any harmful tax practices that persist after the time by which they are expected to be removed.

35. The range of possible defensive measures identified to date as a framework for a common approach with regard to Uncooperative Tax Havens as of 31 July 2001 are as follows:

- To disallow deductions, exemptions, credits, or other allowances related to transactions with Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To require comprehensive information reporting rules for transactions involving Uncooperative Tax Havens or taking advantage of their harmful tax practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.
- For countries that do not have controlled foreign corporation or equivalent (CFC) rules, to consider adopting such rules, and for countries that have such rules, to ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices (Recommendation 1 of the 1998 Report).
- To deny any exceptions (*e.g.* reasonable cause) that may otherwise apply to the application of regular penalties in the case of transactions involving entities organised in Uncooperative Tax Havens or taking advantage of their harmful tax practices.
- To deny the availability of the foreign tax credit or the participation exemption with regard to distributions that are sourced from Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To impose withholding taxes on certain payments to residents of Uncooperative Tax Havens.
- To enhance audit and enforcement activities with respect to Uncooperative Tax Havens and transactions taking advantage of their harmful tax practices.
- To ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with Uncooperative Tax Havens and to transactions taking advantage of their harmful tax practices.
- Not to enter into any comprehensive income tax conventions with Uncooperative Tax Havens, and to consider terminating any such existing conventions unless certain conditions are met (Recommendation 12 of the 1998 Report).
- To deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in Uncooperative Tax Havens.
- To impose "transactional" charges or levies on certain transactions involving Uncooperative Tax Havens.

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36. Governments are invited to take into account that a jurisdiction is listed as an Uncooperative Tax Haven in determining whether to direct non-essential economic assistance to the jurisdiction. The Committee also intends to continue to explore what other defensive measures can be taken, including non-tax measures.

37. Governments are also reminded of Recommendation 17 of the 1998 Report, which recommends that countries with particular political, economic, or other links with tax havens ensure that these links do not contribute to harmful tax competition. Also, paragraph 153 of the 1998 Report indicates that countries that have such ties should consider using them to reduce the harmful tax competition resulting from the existence of these tax havens.

38. The Committee invites Member countries to refrain from using the names of jurisdictions in paragraph 17 to identify jurisdictions against which new or enhanced defensive measures should be applied, but rather to use the List of Uncooperative Jurisdictions for this purpose. The Forum recognises that Member countries retain the right to apply, or not apply, defensive measures unilaterally to any jurisdiction.

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VI. The Resource Implications for the OECD

39. The success of the work programme outlined above will depend upon OECD Member countries being prepared to strengthen the parts of their administrations dealing with international tax issues and to ensure that the organisation has the resources necessary to carry out this work which the Committee recognises may require a review of priorities within the OECD budget. The Committee does not underestimate the constraints that countries face in providing such resources. Ministers are therefore encouraged to ensure that their national administrations and the OECD have the resource bases from which to move to a successful conclusion of this work.

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RECOMMENDATION OF THE COUNCIL ON IMPLEMENTING THE PROPOSALS CONTAINED IN THE 1998 REPORT ON HARMFUL TAX COMPETITION (ADOPTED BY THE COUNCIL ON 16 JUNE 2000)

THE COUNCIL,

- Having regard to Article 5*b)* of the Convention on the Organisation for Economic Co-operation and Development of 14 December 1960;
- Having regard to the Report entitled "Harmful Tax Competition; An Emerging Global Issue" (the "*1998 Report*");
- Having regard to the Recommendation of the Council dated 9 April 1998 on counteracting Harmful Tax Competition adopted by the Council on 9 April [C(98)17/FINAL];*
- Having regard to the Report adopted by the Committee on Fiscal Affairs on "Progress on Identifying and Eliminating Harmful Tax Practices" (the "*2000 Report*") (DAFFE/CFA/FHP(2000)11/REV2/CONF, attached as Annex I) at its meeting on 25 May 2000;
- Recognising the OECD's role in promoting an open, multilateral trading system and the need to promote the "level playing field" which is essential to the continued expansion of global economic growth;
- Recognising that the process of globalisation and the development of new technologies has brought about prosperity for many citizens around the world, but also raises challenges for governments to minimise tax induced distortions in investment and financing decisions and to maintain their tax base in this new global environment;
- Considering that if governments do not intensify their co-operation, the tax base will be eroded, a part of the tax burden will shift from income on mobile activities to taxes on non mobile activities and that such a shift would make tax systems less equitable and may have a negative effect on employment;
- Recognising the need for an ongoing dialogue with non-member economies to encourage them to associate themselves with the recommendations set out in the *1998 Report*;
- Noting, in this respect, the high-level meeting with non-member economies co-hosted by France and the OECD, scheduled for 29-30 June 2000 to explore ways in which they can be more closely associated with the *1998 Report*;
- Noting, furthermore, the high level political commitment made by Bermuda, Cayman Islands, Cyprus, Malta, Mauritius, and San Marino to eliminate harmful tax practices in accordance with the principles set out in the *1998 Report*;

* Luxembourg and Switzerland abstained.

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- Having regard to the jurisdictions identified in the *2000 Report* that meet the criteria set out in the *1998 Report* for being a tax haven;
- Noting the proposal of the Committee on Fiscal Affairs to produce by 31 July 2001 a List of Uncooperative Tax Havens and to use this List as the basis for implementing co-ordinated defensive measures;
- Having regard to preferential tax regimes in OECD Member Countries identified as potentially harmful;

On the proposal of the Committee on Fiscal Affairs:

1. **RECOMMENDS** that Member countries having approved the 1998 Report:
   1. Collectively through the Committee on Fiscal Affairs take forward an active dialogue with the jurisdictions identified in the *2000 Report* as meeting the tax haven criteria with a view to obtaining the commitment of these jurisdictions to eliminate harmful tax practices in accordance with the principles of the *1998 Report*;
   2. Refrain from using the identification of jurisdictions meeting the tax haven criteria in the *2000 Report* as a basis for new or enhanced defensive measures, but rather to use the list of un-cooperative tax havens for this purpose.
   3. Individually and collectively explore ways, on a global as well as regional basis, to assist co-operative jurisdictions to move away from harmful tax practices.
2. **INSTRUCTS** the Committee on Fiscal Affairs to:
   1. Establish a co-operative process to promote the elimination of harmful tax practices by the jurisdictions identified in the *2000 Report* as meeting the tax haven criteria;
   2. Produce an OECD List of Uncooperative Tax Havens, by 31 July 2001;
   3. Include automatically on the OECD List of Uncooperative Tax Havens any jurisdiction identified in the *2000 Report* as meeting the tax haven criteria if the jurisdiction does not by 31 July 2001 commit to eliminate harmful tax practices in accordance with the *1998 Report* in a manner satisfactory to Member countries;
   4. Update regularly the OECD List of Uncooperative Tax Havens;
   5. Carry out work through the Forum on Harmful Tax Practices and, where appropriate, through other subsidiary bodies of the Committee, to develop guidance (application notes) to assist Member and non Member Countries in assessing whether their potentially harmful preferential regimes are, or could be applied to be, actually harmful, and in determining how to remove the harmful features of such regimes, in order to meet their commitments under Recommendation 15 of the *1998 Report* to remove harmful features of harmful preferential tax regimes by April 2003;
   6. Undertake a verification process to ascertain that OECD countries have met their commitments, and report back to the OECD Council no later than June 2003 regarding compliance with Recommendation 15 of the *1998 Report*;
   7. Explore ways in which non-member economies that share the concerns of Member countries to counter harmful tax practices can be brought into an active dialogue with the Forum on Harmful Tax Practices;
   8. Work with interested international and bilateral assistance agencies to assist co-operative jurisdictions to meet the tax and regulatory standards set out in the *1998 OECD Report* and to work with these jurisdictions during the transitional period to support their economies as they move away from harmful tax practices.

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Senate Permanent Subcommittee
On Investigations
EXHIBIT #___26___

July 16, 2001

Senator Carl Levin, Chairman
Senate Governmental Affairs Committee
Permanent Subcommittee on Investigations
SR-100 Russell Senate Office Building
Washington, DC 20510

Senator Susan M. Collins, Ranking Member
Senate Governmental Affairs Committee
Permanent Subcommittee on Investigations
SR-100 Russell Senate Office Building
Washington, DC 20510

Dear Senator Levin and Senator Collins:

I would like to thank the members of the Subcommittee for allowing me the opportunity to submit this written statement on the important issue of exchanges of taxpayer information pursuant to the provisions of the Income Tax Treaties ("Treaties") and Tax Information Exchange Agreements ("Agreements") the United States has in force and effect with more than 70 other nations. This statement reflects my views and should not be considered as representing either the position of my firm, Deloitte & Touche, or any of its clients.

The exchange of information with our Treaty and Agreement partners for legitimate criminal and civil tax administration purposes is an essential element in maintaining the integrity of our voluntary compliance system of taxation. My conclusion is based on more than fifteen years of experience in several key executive positions in the Internal Revenue Service.

From 1985 to 1988, I served as the District Counsel for the IRS in Miami, Florida. Among other responsibilities, I was the lead IRS attorney to the special agents assigned to Operation Greenback. This operation was the vanguard in our government's war against narcotics trafficking and money laundering.

From 1988 to 1993, I was the IRS Assistant Chief Counsel (International – Litigation). In that position, I either led or supervised the negotiation of Agreements with Colombia, Costa Rica, Dominican Republic, Honduras, Mexico, Peru, and Trinidad and Tobago. The Agreement with Peru was signed by President George Bush at the February 15, 1990, Drug Summit in Cartagena, Columbia.

Beginning in August 1995, and until my retirement from federal service in January 2000, I served as IRS Assistant Commissioner (International). As such, I became the United States Competent Authority (USCA) responsible for administering all Treaties and Agreements. A significant component of my duties involved the oversight of, and ultimate responsibility for, the exchange of information program. During my tenure, I supervised thousands of exchanges of information between the United States and Treaty and Agreement partners. These exchanges were both "outbound" (information provided by the United States) and "inbound" (information provided to the United States) and covered various types of information.

The Exchange of Information

Generally, there are three categories of information exchanges that would be of interest to this subcommittee:

1. Routine exchanges involve the provision of information on U.S.-source income paid to a resident of a Treaty or Agreement partner that is subject to withholding tax such as interest, royalties, and dividends. Similar information is provided to the United States by its partners. Measured by volume of information, routine exchanges constitute the bulk of the exchange program.

2. Spontaneous exchanges involve furnishing information discovered during a tax examination or investigation that suggests or establishes noncompliance with the tax laws of a Treaty or Agreement partner.

3. Specific requests for information are generated as a result of a tax audit or examination of the taxpayer(s) by the Treaty or Agreement partner requesting the information. In the case of an inbound request (a request made to the United States), if the information sought is not already in the possession of the IRS, the agency will attempt to obtain it from other sources. For this purpose, the IRS may use any of the procedures available for domestic tax investigations. To execute a specific request, the IRS must determine that the request has a proper purpose under the treaty and the request must be sufficiently precise to facilitate processing. The type of information sought through a specific request is frequently information in the possession of third parties, such as bank account information, books and records, financial statements, testimony, etc.

Safeguards and Restrictions on the Use of Information

When dealing with specific requests for information, the USCA is particularly mindful of the safeguards and restrictions contained in the Treaty or Agreement with the receiving country. These safeguards and restrictions require that the information provided in response to the request: be used strictly for tax administration purposes; be treated with the same level of confidentiality as mandated by the laws of the receiving state (all Treaty and Agreement partners have anti-disclosure provisions similar to section 6103); and, not be obtained in a manner at variance with the laws and administrative practices of either the receiving country or the United States. Because a Treaty or Agreement partner "steps into the shoes" of the IRS when making a request, these same safeguards and restrictions apply to the request.

Codified Safeguards

The Internal Revenue Code also provides safeguards that apply to specific information requests. In relevant part, section 7602 authorizes the IRS to issue summonses for the production of materials and to compel testimony to: (1) ascertain the correctness of any return to; (2) make a return where none has been filed; (3) determine the liability of any person for any internal revenue tax; and (4) determine the liability at law or in equity of any transferee or fiduciary or any person for any internal revenue tax.

Section 7609 restricts this authority when the IRS issues summonses for records and testimony from any "third-party recordkeeper." The term third-party recordkeeper includes banks, savings and loan

institutions, credit unions, consumer reporting agencies, credit card issuers, brokers, attorneys, and barter exchanges. Specifically, section 7609 requires that the IRS notify the taxpayer being investigated in the summons within three days after serving the third party and no later than the twenty-third day before the date specified in the summons as the date when the records will be examined. This protection affords the taxpayer an opportunity to intervene by filing a motion to quash the summons in the United States district court. For this purpose, the term "taxpayer" includes the taxpayers of the requesting state who are entitled to the same notification and intervention opportunities.

In the case of John Doe Summonses (summonses that do not identify the taxpayer about whom information is being requested), additional restrictions apply. Prior to issuing a John Doe Summons, the IRS must first establish in an ex-parte court proceeding that: (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons; (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) the information sought (as well as the identity of the person or persons under investigation) is not readily available from other sources.

Judicial Safeguards

In addition to those requirements, the criteria set forth in *Powell v. United States*, 379 *U.S. 48 (1964)* apply to specific requests for information. In *Powell,* the Supreme Court outlined the standards that the IRS must meet to obtain judicial enforcement of its summons. It must show that: 1) the investigation has a lawful purpose; 2) the inquiry may be relevant to that purpose; 3) the information sought is not already within the government's possession; and 4) the administrative steps required by law have been followed.

The application of sections 7602 and 7609 and the protections afforded in these sections and in *Powell* have been sustained in the context of specific requests for information pursuant to a Treaty or Agreement. *See U.S. v. A.L. Burbank & Co., Ltd.*, 525 F.2d 9 (2d Cir. 1975) (relating to an exchange of information request under the U.S./Canada Treaty involving section 7602); *U.S. v. Manufacturers and Traders Trust Co.,* 703 F.2d 47 (2d Cir. 1983) (relating to an exchange of information request under the U.S./Canada Treaty involving section 7602 and *Powell* where the information obtained would also be used in a Canadian criminal investigation); *U.S. v. Lincoln First Bank, N.A.,* 80-1 U.S.T.C. 9231 (S.D.N.Y. 1980) (relating to an exchange for information request under the U.S./Norway Treaty involving the protections afforded under section 7609); and *U.S. v. Stuart*, 109 S. Ct. 1183 (1989) (relating to an exchange of information request under the U.S./Canada Treaty involving section 7609 and *Powell* where the Canadian tax investigation was directed toward criminal prosecution under Canadian law).

Finally, in addition to the noted legal safeguards, administratively imposed layers of review provide an enhanced level of due diligence to insure against any improper purpose. At a minimum, every specific request is carefully reviewed by at least one member of the team of experts assigned to the staff of the USCA. Furthermore, a summons cannot be enforced in federal district court without the review and approval of the USCA, the Office of Chief Counsel of the IRS, and the Department of Justice.

In my 4.5 years as the USCA, I am aware of only two situations, involving two different countries, in which there was a possible violation of the above-noted safeguards and restrictions. Each case involved an alleged or apparent abuse of the strict disclosure prohibition contained in the treaties and agreements and I, as the USCA, suspended the exchange of information program with regard to each country. With regard to one of the countries, the exchange program was resumed only after my counterpart in that

country investigated the matter, reported the results of the investigation to me, and I determined that insufficient evidence of an abuse existed to justify a continuation of the suspension. To my knowledge the exchange of information program was never resumed in the other country. It is important to note that in each case, the abuse involved the alleged unlawful disclosure of taxpayer information but did not deal with an allegation of improper purpose.

Benefits of Exchanging Information

It is axiomatic that there is a very strong correlation between criminal tax evasion and other illegal activities such as narcotics trafficking and money laundering. Indeed, some form of tax evasion is nearly inevitable in any illegal activity that generates income. The role that bank secrecy and anonymous commercial structures, such as bearer shares, play in facilitating tax evasion as well as the underlying criminal enterprises themselves, is well known and undeniable. At the Senate Committee on Governmental Affairs Permanent Subcommittee on Investigations hearing on crime and secrecy and the use of offshore banks and companies, which was conducted on March 15, and 16, 1983, the testimony given by Reagan Administration officials emphatically affirmed this dangerous relationship. Their testimony is also entirely consistent with my experiences as a participant in the government's war against the narcotics traffickers and money launderers.

Reagan Administration officials also spoke about the role of the Caribbean Basin Initiative (CBI), the legislation that was the genesis for the creation of Tax Information Exchange Agreements, in combating illegal activity. Glenn Archer, Assistant Attorney General of the Department of Justice's Tax Division, called the CBI an "important development" in getting Caribbean countries to relax their bank secrecy rules that allow money from illegal activities to be laundered through tax havens in the Caribbean. D. Lowell Jensen, Assistant Attorney General of the Department of Justice's Criminal Division cited bilateral treaties that provide "mutual assistance in the investigative effort" as the most appropriate and effective way to attack international crime. And John Walker, Treasury's Assistant Secretary for Enforcement Assistant, said the CBI was "an important part of the initiatives undertaken by the United States to combat international tax avoidance and evasion."

The Exchange of Information Requirement

Congress passed the CBI as part of the Caribbean Basin Economic Recovery Act (CBERA) in 1983. The CBI uses a carrot-and-stick approach to encourage Caribbean jurisdictions to share information with the United States that could be used to detect and prosecute illegal activity. Generally, section 274(h) restricts the ability of U.S. taxpayers to deduct the cost of conventions or seminars outside the "North America area" (the United States, its possessions, and the Trust Territory of the Pacific Islands, and Canada and Mexico) unless the taxpayer establishes that the meeting is directly related to the active conduct of his trade or business and if (after taking into account criteria prescribed by the Secretary) it is as reasonable for the meeting to be held outside the North American area as within the North American area.

As an incentive to encourage the sharing of information regarding civil and criminal tax matters, Congress added section 274(h)(6) as part of the CBI. Section 274(h)(6) expands the definition of North American area to include any "beneficiary country" (Caribbean Basin countries including Bermuda) which has in effect an exchange of information agreement between the United States and such country

and gives the Secretary authority to negotiate and conclude exchange of information agreements with any beneficiary country. Consistent with the goals of the CBI, section 274(h)(6)(C) further mandates that, among other things, any such exchange of information agreement negotiated and concluded by the Secretary shall provide for the exchange of information:

> ... as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares.

Expansion to Non-CBI Countries

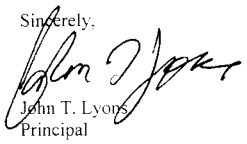
With the increased globalization of our economy, there is continuing need to share information with other countries. The authority granted to the Secretary under the CBI to enter into tax information exchange agreements (TIEA) with Caribbean nations has been expanded to include non-CBI jurisdictions.

In *Barquero v. United States*, 18 F.3d 1311 (April 20, 1994), the court rejected a challenge to the validity of the TIEAs, holding that the government has the authority to enter into such agreements with any foreign country, not only with those listed in the CBERA.

Conclusion

In my experience, the exchange of information program is a critical element in our effort to curb narcotics trafficking, money laundering, tax evasion and other crimes. In addition, exchanges of information for civil purposes enhance our system of taxation by protecting its integrity. As discussed above, the safeguards and restrictions contained in sections 6103, 7602, and 7609, as well as the protections afforded by the Powell Doctrine provide ample protection aginst the improper use of the exchange of information by a treaty or agreement partner. The continuation, and possible expansion of the program, within the context of these safeguards, is in the best interests of our country.

Sincerely,



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Senate Permanent Subcommittee
On Investigations
EXHIBIT #___27___

Citizens for Tax Justice

July 17, 2001

Chairman Carl Levin
U.S. Senate Governmental Affairs Permanent Subcommittee on Investigations
Washington, D.C.

Dear Senator Levin:

I want to commend you for your hearing this week about recent threats to the ongoing efforts by the United States and other developed countries to protect their honest taxpaying citizens against tax evasion by the rich and powerful through tax havens. This is a very important issue—honest taxpayers should not have to pay higher taxes or receive less in government service because tax cheaters evade their responsibilities—and I have a few thoughts about it that I'd like to share with you.

A tax haven is a country that sells the benefits of its sovereignty to companies and individuals that want to cheat on their income taxes by funneling their money through that country. The scope of the problem is suggested by a 1999 report by the French government's office for drug control and crime prevention, which found that more than $5 trillion in U.S. financial assets were located in tax havens and offshore financial centers.[1]

A key to the successful use of tax havens is secrecy. Tax haven abuses are not caused simply by low tax rates—or no income taxes at all—in a tax-haven country. If the country where the tax-haven income is actually earned discovers the hidden income, that income will often be subject to tax there. Alternatively, if the country where the tax cheats actually live or are incorporated can discover the hidden income, it will generally be subject to that resident country's income tax.[2]

Thus, the role of tax havens in acting as conduits for tax evasion can be defeated by full disclosure, both to the countries where the income is earned and to the countries of residence.

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[1]Cited in Berthault, Anne-Marie, "A French Perspective on Tax Havens and Bank Secrecy: Is the Future a Transparent One?" 22 *Tax Notes Int'l* 3171, Mar. 29, 2001.

[2]To prevent certain tax-haven abuses, Congress enacted the subpart F provisions of the Internal Revenue Code to tax on a current basis the income earned by foreign corporations controlled by U.S. shareholders (CFCs). These subpart F rules are necessary to protect U.S. residence jurisdiction. Secrecy rules in the tax-havens are sometimes used by CFCs to evade the subpart F rules.

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Over the past several years, the United States and its OECD trading partners have been working to pierce the veil of secrecy that has allowed unscrupulous individuals and companies to shift their taxes onto others through the use of tax havens. This laudable effort has struck fear into the hearts of tax cheats, who have been lobbying intensely to fight against disclosure of their illegal activities. As a result, our own Treasury Department has recently been wavering in its support for a crack-down on tax haven abuses. We hope your hearing will help rekindle the U.S.'s long-standing commitment to protecting honest Americans against tax cheating.

Statement of the problem

As a longstanding general rule, U.S. citizens and corporations must report their earnings on their U.S. tax returns, wherever their income happens to be earned. To avoid double taxation, taxes paid to foreign governments on overseas income are creditable against U.S. taxes otherwise due on foreign income.[3]

Tax havens undermine the equity of our tax system and increase burdens on honest Americans by allowing unscrupulous citizens and companies to avoid paying their fair share of taxes. The tax havens do so in two steps, each involving secrecy.

First, tax havens act as conduits to shift income outside of the country where the income is actually earned and into a tax-free jurisdiction. This shift is a fiction, of course. No one, for example, can honestly argue that interest allegedly "earned" in the Cayman Islands is actually attributable in any real sense to interest payments by Cayman Island borrowers. If the country where the income is actually earned—say, Germany—can discover the phony, paper recharacterization of the source of the income, it will have the right to tax it.

But even if source countries do not—or because of non-disclosure, cannot—assert their tax jurisdiction over tax-haven income, it takes a second step for tax-haven tax

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[3]It is very hard to tax investment income in a source country unless that income is also subject to tax on a global basis in the residence country—with a credit for taxes paid to the source country. Tax havens can defeat residence taxation, and then the market can defeat source taxation. For example, if the US successfully taxes the worldwide capital income of its residents (individuals and corporations), giving a credit for foreign income taxes paid, then there is no tax competition for U.S. investment dollars because a lower foreign tax just increases U.S. tax. If the tax havens defeat the U.S. residence tax, then the source tax has bite and there may be tax competition for U.S. investment dollars. The U.S. position since the dawn of the U.S. income tax has been to tax worldwide income of U.S. residents and citizens and thereby prevent countries from using tax policy to attract U.S. capital.

To be sure, in 1984, the United States adopted rules that exempted foreigners on most forms of interest income earned here, and it specifically refused to provide routine disclosure to foreign governments of the interest their citizens earned. The objective was to attract investment from foreigners not taxable abroad to help cover the Reagan budget deficits. Often the reason those foreigners wer not taxable in their home country was that they were engaged in tax evasion. This was a very bad law on moral and economic grounds and has been much abused. But this type of bad law is not the target of the OECD initiative because the U.S. is the source country and has the right to give up *its* tax base if it chooses to do so. The U.S. is a rogue state insofar as it is facilitating tax evasion in residence countries, but it is not a tax haven because the income it declines to tax is earned here.

evasion to work for U.S. citizens and corporations. The tax haven country also must refuse to disclose the tax haven income to the U.S. government. That's because, of course, if the U.S. knows about the tax haven income of a U.S. citizen or corporation, it will tax it.

Thus, non-disclosure is at the heart of tax-haven abuses.

The OECD anti-tax-haven initiative

Over the past few years, the U.S. and its leading trading partners in the Organisation for Economic Cooperation and Development (OECD) have been working together to promote full disclosure of tax haven income to the proper taxing jurisdictions. Encouragement of full information exchange would be the preferred means to obtain disclosure. But the history of tax-haven regimes thumbing their noses at other countries makes it clear than such encouragement would have to be backed by sanctions to be effective. Those sanctions would be intended to make it difficult for financial institutions and private residents from OECD countries to do business with tax havens that facilitate tax evasion through secrecy.

OECD's goal is pretty straightforward. As U.S. Assistant Treasury Secretary Mark Weinberger put it earlier this year, "Countries generally should not engage in practices that make it easier for other countries' laws to be broken or frustrated. . . . [T]hose practices might include bank secrecy rules or an unwillingness to exchange tax information with us that would permit taxpayers more readily to evade our laws."

The opposition to disclosure

Who could be against full disclosure of illegal tax evasion? Well, for starters, multinational corporations, which have strongly opposed the OECD initiative. The extent to which U.S.-based multinational companies are engaging in tax fraud and/or aggressive tax avoidance is not known, for obvious reasons. It is suspected that the U.S. multinationals are afraid that without bank secrecy in the havens, the IRS will discover the extent of their vast dealings and challenge aggressive avoidance etc. Also, the companies regularly take inconsistent positions on the same transactions (for example, calling something a lease in one country and a purchase with interest payments in another), and the bank secrecy laws mask what they are doing.

Of course, dishonest rich Americans engaged in tax evasion also oppose the OECD initiative. They use financial intermediaries located in tax havens to earn dividends, interest, and other investment income in the United States and other developed countries and then fail to report that income to the U.S. government. Full disclosure of their dealings by the tax havens would bring their evasion to light and force them to pay their fair share of taxes to the government.

Strangely, numerous "conservative" groups and individuals have spoken out in favor of continued tax-haven abuses. This "tax cheaters lobby" includes a long list of the right's luminaries, such as Jack Kemp, House Majority Leader Dick Armey, Paul Weyrich of the Christian Right, Steve Moore, ex-Cato, now leader of the Club for Growth PAC,

the anti-union National Taxpayers Union, the Heritage Foundation, corporatist groups such as Citizens for a Sound Economy and Citizens against Government Waste, former Chamber of Commerce chief economist Richard Rahn, Arthur Laffer, and Grover Norquist of Americans for Tax Reform.

These and others have banded together under an umbrella organization called the "Center for Freedom and Prosperity." Although this group has so far refused to reveal its funding, it's reasonable to assume that tax-evading companies and dishonest wealthy people provide most of the support.

One might think from their usual public rhetoric that law and order would be something ultra-conservatives would support. But that's apparently not the case when it comes to taxes. "A network of global tax police!" complains Dick Armey. "A display of imperialism not seen since the collapse of the Soviet empire!" thunders Dan Mitchell of the Heritage Foundation. "A Frenchman, for example, who parks some money in Switzerland or the Cayman Islands . . . will find his bank there required to report his holdings to the French government," laments supply-sider Paul Craig Roberts.

One article on the Center for Freedom and Prosperity's pro-tax-evasion web site explains "Why the War on Money Laundering is Counterproductive." Another offers "The Case for Swiss Bank Secrecy." And still another worries about "the future of offshore financial centres, such as Vanuatu"—a south Pacific tax haven also known for its promotion of pay-per-view pornography scams on the Internet.

The conservative defense of tax havens may represent a backdoor way to try to get the essence of what they want from the flat tax, namely a tax exemption for investment income. At least for those with insufficient patriotism and enough investment income to make it worth the trouble, a de-facto exemption for allegedly "foreign" investment income would in the long run mean an exemption for all investment income. And that would inevitably lead to higher taxes on the wages and other earnings of ordinary American taxpayers.

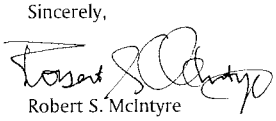
Conclusion

Despite the obvious benefits to the vast majority of honest American taxpayers from stopping tax evasion, the Bush administration has been trying to water down the OECD's crackdown on tax havens. In May, Treasury Secretary Paul O'Neill overruled his tax policy staff and shockingly characterized the OECD's anti-tax-haven effort as "not in line with this administration's tax and economic priorities."

As a result of the Bush Administration's backpedaling, a tentative agreement has been reached between it and the other OECD countries to give tax havens extra time to comply with OECD demands for fuller disclosure. In addition, tax havens that refuse to comply will not face sanctions until at least April 2003, which is much later than previously anticipated. And any sanctions apparently will be delayed indefinitely unless and until all of the OECD's 30 member countries have scrapped their own preferential tax policies toward investment income—even though those policies may have nothing to do with promoting tax evasion.

Such an astonishing reversal of long-standing U.S. policy against tax cheating, reaffirmed by both the Reagan and Clinton administrations, would be a terrible mistake. We hope that your hearing will help focus public attention on the injustice to average taxpayers that failure to curb tax haven abuses would entail.

Sincerely,



Robert S. McIntyre
Director

Senate Permanent Subcommittee
On Investigations
EXHIBIT # 28

STATEMENT

of the

UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

For submission to:

The U.S. Senate Permanent Subcommittee on Investigations
Committee on Governmental Affairs

Regarding:

The Harmful Tax Competition
Project Undertaken by
The Organization of Economic
Cooperation and Development (OECD)

July 12, 2001

1212 Avenue of the Americas, New York, NY 10036 • t: 212-354-4480 • f: 212-575-0327 • www.uscib.org • info@uscib.org

Dear Sirs:

The United States Council for International Business (USCIB) is grateful for the opportunity to present this statement to the U.S. Senate's Permanent Subcommittee on Investigations with regard to the OECD's project on Harmful Tax Competition (HTC).

The USCIB advances the global interests of American business both at home and abroad. It is the American affiliate of the International Chamber of Commerce (ICC), the Business and Industry Advisory committee (BIAC) to the OECD, and the International Organisation of Employers (IOE). As such, it officially represents U.S. business positions in the main intergovernmental bodies, and vis-à-vis foreign business and their governments.

The USCIB addresses a broad range of policy issues with the objective of promoting an open system of world trade, finance and investment in which business can flourish and contribute to economic growth, human welfare, and protection of the environment.

The USCIB formulates its various positions in over forty committees and in other working groups, composed of corporate and other experts drawn from its membership of 300 multinational corporations, service companies, law firms, and business associations. It advocates these positions to the U.S. Government and to such intergovernmental organizations as the OECD, ILO and other bodies of the UN system with which its international affiliates have official consultative status on behalf of world business.

In addition to our participation in the activities of BIAC (the undersigned is a committee chair), the USCIB Taxation Committee has been engaged for over two years in consultations with representatives of the U.S. Treasury Department (Treasury) concerning the role of the U.S. in the HTC project. We strongly criticized the HTC project to Treasury at the outset, because the initial approach embodied in the HTC report seemed to us to be dictating tax policy and encouraging tax harmonization, while, at the same time, attempting to eradicate various legitimate tax planning opportunities available to the multinational business community.

Since then, we have continued to counsel Treasury to use its best efforts to change the focus of the project to deal solely with transparency and information exchange primarily aimed at eliminating, to the extent possible, illegal activities, both criminal and civil. We strongly believe that such a refocus would be much more successful in attacking, prosecuting, and ultimately minimizing tax fraud and evasion.

We fully appreciate that a responsibly administered information exchange program can also assist various tax authorities in carrying out their audit functions, and the U.S. business community does not object to such use of information exchanges. Although the U.S. business community accepts the need for responsible and legitimate information exchanges, we are concerned that such activity not lead to burdensome or illegal "fishing expeditions."

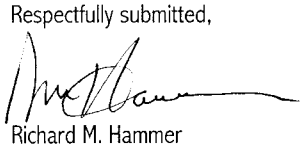
Although we have not yet seen an official statement of position from the OECD on the HTC project arising out of its June 2001 meeting, we are hopeful that our concerns have been addressed in a constructive manner. The U.S. business community has informally advised Treasury that it would be supportive of the project if it focused solely on the encouragement of appropriate transparency in tax systems throughout the world (both member and non-member countries) as well as the development of appropriate exchange of information regimes, to be established by way of bilateral treaty arrangements.

We would like to call your attention to the May 10, 2001 public statement by Treasury Secretary O'Neill on the OECD Harmful Tax Competition Project. As set forth in this letter, on the issue of information exchange in the context of this OECD project, the position of the USCIB is consistent with that of the Secretary, and, therefore, we very strongly support his approach.

* * * * *

Thank you again for the opportunity to present this statement. We are very appreciative.

Respectfully submitted,



Richard M. Hammer
International Tax Counsel

Senate Permanent Subcommittee
On Investigations
EXHIBIT #29a

CURRENT STATUS OF OECD'S HARMFUL TAX PRACTICES INITIATIVE

A statement by the Chairman of the OECD's Committee on Fiscal Affairs

Mr. Gabriel Makhlouf

Introduction

Today the OECD Council agreed to release a report which provides an update on the current status of the OECD's project on harmful tax practices and clarifies the aims and scope of the project.

Before getting into the details I want to emphasise that OECD countries are committed to ensuring that there is a genuine dialogue between them and the jurisdictions identified in the OECD's 2000 Report as well as the jurisdictions that made commitments prior to the release of the 2000 Report. We are convinced that with the enhancements to the OECD project set out in the 2001 Report, which take account of the extensive and constructive dialogue we have had with the jurisdictions over the last 12 months, it will be possible for all jurisdictions to make the commitments we are now looking for.

Background

1. The OECD's project on counteracting harmful tax practices is part of a wider initiative of Member countries to promote good governance in a globalised economy. Globalisation has enormous potential to improve living standards around the world. But it also brings risks, including the risk of abuses of the free market system, which could have a negative impact on the world economy and its people by distorting the free flow of capital and undermining the ability of governments to finance the legitimate expectations of their citizens for publicly provided goods and services. Unfair tax practices which attract financial services and highly mobile activities can be exploited by tax evaders and therefore can erode a country's tax base, shift the tax burden from dishonest to honest (and generally poorer) taxpayers and distort decisions on where to locate economic activities.

2. The OECD project is intended to counteract such practices. The focus of the project is on geographically mobile activities, including financial and other services, given that the risks posed to governments are greater with respect to these activities than in others.

3. By providing a framework within which all countries - large and small, rich and poor, OECD and non-OECD - can work together to eliminate harmful tax practices, the OECD seeks to promote tax competition that will achieve the overall aims of the OECD to foster economic growth and development world-wide. The OECD project does not seek to dictate to any country what its tax rates should be, or how its tax system should be structured. It also does not seek to hinder enterprises in carrying out their normal business or to threaten the privacy of taxpayers. It seeks to encourage an environment in which transparent and fair tax competition can take place.

4 It was with this objective in view, that the OECD published a report in 1998 entitled *"Harmful Tax Competition: An Emerging Global Issue (the "1998 Report")*, which amongst other things, developed criteria to identify the harmful aspects of a particular regime or jurisdiction.

5. The 1998 Report was followed by a report in June 2000 entitled *"Towards Global Tax Co-Operation: Progress in Identifying and Eliminating Harmful Tax Practices (the "2000 Report")*. That report:

- Identified 47 potentially harmful preferential tax regimes in OECD Member countries.
- Listed 35 jurisdictions found to meet the tax haven criteria.
- Proposed a process whereby tax havens could commit to eliminate harmful tax practices.
- Made proposals for associating non-member economies with the harmful tax practices project.
- Proposed elements of a possible framework of co-ordinated defensive measures designed to counteract the erosive effects of harmful tax practices.

6. Already today the OECD has had considerable success in its dialogue with offshore jurisdictions. Eleven jurisdictions – Aruba, Bahrain, Bermuda, Cayman Islands, Cyprus, Isle of Man, Malta, Mauritius, Netherlands Antilles, San Marino and Seychelles - have committed to eliminate their harmful tax practices. And these jurisdictions are working with us to develop a new legal instrument on Exchange of Information (in fact they are meeting with OECD in Paris this week). Tonga has taken steps to eliminate its harmful tax practices and no longer meets the tax haven criteria.

Modifications to the Tax Haven Work

7. Several jurisdictions interested in making commitments raised concerns about the commitment process, including concerns regarding the transparency of the process and the need for greater detail regarding the harmful features to be eliminated. In November 2000, the OECD responded to these concerns by establishing an alternative process that set out in greater detail the terms of the commitments sought and a proposed timetable for implementation, and by providing for the publication of the details of any future commitments.

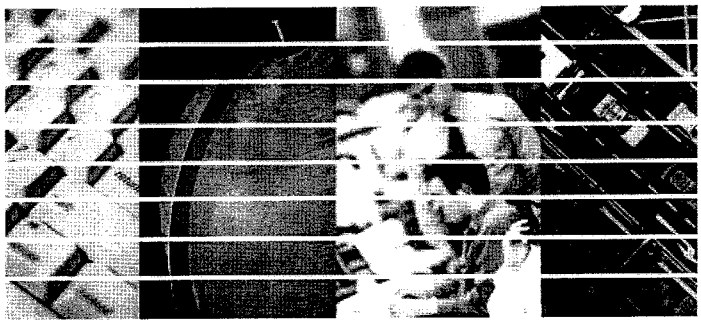
8. In response to concerns regarding the application of the no substantial activities criterion to tax havens, the application of a framework of co-ordinated defensive measures to tax havens as of 31 July 2001 and the timeframe for developing implementation plans, we have agreed today on the following modifications to the project:

- The commitments from tax havens will be sought only with respect to the transparency and effective exchange of information criteria to determine which jurisdictions are considered as uncooperative tax havens. Member countries would, however, welcome the removal by tax havens of practices implicated by the no substantial activities criterion insofar as they inhibit fair competition.

- The potential framework of co-ordinated defensive measures would not apply to uncooperative tax havens any earlier than it would apply to OECD Member countries. OECD Members retain the sovereign right to apply, or not to apply, any defensive measures as appropriate, either within or outside a framework of co-ordinated defensive measures

- In the light of these developments and given the number of ongoing discussions with jurisdictions on the conclusion of commitments, it was not feasible to maintain the 31st July 2001 deadline for producing a list of uncooperative tax havens. Jurisdictions will now have until the 28th February 2002 to make a commitment. Jurisdictions that meet the deadline will not be included in the list of uncooperative tax havens, which will be issued once the CFA has reviewed the outcome of the commitment process.

Senate Permanent Subcommittee
On Investigations
EXHIBIT #_____29b_____



THE OECD'S PROJECT ON HARMFUL TAX PRACTICES:

THE 2001 PROGRESS REPORT

OECD

Centre for Tax Policy and Administration

CTPA

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 declassified by the OECD Council on 14th November 2001.

Disponible en français sous le titre :
PROJET DE L' OCDE SUR LES PRATIQUES FISALES DOMMAGEABLES: RAPPORT D'ETAPE 2001

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THE OECD'S PROJECT ON HARMFUL TAX PRACTICES: THE 2001 PROGRESS REPORT[1]

I. INTRODUCTION

1. The more open and competitive environment of the last decades has had many positive effects on tax systems, including the reduction of tax rates and broadening of tax bases which have characterized tax reforms over the last 15 years. In part these developments can be seen as a result of competitive forces which have encouraged countries to make their tax systems more attractive to investors. In addition to lowering overall tax rates, a competitive environment can promote greater efficiency in government expenditure programs.

2. However, some tax and related practices are anti-competitive and can undercut the gains that tax competition generates. This can occur when governments introduce practices designed to encourage noncompliance with the tax laws of other countries. Many countries have put in place measures to prevent the erosion of their tax bases. Such measures often increase the complexity of their tax systems and put greater burdens and costs on tax administrations as well as on compliant taxpayers. Ultimately, taxpayer confidence in the integrity and fairness of the tax system, and in government in general, declines as honest taxpayers feel that they shoulder a greater share of the tax burden and that government cannot effectively enforce its own tax laws. Harmful tax practices also distort financial and, indirectly, real investment flows. Furthermore, such practices undermine the ability of each country to decide for itself the allocation of tax burden among mobile and less mobile tax bases, such as labor, property and consumption.

3. By providing a framework within which countries -- large and small, rich and poor, OECD and non-OECD -- can work together to eliminate harmful tax practices, the OECD seeks to promote tax competition that will achieve the overall aims of the OECD to foster economic growth and development world-wide. The OECD project does not seek to dictate to any country what its tax rate should be, or how its tax system should be structured. It seeks to encourage an environment in which free and fair tax competition can take place.

4. It was with this objective in view, that the OECD Member countries published the report in 1998 entitled *"Harmful Tax Competition: An Emerging Global Issue" (the "1998 Report").* That report focused on geographically mobile activities, such as financial and other service activities, including the provision of intangibles. It developed criteria to identify the harmful aspects of a particular regime or jurisdiction. In particular, it focused on factors that could cause harm by undermining the integrity and fairness of tax systems. Thus, it focused on four criteria in particular:

- No or nominal taxes in the case of tax havens and no or low effective tax rates on the relevant income in the case of preferential regimes,
- Lack of effective exchange of information,

1. Belgium and Portugal abstain from this Report. Luxembourg recalls its abstention to the 1998 Report, "Harmful Tax Competition: An Emerging Global Issue," which also applies to the present Report and regrets that the 2001 progress report is further away from the goal of combating harmful tax competition with respect to the location of economic activities. In addition, Switzerland notes that its 1998 abstention applies to any follow up work undertaken since 1998.

- Lack of transparency, and
- No substantial activities, in the case of tax havens, and ring fencing, in the case of preferential regimes.

The first factor -- no or nominal taxes in the case of tax havens and no or low effective tax rates on the relevant income in the case of preferential regimes -- is a gateway criterion to determine those situations in which an analysis of the other criteria is necessary.

5. Effective exchange of information enables governments to ensure that their own tax laws are being complied with, particularly where cross-border transactions are involved. Globalisation of the economy has had the side effect of opening up new ways in which companies and individuals can avoid taxes that are legally due. As the level of taxpayers' activities outside national borders expands, governments cannot always rely on domestic sources of information to enforce their tax laws. Exchange of information between tax authorities is widely recognised as an effective means of deterring and discovering non-compliance in cross-border transactions. Both the OECD and United Nations model tax conventions include a provision that permits tax authorities to exchange information. Over 225 treaties between OECD Member countries and over 1,500 treaties world-wide are based on these model treaties. In addition, detailed provisions for exchange of information were developed jointly by the OECD and the Council of Europe in the Convention on Mutual Administrative Assistance in Tax Matters. The Inter-American Center of Tax Administrations (CIAT) has also developed a model exchange of information agreement. Other countries have developed similar models. All of these agreements recognise that where effective exchange of information is present, a country's ability to enforce its own tax rules is enhanced.

6. The transparency criterion is concerned with ensuring that 1) laws are applied on an open and consistent basis among similarly situated taxpayers, and 2) information needed by tax authorities to determine a taxpayer's situation is in place. Lack of transparency can make it difficult, if not impossible, for tax authorities to apply their laws effectively and fairly. "Secret" rulings, negotiated tax rates, or other practices that fail to apply the law in an open and uniform way are examples of lack of transparency. Lack of transparency is also present if there is inadequate regulatory supervision or if the government does not have legal access to financial records. Taxpayers as well as the governments of other countries have an interest in knowing how the laws of a particular country are applied and that they are being applied in a consistent and fair manner.

7. The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a jurisdiction does not (or cannot) provide a legal or commercial environment that would attract substantive business activities in the absence of the tax minimising opportunities it provides.

8. In the case of jurisdictions that offer preferential regimes, the 1998 Report includes as a factor whether a country insulates its core tax base from the effects of providing a preference. For example, if a country offering a preferential regime denies that regime to resident taxpayers or domestic activities, it is not willing to bear the costs in lost revenues with respect to its own tax system. Such regimes are said to be "ring fenced".

9. The Report also provides eight additional factors which can assist in identifying harmful preferential tax regimes.

10. The 1998 Report was followed by a progress report in June 2000 entitled *"Towards Global Tax Co-Operation: Progress in Identifying and Eliminating Harmful Tax Practices (the "2000 Report")*. That report outlined the progress made by the Forum on Harmful Tax Practices in its work. In addition, the Report:

- Identified 47 potentially harmful preferential tax regimes in OECD Member countries.
- Listed 35 jurisdictions found to meet the tax haven criteria.
- Proposed a process whereby tax havens could commit to eliminate harmful tax practices. Those jurisdictions that make such a commitment are referred to in this Report as "committed jurisdictions."
- Made proposals for associating non-member economies with the harmful tax practices project.
- Proposed elements of a possible framework of co-ordinated defensive measures designed to counteract the erosive effects of harmful tax practices.

11. The 1998 Report envisioned three parts to the harmful tax practices work: Member country preferential regimes, tax havens and non-member economies. This progress report focuses primarily on the tax haven work in accordance with the mandate of the 2000 Report[2].

II. MEMBER COUNTRY WORK

12. At the present time, the work with Member countries is focused on developing several application notes. The application notes will assist Member countries in determining whether preferential regimes are, or could be applied to be, harmful and in determining how to remove the harmful features of such regimes. The 1998 Report and the 2000 Report envisaged an appropriate balance between the Member country, non-member economy, and tax haven work. In the light of the modifications in Chapter IV, the Committee will determine this issue in the context of its work relating to preferential tax regimes taking into account the application notes including those relating to ring fencing. Future reports will focus on progress on this work.

13. The Committee recognises the importance of involving the business community in the development of the application notes. For this reason, the Committee regularly consults the Business and Industry Advisory Committee (BIAC). BIAC has established a liaison group to work closely with Member countries in taking forward this work.

2. The 2000 Report was accompanied by a Council recommendation.

III. NON-MEMBER ECONOMY WORK

14. As regards the work with non-OECD countries, the 2000 Report stressed the need to "encourage non-member economies to associate themselves with the 1998 Report". The Forum is actively pursuing this mandate and has had discussions with several non-member economies in Asia and in Latin America. Multilateral regional meetings with non-member countries in Africa, Asia and South America have also been held in conjunction with the Southern African Development Community, the Asian Development Bank, and the Inter-American Center of Tax Administrations (CIAT). An international symposium was also held in Paris in June 2000, co-hosted by France. It was attended by 27 OECD Member countries and 29 non-member economies, along with the IMF, World Bank, Commonwealth Secretariat and four tax organisations. Ministers and senior officials discussed the global implications of harmful tax practices and support for a global drive to address harmful tax practices came from a wide range of countries.

15. In September 2001, the OECD hosted another meeting on harmful tax practices under the auspices of the Global Forum. This meeting brought together OECD Members, committed jurisdictions and non-member economies. The meeting considered the experiences of OECD Member and non-member countries with harmful tax practices, effective exchange of information, certain draft application notes, and the process under which non-member economies can associate themselves with the harmful tax practices work.

IV. TAX HAVEN WORK

16. Part II(b) of the 1998 Report describes four key factors to determine whether a jurisdiction is a tax haven. The first is that the jurisdiction imposes no or only nominal taxes. The no or nominal tax criterion is <u>not</u> sufficient, by itself, to result in characterisation as a tax haven. The OECD recognises that every jurisdiction has a right to determine whether to impose direct taxes and, if so, to determine the appropriate tax rate. An analysis of the other key factors is needed for a jurisdiction to be considered a tax haven. The three other factors to be considered are:

- Whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation.
- Whether there is a lack of transparency.
- Whether there is an absence of a requirement that the activity be substantial, which would suggest that a jurisdiction may be attempting to attract investment or transactions that are purely tax driven.

17. Beginning in 1998, the Forum entered into discussions with 47 jurisdictions. These jurisdictions were invited to submit information to assist the Forum in its determination of whether they met the tax haven criteria. Most jurisdictions participated in the review process through bilateral or multilateral contacts. The Committee concluded that six jurisdictions did not meet the tax haven criteria. In addition,

another six jurisdictions -- Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino -- were not included in the 2000 Report because, prior to its release, they committed to eliminate their harmful tax practices. It should be noted that several of these jurisdictions currently do not impose direct taxes and need not do so to fulfil their commitments. The Report was clear that its identification of jurisdictions as tax havens reflected the technical conclusions of the Committee based upon the criteria set out in the 1998 Report and was not intended to be the basis for the application of a possible framework of co-ordinated defensive measures. The Council instructed the Committee to take forward an active dialogue with the jurisdictions listed in the 2000 Report with a view to obtaining the commitment of the jurisdictions to eliminate harmful tax practices in accordance with the principles of the 1998 Report.[3]

Progress in the Commitment Discussions

18. The Forum has engaged in an extensive dialogue with the tax havens listed in the 2000 Report through bilateral and multilateral discussions. These discussions have resulted in additional commitments. The discussions also have greatly improved the understanding of the jurisdictions regarding the objectives of the harmful tax practices work. Almost all of the jurisdictions have indicated in discussions that they agree with the broad principles underlying the harmful tax practices project.

19. A number of multilateral discussions have also occurred since the issuance of the 2000 Report. A joint OECD-Commonwealth meeting was hosted by Barbados in January 2001 under the Chairmanship of the Prime Minister of Barbados. That conference had over 160 participants from 13 OECD countries, 13 Commonwealth Caribbean jurisdictions, 5 Pacific Commonwealth Islands, 8 other Commonwealth non-OECD countries[4], as well as the International Monetary Fund, the World Bank, the Inter-American Development Bank, the Inter-American Center of Tax Administrations (CIAT), the Caribbean Community (CARICOM), the Caribbean Development Bank and the Pacific Islands Forum. A conference for the Pacific region was hosted in Japan in February 2001. That conference was co-sponsored with the Pacific Islands Forum (PIF) and was attended by 13 PIF members and 8 OECD Members[5], the Asian Development Bank, the World Bank, the International Monetary Fund and the Commonwealth Secretariat. A joint OECD-Pacific Islands Forum meeting was held with South Pacific Island jurisdictions in Fiji in April of 2001. That conference was attended by PIF Members and OECD Member countries as well as the

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3. 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.

4. The 13 OECD countries were: Australia, Canada, Czech Republic, France, Germany, Ireland, Italy, Japan, Mexico, Netherlands, Sweden, the United Kingdom and the United States. The 13 Commonwealth Caribbean jurisdictions were: Anguilla, Antigua and Barbuda, The Bahamas, Barbados, Belize, British Virgin Islands, Cayman Islands, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines and Turks & Caicos Islands. The 5 Pacific Commonwealth Islands were: The Cook Islands, Niue, Seychelles, Tonga and Vanuatu. The eight other Commonwealth non-OECD countries were: Brunei Darussalam, Cyprus, Jamaica, Malaysia, Malta, Mauritius, Namibia, and Singapore.

5. The PIF members were: Cook Islands, Fiji, Republic of Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. The OECD Members were Australia, Canada, France, Japan, Korea, New Zealand, Norway and the United Kingdom. Australia and New Zealand are also PIF Members.

PIF and OECD Secretariats. A meeting among jurisdictions from Europe, the Middle East, and OECD Member countries was held in Paris in February 2001[6].

20. As a result of the meeting held in Barbados, a Joint Working Group co-chaired by Australia and Barbados was established. The OECD Members of the group include Australia, France, Ireland, Japan, the Netherlands and the United Kingdom. The non-OECD jurisdictions include Antigua and Barbuda, Barbados, the British Virgin Islands, the Cook Islands, Malaysia, Malta, and Vanuatu. The Joint Working Group was given a remit to find a mutually acceptable political process by which commitments could be made and to examine how to continue the dialogue begun in Barbados. Meetings of the Joint Working Group took place in London in January 2001 and in Paris in March 2001.

21. Discussions have been held with all 35 jurisdictions listed in the 2000 Report. These discussions are continuing on either a bilateral or multilateral basis. Many of the jurisdictions have substantially advanced towards making a commitment and the OECD looks forward to receiving their commitments in the near future.

22. Since the issuance of the 2000 Report, 5 jurisdictions have made commitments to eliminate harmful tax practices. They are Aruba, Bahrain, the Isle of Man, the Netherlands Antilles, and the Seychelles. These jurisdictions are now considered committed jurisdictions. Thus, there are now 11 committed jurisdictions. In addition, Tonga has recently made legislative changes and taken administrative actions to address those areas that led to its identification by the OECD in June 2000 as a tax haven and therefore will not be considered for inclusion in any list of uncooperative jurisdictions.

Modifications to the Tax Haven Work

23. The dialogue between the OECD Members and the tax haven jurisdictions has resulted in the OECD having a better understanding of the concerns of the jurisdictions regarding the commitment process and participation in the harmful tax practices work. Since the inception of the harmful tax practices project, the Committee has sought to operate through a co-operative process.

24. Several jurisdictions interested in making commitments raised concerns about the commitment process, including concerns regarding the transparency of the process and the need for greater detail regarding the harmful features to be eliminated.

25. The OECD Members responded to these concerns by establishing an alternative process that set out in greater detail the terms of the commitments sought, a proposed timetable for implementation and by providing for the publication of the details of any future commitments.

26. Some Member countries, as well as some tax havens, have expressed concerns regarding the application of the no substantial activities criterion, the application of a framework of co-ordinated defensive measures to tax havens as of 31 July 2001 and the timeframe for developing implementation plans.

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6. The participants were 12 non-OECD jurisdictions (Andorra, Bahrain, Cayman Islands, Cyprus, Gibraltar-Overseas Territory of the United Kingdom, Guernsey-Dependence of the British Crown, Isle of Man-Dependency of the British Crown, Jersey-Dependency of the British Crown, Liechtenstein, Malta, Monaco and San Marino) and 14 OECD Member countries (Australia, Belgium, Canada, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Poland, the United Kingdom and the United States). In addition, the OECD Secretariat, the European Commission and the International Monetary Fund were also present.

27. The 1998 Report indicates that the lack of substantial activities is one of the criteria to be applied in identifying a jurisdiction as a tax haven. However, the determination of whether local activities are sufficiently substantial is difficult, as was anticipated in paragraph 55 of the 1998 Report. Consequently, in interpreting the no substantial activities criterion, the Forum sought to determine whether there were factors that discouraged substantial domestic activities. In the light of the discussions with the jurisdictions, the Committee concluded that it should not use this method to determine whether or not a tax haven is uncooperative.

28. Thus, the Committee has decided that commitments will be sought only with respect to the transparency and effective exchange of information criteria to determine which jurisdictions are considered as uncooperative tax havens. In applying the transparency and exchange of information criteria many factors are relevant, including a relaxed regulatory framework, which reduces transparency and makes it less likely that the information needed for effective exchange of information will be available. The Forum will continue to examine all factors affecting the ability of a jurisdiction to engage in effective exchange of information.

29. The jurisdictions that have made commitments prior to the issuance of this report will be informed that they can choose to review their commitments in respect of the no substantial activity criterion.

30. Member countries would welcome the removal by tax havens of practices implicated by the no substantial activities criterion insofar as they inhibit fair competition.

31. Some Member countries, as well as some tax havens, have expressed concern over the lack of symmetry in the timing of the potential application of a framework of co-ordinated defensive measures to Member countries and tax havens. While the 1998 Report anticipated the potential need for such measures, it did not set a time for their application. The 2000 Report provided that the co-ordination of the defensive measures would not be implemented prior to 31 July 2001.

32. The Committee recognises that the potential application of a framework of co-ordinated defensive measures to tax havens prior to their potential application to OECD Member countries raises concerns regarding a level playing field between Member countries and tax havens. Therefore, the Committee agreed that 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. Each OECD Member country 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.

33. In the light of the above developments and given the number of ongoing discussions with jurisdictions on the conclusion of commitments, the Committee has decided that the time for making commitments will be extended to **28 February 2002**. Such an approach is in accord with the aim of the 2000 Report to "establish a co-operative process to promote the elimination of harmful tax practices in jurisdictions identified in the 2000 Report...". The objective of the tax haven work remains to obtain commitments from as many of the jurisdictions as possible. The modifications to the work contained in this Report are likely to facilitate this process by promoting an inclusive and constructive approach which emphasises the benefits of the initiative, including the opportunities for technical and capacity building assistance which OECD Member countries commit themselves to provide to jurisdictions who commit to the process. If all jurisdictions make a commitment prior to 28 February 2002, it will not be necessary to issue a list differentiating between those jurisdictions that have made a commitment and those that have not.

34. In order to ensure that jurisdictions that have made commitments have sufficient time to develop implementation plans, the Committee has decided to extend the time for developing implementation plans from six months after the date of making the commitment to twelve months after the date of making the commitment.

35. These modifications do not affect the application of the 1998 and 2000 Reports to Member countries and non-member economies. In addition, the factors in the 1998 Report used to identify tax havens remain unchanged.

Commitments to Transparency and Effective Exchange of Information

36. A jurisdiction will not be considered uncooperative if, by 28 February 2002, it commits to transparency and effective exchange of information, as discussed in paragraphs 37 and 38.

37. By committing to transparency, a jurisdiction agrees that there will be no non-transparent features of its tax system, such as rules that depart from established laws and practices within the jurisdiction, "secret" tax rulings or the ability of persons to "negotiate" the rate of tax to be applied. Transparency also requires financial accounts to be drawn up in accordance with generally accepted accounting standards and that such accounts either be audited or filed. Exceptions to this standard may be warranted where the transactions of an entity are de minimis or the entity is engaged solely in local activities and does not have foreign ownership, beneficiaries, management or other involvement. A committing jurisdiction also agrees that its governmental authorities should have access to beneficial ownership information regarding the ownership of all types of entities and to bank information that may be relevant to criminal and civil tax matters. The information to be maintained to meet the transparency criterion should be available for exchange pursuant to legal mechanisms for exchange of information as described below.

38. By committing to effective exchange of information, a jurisdiction agrees to establish a mechanism for the effective exchange of information that includes the following elements. The commitment ensures that there is a legal mechanism in place that allows information to be given to a tax authority of another country in response to a request for information that may be relevant to a specific tax inquiry. An essential element of effective exchange of information is the implementation of appropriate safeguards to ensure that the information obtained and provided is used only for the purposes for which it was sought. The adequate protection of taxpayers' rights and the confidentiality of their tax affairs is essential to preserving the integrity and effectiveness of exchange of information programmes. The OECD Member countries have agreed to provide technical assistance to establish such safeguards and more generally, to assist in the implementation of exchange of information programmes in the jurisdictions. In the case of information requested for the investigation and prosecution of a criminal tax matter, the information should be provided without a requirement that the conduct being investigated would constitute a crime under the laws of the requested jurisdiction if it occurred in that jurisdiction. In the case of information requested in the context of a civil tax matter, the requested jurisdiction should provide information without regard to whether or not the requested jurisdiction has an interest in obtaining the information for its own domestic tax purposes. The committing jurisdiction is also asked to agree that it will have administrative practices in place so that the legal mechanism for exchange of information will function effectively and can be monitored. The committed jurisdictions have been invited to work with OECD Members to develop an exchange of information instrument that could be used to satisfy their commitments. This work is described more fully in the section on Implementation of Commitments, below.

Implementation of Commitments

39. Each committed jurisdiction has agreed to develop together with the Forum a plan (an "implementation plan") describing the manner in which it intends to achieve its commitment to eliminate harmful tax practices by 31 December 2005. This is the date set in the 1998 Report for Member countries to remove the benefits to taxpayers benefiting on 31 December 2000 from any harmful preferential regimes, and is approximately 2-1/2 years after the main deadline by which Member countries have committed to remove the harmful features of their harmful preferential tax regimes.

40. Implementation plan discussions have been held with all of the advance commitment jurisdictions and will begin soon with those jurisdictions that have committed since the issuance of the 2000 Report. The Committee has decided that implementation plans should be completed within twelve months (rather than within six months) of making the commitment to ensure that committed jurisdictions have sufficient time to undertake those changes that are necessary to eliminate harmful tax practices by 31 December 2005.

41. A key component of the commitments is to establish a programme of effective exchange of information. As foreseen in the 2000 Report, a collaborative process has been established between OECD Member countries and the committed jurisdictions to achieve that goal. The committed jurisdictions were invited in September 2000 to join a working group of OECD Member countries in the development of an instrument for effective exchange of information. The group has met twice in Paris and once in Malta and is holding a fourth meeting in Paris on 12-16 November 2001. The meetings of the working group are jointly chaired by the Netherlands and Malta.

42. The group has focused its discussions on developing an instrument that would provide a legal framework for effective exchange of information and at the same time would adequately protect the confidentiality of taxpayer information and prevent use of the information for unauthorized purposes. The group has considered the types of information that should be available for exchange and the means by which the information could be obtained. Considering the importance of the work on exchange of information, the Committee encourages the group to continue to advance its work.

43. The Committee recognises the importance of working co-operatively with jurisdictions. To further involve committed jurisdictions in the harmful tax practices work, committed jurisdictions will be invited to provide input into the development of relevant application notes. Committed jurisdictions also will be invited to participate in events organised under the auspices of the Global Forum that relate to their commitment. In this connection, committed jurisdictions participated in a meeting on harmful tax practices held in September 2001.

Assisting Committed Jurisdictions

44. The Council has instructed the Committee to work with interested international and bilateral assistance agencies to assist committed jurisdictions to fulfil their commitments and to work with these jurisdictions during the transitional period to support their economies as they move away from harmful tax practices.

45. Some jurisdictions have indicated concerns about their administrative capacity to meet their commitments. OECD Member countries will offer, through the OECD and other organisations, specific assistance in strengthening and improving the design of the administrative capacities of those jurisdictions that require it.

46. The Committee has also explored with the Development Assistance Committee the forms of assistance that may be appropriate to help committed jurisdictions further develop their economies as they move to eliminate harmful tax practices. Other international organisations and development banks, such as the World Bank, have also offered to assist in this effort. OECD Member countries will continue to examine how their assistance programmes can, on a bilateral basis, be re-targeted to assist committed jurisdictions and to encourage international organisations to take into account the special needs of committed jurisdictions in the design of multilateral assistance programmes.

V. FRAMEWORK OF CO-ORDINATED DEFENSIVE MEASURES

47. To mitigate the impact of harmful tax practices a variety of measures are currently used by OECD Member countries and non-member economies. The 1998 Report noted that there are limits to the effectiveness of such measures when they are applied on a unilateral or bilateral basis to a problem that is inherently global in nature. The 1998 Report examines how the measures that are already in place, and any appropriate new measures, can be co-ordinated in a way that will enable countries to more effectively support each other's efforts to protect themselves from harmful tax practices. Thus, a framework of co-ordinated defensive measures is a means by which countries with similar concerns can support each other's efforts to counter the effects of harmful tax practices. It would address the global nature of harmful tax practices and allow each individual country's defensive measures to be applied in the most effective manner. A framework of co-ordinated defensive measures also serves to protect the competitive position of those jurisdictions that have eliminated harmful tax practices with respect to jurisdictions that have not committed to do the same. Each individual Member country has the right to implement the measures it deems necessary to counteract harmful tax practices.

48. In the design of a framework of co-ordinated defensive measures, the Committee will be guided by several considerations:

- A framework of co-ordinated defensive measures should be proportionate and targeted at neutralising the deleterious effects of harmful tax practices.
- The adoption of defensive measures is at the discretion of individual countries.
- Each country is free to choose to enforce defensive measures in a manner that is proportionate and prioritised according to the degree of harm that a particular practice has the potential to inflict.

49. Although the Committee believes that a framework of co-ordinated defensive measures can help mitigate the impact of the erosive effects of harmful tax practices and ensure against their spread, it strongly prefers an approach that promotes change through dialogue and consensus.

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On Investigations
EXHIBIT # 30

Stepping Up the Pressure on Tax Havens

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Changes on several fronts, if implemented, would limit bank secrecy and require the exchange of tax information—significant steps in combating tax evasion in the international context that would lead to major restructuring of the international financial system. The Organization for Economic Cooperation and Development (OECD) has proposed changes in potentially harmful preferential tax regimes in OECD member states, and in the operation of tax havens (both offshore and onshore) in member and non-member states. The European Union (EU) has proposed the automatic exchange of information about cross-border interest payments within the EU received by individuals. And the IRS recently proposed regulations that could result in the exchange of information by the U.S. with tax-treaty partners about interest earned by nonresident aliens on bank deposits in the U.S.

Part 1 of this article (below) covers the major developments up to the OECD's issuance on November 24, 2000, of the Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices. Part 2 in the May issue will pick up with the November 2000 Framework and recent initiatives in Brazil and Mexico.

Tax Evasion on Cross-Border Interest Income

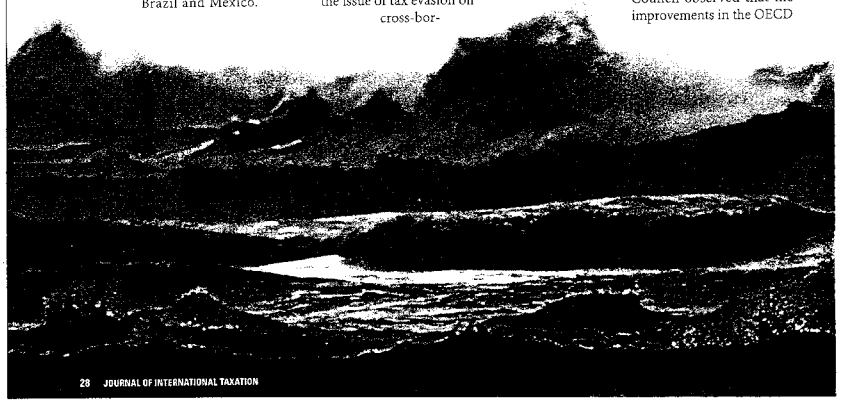
Tax evasion on cross-border income payments, especially interest income, has traditionally been facilitated and encouraged by the international financial system, which permits individuals and corporate entities to place deposits in offshore and onshore financial centers tax free. These financial centers ("source country") do not impose withholding tax on such cross-border interest payments and they provide confidentiality (including bank secrecy) by not exchanging tax information with the residence country of the depositor/investor ("residence country").[1] This permits capital flight and tax evasion, and contributed to the international debt crisis and the Mexican and Russian financial crises.[2] Such capital flight can be intensified by electronic technology. The capital flight issue has been highlighted by recent allegations that several prominent foreign government leaders, and some of their relatives, had secret bank accounts abroad.[3]

OECD Information–Exchange Recommendations

In 1997, the OECD, in a profoundly significant but hardly noticed action, signaled that it was going to confront the issue of tax evasion on cross-border income flows, and recommended measures that would result in the taxation of such income. The OECD issued two Recommendations intended to combat tax evasion in the international context: (1) the Recommendation on the Use of Tax Identification Numbers in an International Context ("TIN Recommendation") and (2) the Recommendation on the Use of the Revised Standard OECD Magnetic Format for Automatic Exchange of Information ("Magnetic Format Recommendation").[4]

In the TIN Recommendation, the more significant of the two, the OECD Council noted the need to improve the exchange of information on cross-border income flows to ensure that such income does not escape taxation. The TIN Recommendation stated that the most effective method of enforcing tax compliance on cross-border income would be to require nonresidents to disclose their residence-country TIN to the payor of income in the source country, and that such payor would be required to transmit that information to the tax administration in the source country. This would permit exchange of information about such income and the recipient between the tax authorities of the source and residence countries.

In the Magnetic Format Recommendation, the OECD Council observed that the improvements in the OECD



Standard Magnetic Format for information exchanges would facilitate finalization of the design of a new standard for electronic exchange of tax information.

These Recommendations were a significant development in international tax enforcement of cross-border income flows, emphasizing that these income flows should not escape taxation, and serving as the necessary practical mechanism for the implementation of far-reaching proposals being developed by the EU and the OECD.[5]

OECD Report on Tax Havens

In 1998, the Committee on Fiscal Affairs ("the Committee") of the OECD issued a report, "Harmful Tax Competition: An Emerging Global Issue" ("the 1998 Report"), which the OECD Council approved on April 9, 1998, with significant abstentions from Luxembourg and Switzerland.[6]

The 1998 Report emphasized the concern of OECD-member countries that "governments cannot stand back while their tax bases are eroded through the actions of countries which offer taxpayers ways to exploit tax havens and preferential tax regimes to reduce the tax that would otherwise be payable to them," especially in an era of increasing globalization and new electronic technologies.[7] Another objective of the Report was to promote the progressive liberalization of cross-border trade and investment, and therefore the expansion of global economic growth, by reducing the distorting influence of taxation on the location of mobile financial and service activities.[8] The 1998 Report indicated that the main factors for being a tax haven are (1) no or only nominal effective tax rates; (2) lack of effective exchange of information; (3) lack of transparency; and (4) absence of requirement of substantial domestic activities ("ring fencing").

Movement of funds. The 1998 Report's recommendations cover harmful tax practices in the form of tax havens and harmful preferential tax regimes not only in OECD-member countries, but also in non-member countries, and in their dependencies.[9] Therefore, the 1998 Report would have far-reaching implications for the movement of funds between OECD-member countries, and also between member and non-member countries.

Bank secrecy, information access. The recommendations in the 1998 Report, if implemented, would limit the application of bank secrecy in tax matters and increase bilateral and multilateral intergovernmental cooperation for tax enforcement and collection. This would significantly affect international private banking and influence the structure of financial markets and, consequently, international banking and finance.

The 1998 Report noted that some progress had been made in the area of access to information, in that some tax-haven jurisdictions have entered into mutual legal assistance treaties with non-tax havens that permit exchange of information on criminal tax matters related to other crimes (e.g., narcotics trafficking) or when criminal tax fraud is at issue. The 1998 Report emphasized that, nevertheless, these tax-haven jurisdictions do not allow tax administrations access to bank information for the critical purposes of detecting and preventing tax avoidance, which, from the perspective of raising revenue and controlling base erosion from financial and other service activities, are as important as curbing tax fraud.[10]

The 1998 Report further stated that the limited access that certain countries have to bank information for tax purposes (e.g., because of bank secrecy rules) is increasingly inadequate to detect and prevent the abuse of harmful preferential tax regimes by taxpayers, and that the Committee had commissioned a survey of country practices regarding access to bank information for tax purposes.[11] The 1998 Report noted that, in 1998, the Committee would complete a survey of pro-

OECD June 2000 Report: 35 Tax Havens

- Andorra
- Anguilla (Overseas Territory of the United Kingdom)
- Antigua and Barbuda
- Aruba (Kingdom of the Netherlands)
- Commonwealth of the Bahamas
- Bahrain
- Barbados
- Belize
- British Virgin Islands (Overseas Territory of the United Kingdom)
- Cook Islands (New Zealand)
- 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)
- Liberia
- The Principality of Liechtenstein
- The Republic of the Maldives
- The Republic of the Marshall Islands
- The Principality of Monaco
- Montserrat (Overseas Territory of the United Kingdom)
- The Republic of Nauru
- Netherlands Antilles (Kingdom of the Netherlands)
- Niue (New Zealand)
- Panama
- Samoa
- The Republic of the Seychelles
- St. Lucia
- The Federation of St. Christopher & Nevis
- St. Vincent and the Grenadines
- Tonga
- Turks & Caicos (Overseas Territory of the British Crown)
- U.S. Virgin Islands (External Territory of the U.S.)
- The Republic of Vanuatu

visions in force in member countries governing access to banking information by tax authorities and that it had begun preparing a broad set of proposals on how to improve the authorities' access to this information.[12] The Report pointed out that governments collectively would be better off by not offering incentives, but that in the past each government felt compelled to offer incentives to maintain a competitive business environment.

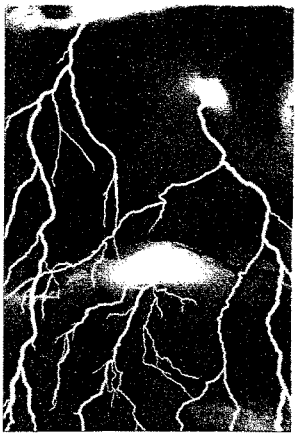
The 1998 Report created a Forum on Harmful Tax Practices, set forth Guidelines for Dealing with Harmful Preferential Regimes in Member Countries, and adopted a series of Recommendations for combating harmful tax practices. The Forum on Harmful Tax Practices is responsible for undertaking an ongoing evaluation of existing and proposed preferential tax regimes in OECD-member and non-member countries, analyzing the effectiveness of counteracting (including nontax) measures, and examining whether particular jurisdictions constitute tax havens.

The Guidelines on harmful tax practices incorporate stand-still and roll-back provisions.[13] Under the stand-still provision, the OECD-member countries are to refrain from (1) adopting new measures, and (2) extending the scope of or strengthening existing measures, that constitute harmful tax practices. Under the roll-back provision, the harmful features of preferential regimes must be eliminated before the end of five years. The Guidelines also provide that OECD-member countries should use the Forum to coordinate their national and treaty responses to harmful tax practices.

Implementation of the 1998 Report

Tax evasion in the international context is a financial law issue with global implications, and resolution of this problem, as detailed in the 1998 Report, requires standardized rules and multilateral regulatory cooperation. The 1998 Report is in effect being implemented by:

1. The agreement of the EU countries to exchange information automatically about cross-border interest payments received by individuals, or during a transition period to impose a withholding tax on such payments.
2. The issuance by the OECD in June 2000 of a report, "Towards Global Tax Cooperation (Progress in Identifying and Eliminating Harmful Tax Practices), Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee of Fiscal Affairs" ("June 2000 Report").
3. The issuance by the OECD in November 2000 of the "Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices" ("November 2000 Framework").
4. The agreement by certain tax havens to adopt measures recommended by the June 2000 Report.
5. Policy decisions of certain developing countries, such as Mexico (an OECD member) and Brazil (not an OECD member), intended to limit the use, by corporate or individual residents of those countries, of the benefits offered by tax-haven jurisdictions.



EU Agreement on Information Exchange for Cross-Border Interest

The EU has agreed to exchange information about cross-border interest payments within the EU, that is, interest originating in one member state paid to individua. residents of another member state.[14] The Directive would enter into force in 2003, after a unanimous vote by EU member states in late 2002. However, it would apply only to individuals who are residents of a member state and who receive interest income in another member state, and not to interest received by company entities in the EU.

There had been a contentious dispute between (1) countries that favored a 20% withholding tax (which was vigorously opposed by the U.K. because of its potential negative impact on the internation-

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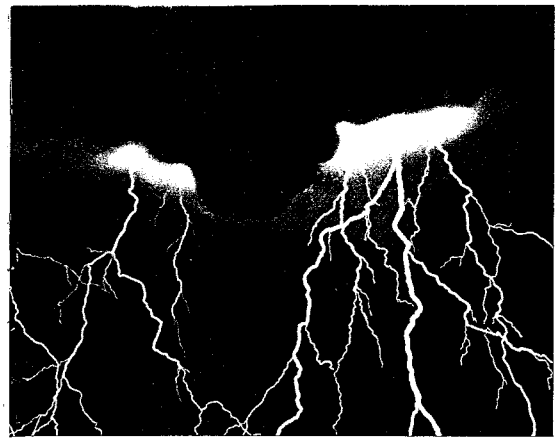

al bond market in London), and (2) countries that favored exchange of information (this exchange was opposed by countries with bank secrecy laws, such as Austria and Luxembourg). Germany switched its position from supporting a withholding tax to supporting information exchange. The Directive confirms "a step by step development toward realization of the exchange of information (rather than a withholding tax) as the basis for the taxation of savings income of non-residents."[15]

Seven-year transition period. All member states will automatically exchange information with each of the other member states seven years after the date that the Directive enters into force (thereby raising potential problems with any applicable bank secrecy laws, which would have to be modified by the date that the Directive enters into force). The Council is to decide on the adoption and implementation of the Directive by December 31, 2002, and by unanimous decision (as with other tax issues).

During the seven-year transition period, member states (except for Austria, Belgium, and Luxembourg) will automatically exchange the information without requiring reciprocity.[16] During the transition period, Austria, Belgium, and Luxembourg will apply a withholding tax on such cross-border interest payments: a minimum withholding tax of 15% during the first three years and 20% during the next four years. Those countries imposing a withholding tax will receive information from other member states. Such withholding tax does not preclude the state in which the beneficial owner is resident from taxing him in accordance with its domestic law, in compliance with the Rome Treaty.[17]

The withholding tax is not applied during the seven-year transition period if the beneficial owner authorizes the paying agent to exchange information with the beneficial owner's state of residence. The choice between one procedure or the other is made by each state levying the withholding tax during the transition period.[18]

During the seven-year transition period, pursuant to a revenue-sharing system, member states operating a withholding tax will transfer 75% of that revenue to the member state in which the investor is resident; and 25% of such tax is retained by the paying agent's member state.[19] The residence state is to ensure the elimination of double taxation that might result from that withholding tax; the potential excess of withholding tax over the tax due in the residence state is refunded to the taxpayer by the residence state.[20]

Interest. For purposes of the Directive, the following are considered to be interest:

1. Paid or account-registered interest relating to debt claims of every kind, whether or not secured by a mortgage or carrying a right to participate in the debtor's profits, and in particular income from government securities and bonds or debentures, including premiums and prizes attaching to such securities, bonds, or debentures, and income from domestic or international bonds. Penalty charges for late payments are not considered interest.[21]
2. Accrued interest relating to products referred to in (1).
3. Capitalized interest relating to capitalization products.
4. Income distributed by distribution coordinated Undertakings for Collective Investment (UCI) invested exclusively in rate products.
5. Income distributed by mixed distribution coordinated UCI.
6. Income relating to investments in coordinated capitalization UCI more than 40% of the assets of which are invested in rate products, this threshold being lowered at the end of the transition period to a level to be decided at a later date.

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[1] In the U.S., payors of interest to residents are required to inform the IRS of the amount and the recipient's name and taxpayer i.d. number. But under present law, if the recipient of the interest is a foreign person, the payor does not have to provide such information to the IRS.

[2] See Spencer, "Capital Flight and Bank Secrecy: The End of an Era?," International Financial Law Review (London, May 1992), pages 17-20.

[3] "Hearings Offer View Into Private Banking: Secret Accounts Under Scrutiny as Foreign Wealth Moves Abroad," New York Times, November 8, 1999, page A6. The Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Treasury and State Departments issued to banks, on January 22, 2001, "Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption," covering senior foreign political figures, their immediate families, and their close associates.

[4] C(97)29, 1997, and C(97)30, 1997.

[5] See Spencer, "OECD Information Exchange Recommendations Are a Significant First Step in Resolving Tax Evasion," 8 JOIT 353 (August 1997).

[6] See Spencer, "OECD Report Cracks Down on Harmful Tax Competition," 9 JOIT 27 (July 1998).

[7] "Harmful Tax Competition: An Emerging Global Issue" (OECD, Paris, 1998) ("the 1998 Report"), para. 85.

[8] *Id.*, para. 8. The 1998 report focused on geographically mobile financial and other service activities.

[9] *Id.*, para. 5.

[10] *Id.*, para. 54.

[11] *Id.*, para. 55.

[12] *Id.*, para. 12.

7. Interest paid directly to or credited to an account held by entities such as uncoordinated UCI, partnerships, trusts, and comparable undertakings.[22]

Grandfather clause. A grandfather clause is to apply to all negotiable loan securities, whether the interest is paid by the issuer's paying agent or by the beneficial owner's agent, and whether that paying agent is situated in a member state that uses exchange of information or that imposes a withholding tax during the transition period. The grandfather clause will apply irrespective of the management of securities directly or through an investment fund or entity. During the transition period, the grandfather clause applies to those securities referred to above that are tied to issues for which the prospectuses have been certified by the competent authority before March 1, 2001, or, absent any prospectus, to issues made before the same date. The grandfather clause will produce effects without it being necessary to assess, case by case, the risk of effectively triggering the gross-up or early-redemption clause. For issues that include or are likely to include such clauses, the grandfather clause applies automatically, whether or not the issue contract effectively includes a gross-up or early-redemption clause. The issues concerned are issues of bonds (domestic and international bonds), negotiable loan securities, in particular, negotiable debt securities, Euro commercial papers, and Euro medium-term notes. The grandfather clause does not prevent member states from taxing income from the securities concerned, in accordance with their laws.[23]

Paying-agent, exchange mechanics. The Directive details the paying-agent mechanism. Although it applies only to interest payments to natural persons, the Directive also discusses exchange-of-information procedures if interest is paid to parties other than a natural person, in a different member state, particularly if it is paid to a company entity but is ultimately received by an individual resident in a member state.[24] The paying agent situated in a member state that uses the exchange-of-information system communicates the information to the competent authorities of that state, which in turn transfers it to the competent authorities of the member state in which the beneficial owner is resident.[25]

The Directive also discusses the mechanics of exchange of information, including the information covered,[26] and refers to the work of the OECD Tax Affairs Committee on the automatic exchange of information, but without detailing the technical implementation of the exchange-of-information procedure or specifically referring to the TIN Recommendation. The Directive (paragraph 20) states:

> [M]ember states will review the technical implementation of the exchange of information procedure in an ad hoc group to be set up after agreement on the substantial content of the Directive, in parallel with the discussions with Third States. The group could take as its basis the work done by the OECD Tax Affairs Committee on the automatic exchange of information.[27]

An important issue: the Directive also analyzes the identification and residence of the beneficial owner.[28]

"Displacement of activity." The Council of the EU, at Santa Maria de Feira, Portugal, on June 20, 2000, emphasized the "displacement-of-activity" issue that had been discussed in the 1998 Report: the implementation of a withholding tax on cross-border interest payments within the EU, or the automatic exchange of information with regard to such payments, would cause mobile assets to be "displaced," merely shifted, to non-EU jurisdictions, such as Switzerland. That is, a resident of an EU-member state, rather than investing in another EU-member state that would automatically exchange information with the country of residence, would move the investment to a non-EU jurisdiction, such as the Bahamas, Cayman, or Switzerland. The Council stated:

> In order to preserve the competitiveness of European financial markets, as soon as agreement has been reached by the Council on the substantial content of the Directive and before its adoption, the Presidency and the Commission shall enter into discussions immediately with the U.S. and key third countries (Switzerland, Liechtenstein, Monaco, Andorra, San Marino) to promote the adoption of equivalent measures in those countries; at the same time the member states concerned commit themselves to promote the adoption of the same measures in all relevant dependent or associated territories (the Channel Islands, Isle of Man, and the dependent or associated territories in the Caribbean). The Council shall be informed regularly on the progress of such discussions. Once sufficient reassurances with regard to the application of the same measures in dependent or associated territories and of equivalent measures in the named countries have been obtained, and on the basis of a report, the Council will decide on the adoption and implementation of the Directive no later than 31 December 2002, and do so by unanimity.

The European Council, at its Nice meeting December 7-9, 2000, (1) noted

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13 See de Brun and van Rooijen, "'Stand Still' and 'Roll Back': EU Finance Ministers Formalize Code of Conduct on Company Taxation," 9 JOIT 43 (March 1998).

14 The details are set forth in "Proposal to Implement the Key Principles of the Directive on Taxation of Savings," as a Presidency Note based on the efforts of The Working Party on Tax Questions, issued to the Council of the EU on November 20, 2000 ("Directive") (Document 13555/00 FISC 190), as amended by the Council meeting of November 26-27, 2000 ("November 2000 Council") (Document 13861/00).

15 Which had been adopted by the Santa Maria de Feira, Portugal European Council Meeting, June 19-20, 2000 (Directive, para. 8).

16 Directive, paras. 11 and 12.

17 *Id.*, para. 24, and November 2000 Council.

18 Directive, para. 24.

19 *Id.*, para. 32, and November 2000 Council.

20 Directive, para. 30.

21 This is basically the definition of interest in Article 11 of the OECD Model Income Tax Convention.

22 Directive, paras. 2, 7, 17, 18, and 27.

23 *Id.*, paras. 5-7.

24 *Id.*, paras. 10-22 and 36-49, in particular, 45 and 49.

25 *Id.*, paras. 10 and 18.

26 *Id.*, paras. 13-22 and 55.

27 *Id.*, para. 20.

28 *Id.*, paras. 50-55.

29 Nice European Council Meeting: Presidency Conclusions, para. 33.

30 Financial Times, January 20, 2001, page 2.

31 Prop. Regs. 1.6049-4(b)(5), 1.6049-6(e)(4), and 1.6049-8(a) (REG-126100-00, January 16, 2001).

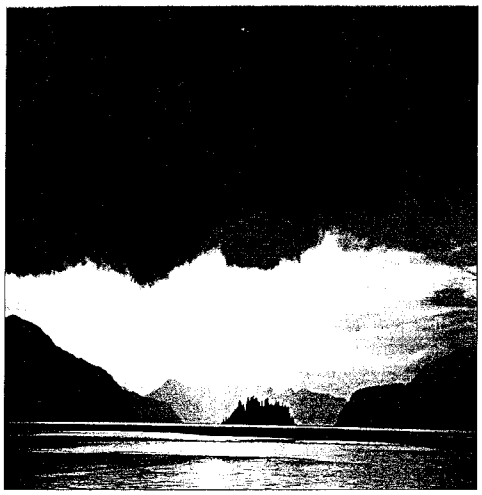
32 Used to report a foreign person's U.S.-source income subject to withholding tax.

33 A person described in Section 7701(b)(1)(B).

34 Section 871(1)(2)(A). Such reporting is already required for U.S. residents who must provide to the payor of interest their U.S. TIN, and by Reg. 1.6049-8(a) for nonresidents alien individuals who are residents of Canada.

35 On Form W-8BEN (rev. December 2000), box 7 reads: "Foreign Tax Identifying Number, if any (optional)." In addition to the automatic and on-request exchanges of information, there is another type of exchange: "spontaneous exchange of information." See Article 7 of the Convention on

that member states concerned have undertaken to make the necessary arrangements for the adoption of the same measures (on the taxation of savings) as those applicable in the EU in all dependent or associate territories referred to in the Feira conclusions, and (2) asked the European Commission and the Presidency to undertake discussions with the U.S. and other third countries as quickly as possible to encourage adoption of the equivalent measures for the taxation of savings.[29] Sweden, the present holder of the EU's rotating presidency, has contacted non-EU financial centers requesting negotiations (starting with the U.S. and Switzerland) to bring their rules for taxing nonresident savings into line with those planned by EU members.[30]



IRS Proposal on Reporting Interest Earned by Nonresident Aliens

On January 16, 2001, the IRS issued extremely significant proposed regulations,[31] evidencing a major change in U.S. government policy, that would require banks within the U.S. to report annually to the IRS on Form 1042-S[32] all interest earned by nonresident alien individuals[33] on bank deposits within the U.S. not effectively connected with a U.S. trade or business.[34]

The Preamble states that until the proposed regulations enter into force, nonresident aliens can make deposits in banks in the U.S. and the bank paying such interest does not have to report such income to the IRS. As such income would not be reported to the IRS, the Service would not have relevant information to provide to the tax authorities of the nonresident alien's residence country:

> The proposed regulations extend the information reporting requirement for bank deposit interest paid to nonresident alien individuals who are residents of other foreign countries [other than Canada]. This extension is appropriate for two reasons. First, requiring routine reporting to the IRS of all bank deposit interest paid within the U.S. will help to ensure voluntary compliance by U.S. taxpayers by minimizing the possibility of avoidance of the U.S. information reporting system (such as through false claims of foreign status). Second, several countries that have tax treaties or other agreements that provide for the exchange of tax information with the U.S. have requested information concerning bank deposits of individual residents of their countries. Because of the importance that the U.S. attaches to exchanging tax information as a way of encouraging voluntary compliance and furthering transparency,... the U.S. Treasury Department and the IRS believe it is important for the U.S. to facilitate, wherever possible, the effective exchange of all relevant tax information with our treaty partners.

The proposals revising Reg. 1.6049-6(e)(4) would require that:

> any person who makes a Form 1042-S under section 6049(a) and § 1.6049-4(b)(5) shall furnish a statement to the recipient either in person or by first-class mail to the recipient's last known address. The statement shall include a copy of the Form 1042-S required to be prepared pursuant to § 1.6049-4(b)(5) and a statement to the effect that the information on the form is being furnished to the U.S. Internal Revenue Service and may be furnished to the government of the foreign country where the recipient resides.

IRS proposals/EU Directive compared. The proposed regulations, like the EU Directive, would apply only to individuals and not to any foreign company that receives interest on a bank deposit in the U.S. However, the proposed regulations differ from the EU Directive in two important respects: First, they apply only to interest paid on bank deposits in the U.S., and not to interest paid by other U.S. obligors, such as U.S. corporations or the U.S. government. The EU Directive applies to a broad range of interest payments. Second, the EU Directive states explicitly that the exchange of relevant information is to be automatic. The proposed IRS regulations, and the Preamble, do not refer specifically to the automatic exchange of information or to the EU Directive.

The Preamble notes that treaty partners (income tax treaties and exchange-of-information treaties) request information about bank deposits. However, the proposed regulations and the Preamble do not specify that the U.S. will exchange information only on request by a treaty partner and do not rule out the automatic exchange of information. Of course, as the IRS will have the relevant information, it could, as a practical matter, automatically provide all such information to the treaty partner, rather than merely providing only that information specifically requested by the treaty partner. Like the EU Directive, the proposed regulations do not refer to the TIN Recommendation.[35]

In effect, if the proposed regulations enter into force, and even if such exchange of information is not automatic, aliens resident in countries with

which the U.S. has a tax treaty (income tax or exchange-of-information) will no longer consider that their bank deposit in the U.S. and the interest thereon are protected from disclosure by the IRS to the tax authorities of their country of residence. The IRS explanation does not discuss the exchange of information by the U.S. with countries that do not have an income tax treaty or an exchange-of-information agreement with the U.S.

The June 2000 Report

The OECD's June 2000 Report[36] summarizes the results of the work of the Forum on Harmful Tax Practices:

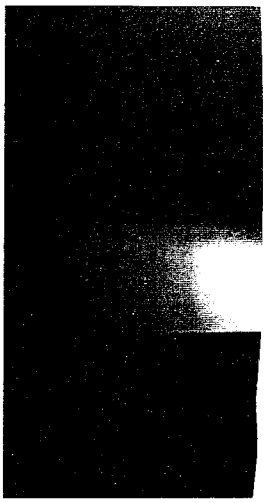
- Identification of potentially harmful preferential regimes in OECD-member states according to the 1998 Report.
- Identification of jurisdictions meeting the criteria for being tax havens according to the 1998 Report.
- Update on work with non-member countries and proposals for taking that work forward.

With regard to OECD-member-country preferential tax regimes that are potentially harmful, the June 2000 Report (paragraphs 10-16) listed the following categories of activity, which member countries had potentially harmful preferential tax regimes in those categories, and the specific harmful tax regime in the respective OECD-member country:

- Insurance (Australia, Belgium, Finland, Ireland, Italy, Luxembourg, Portugal, Sweden).
- Fund managers (Greece, Ireland, Luxembourg, Portugal).
- Financing and leasing (Belgium, Hungary, Iceland, Ireland, Italy, Luxembourg, Netherlands, Spain, Switzerland).
- Banking (Australia, Canada, Ireland, Italy, Korea, Portugal, Turkey).
- Headquarters regimes (Belgium, France, Germany, Greece, Netherlands, Portugal, Spain, Switzerland).
- Distribution-centre regimes (Belgium, France, Netherlands, Turkey).
- Service-centre regimes (Belgium, Netherlands).
- Shipping (Canada, Germany, Greece, Italy, Netherlands, Norway, Portugal).
- Miscellaneous activities (Belgium, Canada, Netherlands, U.S.).

The June 2000 Report indicated that it did not include in the list holding company and similar preferential tax regimes, but stated that the Forum on Harmful Tax Practices is continuing to study this issue.[37] The Report lists only one preferential tax regime in the U.S.—the foreign sales corporation (FSC), which has been repealed by the FSC Repeal and Extraterritorial Income Exclusion Act, signed by President Clinton on November 15, 2000.

The 1998 Report adopted guidelines providing that harmful features of preferential regimes in OECD-member countries must be removed within five years, by April 2003, with a limited "grandfather clause" for taxpayers benefiting from such regimes on December 31, 2000, in which case those benefits must be removed by December 31, 2005. The guidelines specify a "stand-still provision" requiring that member countries refrain from adopting new measures or extending the scope of existing measures that constitute harmful tax practices.[38] With regard to tax havens, the June 2000 Report listed 35 jurisdictions that had been found to meet the tax-haven criteria of the 1998 Report (see sidebar).[39]



Advance commitment. The June 2000 Report noted that, prior to its issuance, some jurisdictions had made a public political commitment at the highest level ("advance commitment") to eliminate their harmful tax practices and comply with the principles of the 1998 Report, in accordance with a schedule proposed in the 1998 Report.[40] Therefore, those six jurisdictions, Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino, were not included on the list of designated tax havens in the June 2000 Report, even if they presently meet the tax-haven criteria of the 1998 Report. The June 2000 Report also noted that, during the consultation process, some jurisdictions that had been included on the list of 35 tax havens indicated an interest in cooperating with the OECD by committing to the elimination of harmful tax practices.[41]

Uncooperative Tax Havens. From the June 2000 Report list of jurisdictions (which may be amended) that meet the tax-haven criteria, the Committee decided to complete, by July 31, 2001, an OECD list of Uncooper-

[36] "Towards Global Tax Co-operation: Progress in Identifying and Eliminating Harmful Tax Practices). Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee of Fiscal Affairs" ("June 2000 Report"). See http://www.oecd.org/daf/fa/harm_tax/harmtax.htm.

[37] June 2000 Report, paras. 12 and 25.

[38] *Id.*, para. 4

[39] *Id.*, para. 17

[40] *Id.*

[41] *Id.*, para. 18.

[42] *Id.*, para. 15

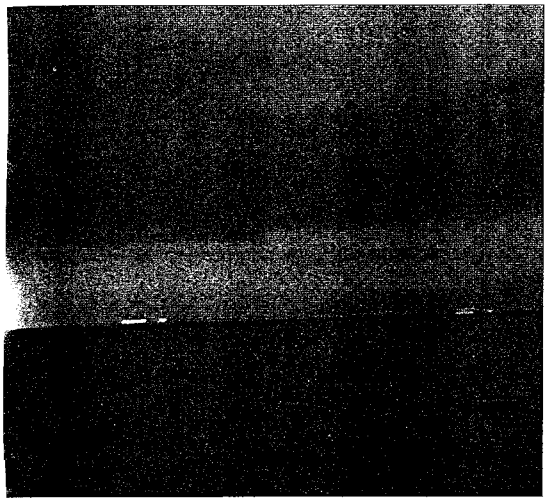
[43] *Id.*, paras. 21-25.

[44] *Id.*, paras. 26-27.

[45] According to www.oecd.org/sge/ccnm, the Centre for Co-operation With Non-Members (CCNM) "is the focal point for the development and pursuit of policy dialogue between the OECD and non-member economies. Established in January 1998, it merges the work of two former OECD bodies: the Centre for Co-operation with the Economies in Transition (CCET) and the Liaison and Co-ordination Unit (LCU)."

[46] 1998 Report, paras. 17, 58-61, and 86.

[47] June 2000 Report, section V, "Framework for Implementing a Common Approach to Restraining Harmful Tax Practices," paras. 32-35



ative Tax Havens.[42] This list would not include jurisdictions that had made an advance commitment or other jurisdictions ("cooperative jurisdictions") that make a public political commitment to adopt a schedule of progressive changes to eliminate their harmful tax practices by December 31, 2005 ("scheduled commitment"). The June 2000 Report establishes a schedule and review process to determine whether jurisdictions that have made an advance or scheduled commitment are complying with their respective commitments and therefore should not be included on the OECD list of Uncooperative Tax Havens.[43] The Netherlands Antilles and the Isle of Man have made such scheduled commitments (November 30, 2000, and December 13, 2000, respectively).

Continuing dialogue. The June 2000 Report noted that the Committee intends to continue the dialogue with cooperative jurisdictions, including:

1. The development of a model vehicle for exchange of information (OECD Model Tax Information Exchange Agreement or a multilateral agreement).
2. The creation of a multilateral framework under the Forum for consultation with cooperative jurisdictions, on exchange of information and other relevant issues pertaining to the elimination of harmful tax practices.
3. An examination of the types of assistance that jurisdictions will need in the transition, recognizing that an initial reduction in certain financial and other service activities may occur in some jurisdictions as a result of complying with the principles of the Report.[44]

OECD governments may consider the following:

1. Examining how their bilateral assistance programs can be re-targeted.
2. Encouraging international organizations to take into account the special needs of these jurisdictions in the design of multilateral assistance programs.
3. Offering under the auspices of the OECD and other organizations specific assistance in the design of their tax systems and in the strengthening of their tax administrations.
4. Encouraging jurisdictions to initiate cooperative programs to improve tax administration and enforcement by using existing organizations such as Intra-European Organization of Tax Administrations (IOTA), Inter-American Centre of Tax Administrators (CIAT), Commonwealth Association of Tax Administrators (CATA), the Caribbean Community (CARICOM), Centre de rencontres et d'etudes des dirigeants des administrations fiscales (CRE-DAF), and the Organization for Economic Cooperation (OEC):

> The Committee accepts that the changes that will be necessary for jurisdictions meeting the tax haven criteria that commit to remove their harmful tax practices may adversely affect the economies of some of those jurisdictions. The OECD will work with other interested international and national organizations to examine how best to assist co-operative jurisdictions in restructuring their economies. A dialogue has already been launched with the OECD's Development Assistance Committee. Also, the Committee on Fiscal Affairs, by means of its CCNM-sponsored outreach programme,[45] is prepared to assist jurisdictions in meeting the standards contemplated by the 1998 Report.

Defensive measures. The 1998 Report referred to counter-measures against harmful tax competition.[46] The June 2000 Report[47] refers to "defensive measures" that OECD-member countries could take after July 31, 2001:

> One objective of identifying harmful tax practices is to facilitate thorough co-ordination the OECD Member countries' actions against such practices, recognizing the limitations on the effectiveness of unilateral actions. The Committee recommends a general framework within which Member countries can implement a common approach to restraining harmful tax competition. This framework will facilitate the ability of countries to take defensive measures swiftly and effectively against jurisdictions that persist in their harmful tax practices. Defensive measures are important so that the adverse impacts from uncooperative jurisdictions can be addressed and so that these jurisdictions do not gain a competitive

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advantage over co-operative jurisdictions. In the application of the co-ordinated defensive measures, no distinction shall be made between jurisdictions that are dependencies of OECD countries and those that are not. These defensive measures would be at the discretion of countries and taken under their domestic legislation or under tax treaties....The range of possible defensive measures identified to date as a framework for a common approach with regard to Uncooperative Tax Havens as of 31 July 2001 are as follows [paragraphs 20 and 32-35 of the June 2000 Report]:

- To disallow deductions, exemptions, credits, or other allowances related to transactions with Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To require comprehensive information reporting rules for transactions with Uncooperative Tax Havens or taking advantage of their harmful tax practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.
- For countries that do not have controlled foreign corporation or equivalent (CFC) rules, to consider adopting such rules, and for countries that have such rules, to ensure that they apply in fashion consistent with the desirability of curbing harmful tax practices [Recommendation 1 of the 1998 Report].
- To deny any exceptions (e.g, reasonable cause) that may otherwise apply to the application of regular penalties in the case of transactions involving entities organized in Uncooperative Tax Havens or taking advantage of their harmful tax practices.
- To deny the availability of the foreign tax credit or the participation exemption with regard to distributions that are sourced from Uncooperative Tax Havens or to transactions taking advantage of their harmful tax practices.
- To impose withholding taxes on certain payments to residents of Uncooperative Tax Havens.
- To enhance audit and enforcement activities with respect to Uncooperative Tax Havens and transactions taking advantage of their harmful tax practices.
- To ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with Uncooperative Tax Havens and to transactions taking advantage of their harmful tax practices.
- Not to enter into any comprehensive income tax conventions with Uncooperative Tax Havens, and to consider terminating any such existing conventions unless certain conditions are met [Recommendation 12 of the 1998 Report].
- To deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in Uncooperative Tax Havens.
- To impose "transactional" charges or levies on certain transactions involving Uncooperative Tax Havens.

The June 2000 Report also refers to the possibility of nontax measures, without specifying them:

> Governments are invited to take into account that a jurisdiction is listed as an Uncooperative Tax Haven in determining whether to direct non-essential economic assistance to the jurisdiction. The Committee also intends to continue to explore what other defensive measures can be taken, including non-tax measures. Governments are also reminded of Recommendation 17 of the 1998 Report, which recommends that countries with particular political, economic, or other links with tax havens ensure that these links do not contribute to harmful tax competitions. Also, paragraph 153 of the 1998 Report indicates that countries that have such ties should consider using them to reduce the harmful tax competition resulting from the existence of these tax havens.[48]

Advance Commitment by Six Tax Havens

As indicated above, on June 19, 2000, the OECD announced that six jurisdictions (Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino) had agreed, each by an advance-commitment letter, to implement reforms to eliminate harmful tax practices by the end of 2005, adopting "international tax standards for transparency, exchange of information and fair tax competition."[49]

Each advance-commitment letter has basically the same language, stating, as in the Bermuda letter, for example (in relevant part):

> [T]he Government of Bermuda hereby commits to the principles of the OECD's Report, "Harmful Tax Competition: An Emerging Global Issue" (the "OECD Report"). In fulfillment of this commitment, the Government of Bermuda undertakes to implement such measures (including through any legislative changes) as are necessary to eliminate any harmful aspects of Bermuda's regimes that relate to financial and other services (as provided in more detail in the Annex to this letter). The Government of Bermuda commits in particular to a program of effective exchange of information in tax matters, transparency, the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activities. Details of these steps and a specific timetable have been agreed with the Forum. We understand that the OECD is prepared to assist us in establishing, improving, or maintaining such practices and procedures as are necessary to implement these principles.

The Government of Bermuda further commits to refrain from: (1) introducing any new regime that would constitute a harmful tax practice under the OECD Report; (2) for any existing regime related to financial and other services that currently does not constitute a harmful tax practice under the OECD Report, modifying the regime in such away that, after the modifications, it would constitute a harmful tax practice under the OECD Report; and (3) strengthening or extending the scope of any existing measure that currently constitutes a harmful tax practice under the OECD Report.

Conclusion

The second and concluding part of this article will pick up with the November 2000 Framework, including a comparison with the EU Directive. It will also discuss recent initiatives in several countries (e.g., Brazil and Mexico) aimed at restricting their corporate and individual residents' use of tax havens. ●

[48] *Id.*, paras. 36-37.

[49] The letters are available at http://www.oecd.org/daf/fa/harm_tax/advcom.htm.