The London School of Economics and Political Science

The impact of globalisation on the position of developing countries in the international tax system

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Declaration

I certify that the thesis I have presented for examination for the PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others.

I warrant that this authorization does not, to the best of my belief, infringe the rights of any third party.

Abstract

The objective of this thesis is to analyse the relationship between international taxation and developing countries. The main idea is to examine this relationship through arguments that challenge the current legal debate that has described their interest as capital importers of foreign direct investment.

Globalisation has changed the economic relations between developed and developing countries. The evolution of the economic aspects as well as tax policies implemented during the process of globalisation provides the background necessary to understand the increased importance of international taxation and the participation of developing countries in the global economy.

The hypothesis tested here addresses the question whether the dichotomy between developing and developed countries and their characterisation as capital importers and capital exporters still provides an appropriate basis for the legal debate on international taxation in the context of globalisation. To approach this question, the behaviour of international flow of capital will be assessed in order to provide an overview of the economic relations among these countries.

To perform this study, initially the meaning of globalisation and international taxation are explained in order to build up the framework of this thesis; secondly, the current debate on harmful tax competition is examined to put in evidence the problem addressed in this thesis; thirdly, an analysis of the international flow of capital is performed to identify new premises that could update the legal debate; fourthly, based on the profile of the international flow of capital, the phenomenon of capital flight is addressed. Fifthly, having in mind the difficulty in taxing capital flight, taxation of portfolio investment is examined. Based on the arguments raised, the legal debate is updated demonstrating the higher importance of double taxation over tax avoidance and evasion in the recent past. Finally, considering the increased relevance of international tax avoidance and evasion, instruments available for exchange of information are analysed, and their effectiveness to curb capital flight from developing countries.

Acknowledgements

In 2006, I started the LLM programme at the London School of Economics and Political Science (LSE). During that year, I focused my studies in international taxation and I came across the question of what was the position of developing countries in the international tax system regarding the current profile of the international flow of capital.

The traditional assumptions regarding the position of developing countries in the international tax system were intriguing me, since based on economic studies it was clear that some premises about the international flow of capital have changed. However, it was not possible to describe what was really going on and how it was affecting countries' interests in international taxation.

After some discussions with Dr. Roxan, I realised that the LSE was the right place to develop my ideas not only because I could count on his expertise in this field, but also because the LSE could provide the interdisciplinary environment that I was looking for to develop my research.

In 2007, I started this journey. The research process fascinated me from the beginning. Throughout this process, I came across many very interesting ideas and the challenge was to narrow them down. During critical moments, I could count on Dr. Roxan, whose knowledge and experience helped me to organise my ideas and to move forward in the research process.

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The opinions and errors in the text are my entire responsibility. I adopted the UK spelling in the text, only in quotations from US sources did I maintain the original spelling.

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LIST OF CHARTS AND DIAGRAMS

LIST OF ABBREVIATIONS

BCIMRS: Brazil, China, India, Mexico, Russia and South Africa

BIS: Bank for International Settlements

BMP: Balance of Payments Manual

BOPS: Balance of Payments Statistics

CCN: Common Communication Network

CEN: Capital Export Neutrality

CFC: Controlled Foreign Company

CIAT: Inter-American Centre of Tax Administration

CIN: Capital Import Neutrality

CMAATM: OECD Convention on Mutual Administrative Assistance in Tax Matters

CPIS: Coordinated Portfolio Investment Survey

CSI: Common System of Interface

DTC: Double Tax Convention

EU: European Union

FATCA: Foreign Account Tax Compliance Act.

FDI: Foreign Direct Investment

GAO: Government Accountability Office

GATT: General Agreement on Tariffs and Trade

GDP: Gross Development Product

IBRD: International Bank of Development and Reconstruction

IFS: International Financial Statistics

IIP: International Investment Position

IMF: International Monetary Fund

KF: Capital Flight

NEO: Net Errors and Omissions

NN: National Neutrality

ODA: Official Development Assistance

OECD: Organisation for Co-operation and Development

OEEC: Organisation for European Economic Cooperation

OFC: Offshore Financial Centres

PI: Portfolio Investment

TIEA: Tax Information Exchange Agreement

UK: United Kingdom

UN: United Nations

US: United States

VAT: Value Added Tax

WB: World Bank

Introduction: Hypothesis and Structure

The objective of this thesis is to analyse the relationship between international taxation and developing countries. The main idea is to examine this relationship through arguments that challenge the current legal debate that has associated their interest as capital importers of foreign direct investment.

Globalisation has changed the economic relations between developed and developing countries. The evolution of the economic aspects as well as tax policies implemented during the process of globalisation provides the background necessary to understand the increased importance of international taxation and the participation of developing countries in the global economy.

The standard assumption that limits the interest of developing countries in attracting foreign direct investment has also guided their involvement with tax policies defined at the international level such as harmful tax competition. What is this tax policy really about? What was the involvement of developing countries in the development of rules to combat harmful tax competition? These aspects need to be addressed to lay down the main question that this thesis will investigate: what is the effective interest of developing countries in international taxation?

In order to update developing countries' perspective of international taxation, the international flow of capital, which represents the economic premises that underpin the legal debate, will need to be examined. The aim of this analysis is to identify new arguments that can make the debate move forward from the paradigm that justifies the interest of developing countries in international taxation only from the perspective of capital importers of foreign direct investment.

The hypothesis tested here addresses the question whether the dichotomy between developing and developed countries and, consequently, their characterisation as capital importers and capital exporters, can still guide the legal debate on international taxation in the context of globalisation. To approach this question, the behaviour of the international flow of capital will be assessed in order to provide an overview of the economic relations among these countries. The idea is not to prove that the old premises are necessarily wrong, but to comprehend how they have changed and in this new context how the legal debate needs to be approached.

Before going through the main ideas explored in each chapter, it is important to understand the driving reasons of this research. The legal debate on international taxation is underpinned on economic facts, more precisely on the profile of the international flow of capital. The basic assumption that derives from the international flow of capital is that developing countries are capital importers and developed countries are capital exporters. Consequently, in the legal debate, source taxation has been associated with developing countries; whereas residence taxation has been associated with developed countries. Based on these assumptions, the legal debate has evolved, focusing mainly on tax treaty rules that allocate taxing rights between source and residence countries. However, the international flow of capital has substantially changed since these taxing rules have been adopted. Countries nowadays have become economically interconnected. There are a significant number of economic studies analysing this new economic scenario, which is associated with the phenomenon of globalisation. Nevertheless, it is very hard to find a study that provides a complete view of the international flow of capital from different countries at the same time. Usually you have individual countries' analysis or even regional analysis of countries with similar profile. A broader range study is quite hard to identify, remaining a segmented view of the economic facts that underpin the legal debate. As a result, the legal debate remains focused on paradigm economic arguments originating from the 1920s. Of course, there are economic studies demonstrating significant changes in the international flow of capital of individual countries, though a macro view of these facts was missing as well as its connections to the legal debate. Therefore, the contribution of this thesis consists in providing a critical view of the international flow of capital that underpins the legal debate on international taxation in order to push the discussion to arguments that cannot be understood without an interdisciplinary approach of the subject.

On the other hand, it has to be clear that the objective of this study was not to improve data on international flow of capital. The scope is limited to the economic data available from international organisations (e.g. International Monetary Fund, World Bank, OECD, etc.) and economic studies performed by other researchers. To this extent, the analysis performed reflects the limitations of the economic data adopted. These limitations are also connected to the broad scope of this research. If the focus was narrower, it would be easier to find more detailed information about countries' economic profiles. Nevertheless, the broader scope allowed a logical view of the relationship between countries of different profiles. The legal debate on international taxation was then examined based on the outcomes of the economic analysis.

Having in mind the cornerstone arguments of this study, as well as its limitations, the research developed in each chapter and the connection between them becomes clear. In other words, the structure of this study reflects a logical sequence of questions originated in the development of the research. Consequently, firstly, basic concepts related to the scope of the thesis were examined (globalisation and international taxation); secondly, current flaws of the legal debate were identified (harmful tax competition); thirdly, economic data that underpin the legal debate were examined (international flow of capital); fourthly, possible explanations for the current profile of the international flow of capital were analysed (tax havens' behaviour and the problem of capital flight); fifthly, regarding the problem of capital flight, tax policies on portfolio investment were examined; and sixthly, putting together the arguments raised in the previous chapter, the legal debate was updated, recasting the position of developing countries and their interest on international exchange of tax information.

Chapter I and II.

To perform the analysis, first of all, it will be necessary to explore the meaning of globalisation and how developing countries have adapted their tax policies to this new economic scenario. It will emerge that some tax issues need to be tackled at the international level, whereas others remain to be decided domestically. To this extent, international taxation has been dealt with at the international level under two main issues: tax treaties and harmful tax competition. The former tackles the discussion based on allocation of taxing rights between source and residence countries as well as to the classification of income in different categories (e.g. dividends, interest, capital gains, etc.); while the latter is focused on harmful tax practices involving tax havens and offshore financial centres. The initial step, therefore, will be to dismantle these arguments in order to understand how they have guided the discussion to aspects that cannot really point out the effective position of developing countries.

Chapter III.

In order to challenge the current legal debate, new economic premises will be evaluated. The analysis will use data from the international flow of capital as well as the international stocks of assets and liabilities held by three groups of countries: developing countries, high income OECD countries and tax havens. The economic data will be used to demonstrate that the international flow of capital is much more complex and basic assumptions that have characterised developing countries as capital importers and developed countries as capital exporters. Furthermore, it will emerge that the discussion cannot be polarised into two groups only (developed countries v. developing countries); it is necessary to evaluate the position of tax havens separately.

Chapter IV.

The economic analysis performed in the previous chapter demonstrated that (i) the North/South assumption cannot explain the behaviour of the international flow of capital; (ii) tax havens are important players; and (iii) developed and developing countries have increased difficulties in reporting outflows of capital. However, why have countries difficulties in reporting outflows? What is not clear in the official figures of outflows analysed? What is the relationship between tax havens' behaviour and the difficulty of countries in reporting outflows? The phenomenon of capital flight might be a reasonable explanation. The phenomenon of capital flight will be examined in order to evaluate a possible explanation for the current profile of the international flow of capital and, consequently, to verify how it can be affecting developing countries' interest in international taxation.

Chapter V.

Another aspect emphasised by the economic analysis is the significant increase of Portfolio Investment. This type of investment is concentrated in developed countries and this premise has dominated the studies about this topic, underestimating its importance to developing countries. It is necessary to evaluate their interest regarding not only inflows but also outflows, i.e. accumulated capital flight held abroad. Thus, the importance of portfolio investment to developing countries needs to be considered from this angle, which extrapolates the conclusions reached until now, relating portfolio investment to developing countries.

Chapter VI.

Putting together the arguments raised in the previous chapters, a question is raised: Does it still make sense to discuss the interest of developing countries in international taxation based on source taxation? The analysis of the international flow of capital demonstrated that it is very hard to classify developing countries as capital importers and developed ones as capital exporters. Consequently, the justification of their tax policies based on their economic profile became much more complex. But why has international taxation been debated in terms of allocation of taxing rights between source and residence countries? What is in fact being discussed and why has the discussion taken this path? The historical analysis of the relationship between double taxation and tax evasion will help to understand the current profile of the international tax debate and how it might be updated.

Chapter VII.

Assuming that developing countries are also interested in taxing income derived from assets held abroad by their residents, tax policies that deal with the problem of harmful tax practices are also of interest to them. In other words, developing countries are also interested in enforcing residence taxation. The OECD through the work on harmful tax competition has developed rules to improve transparency and exchange of information for tax purpose. How do these rules work? What are the advantages and weaknesses of these tax policies? These questions will be addressed in order to demonstrate whether these tax policies can help developed countries to solve the crisis of residence taxation.

Chapter VIII.

The analysis of the rules to improve transparency and exchange of information for tax purposes created the requested background to examine whether they can help developing countries to deal with the problem of capital flight. In a sense, the problem of capital flight represents the crisis of residence taxation for developing countries. This last chapter, therefore, will close the debate about developing countries and international taxation by examining the current instruments for exchange of information from the perspective of developing countries, considering the problem of capital flight. It will become clear if the measures adopted by developed countries to solve the crisis of residence taxation from their perspective can also help developing countries to deal with the problem of capital flight.

Chapter IX.

The final chapter will highlight the important outcomes reached in the previous chapters and, consequently, how they contributed to the final conclusion of this project. The connections between each chapter will become clear as well as the contribution of this thesis to the literature.

Chapter I. Globalisation and International Taxation

Most studies have discussed the impact of globalisation on taxation in order to call for changes in tax policies. However, what is the effective meaning of globalisation? This term has been used in so many different contexts that before associating it to taxation it is necessary to approach its effective meaning for the study performed. The approach adopted to understand globalisation will reveal its impact on taxation and, consequently, the increased importance of international taxation. To this extent, the history of tax treaties will show how international taxation has been discussed and its focus on allocation of taxing rights.

The structure of this chapter consists of three sections: (i) the meaning of globalisation; (ii) the impact of globalisation on tax policies; and (iii) the use of tax treaties to allocate taxing rights. The first section provides the necessary arguments to comprehend the development of international taxation from a broader perspective, considering the economic changes suffered by countries brought on by globalisation. The second section explains the increased importance of the international aspect of domestic tax policies. The third section examines the background of tax treaties in order to demonstrate how the legal debate on international taxation has focused on allocation of taxing rights between source and residence countries. Globalisation has reshaped the economic relations among countries and international taxation became an emerging issue in this scenario.

1.1. The meaning of globalisation

The understanding of the term ‘globalisation’ is important because many studies associate it with international taxation without contextualising what its effective meaning is. As this word has been used in so many different situations and different fields, an explanation is required in order to produce a meaningful understanding of what has become an ambiguous term in the tax field.

The analysis of the characteristics of the current process of globalisation as well as its historical context will provide the required information to understand the underlying economic relations among countries that gave support to the development of international taxation.

Globalization is a complex phenomenon encompassing economic, political and social aspects, which allows it to be interpreted in many different ways by researchers, depending on their field of research and the question being investigated. Kohler, former managing director of the IMF, defined globalisation in a broad sense, focusing on the idea of free flow: 'the process through which an increasingly free flow of ideas, people, goods, services and capital leads to the integration of economies and societies'.[1]

The idea of free flow is the core characteristic of globalisation. In fact, people, goods, services and capital can flow in different manners depending on the level of liberalisation adopted. As discussed next, the characteristics of the two periods (i.e. 1870-1914 and 1970- to present date) of outstanding economic integration differ considerably due to the combination of restrictions on trade and movement of capital and labour.

From a historical perspective, globalisation is not a new phenomenon. The period from 1870 to 1914 (start of the First World War) was also marked by high levels of overseas investment and labour migration.[2] By that time, labour's mobility was at the same level as capital mobility. In terms of international trade, industrialised countries exported manufactured goods while the rest of the world supplied raw materials to them.[3] Most

[1] H. Kohler, 'Working for a Better Globalization' (Conference on Humanizing the Global Economy, Jan 2002) <http://www.imf.org/external/np/speeches/2002/012802.htm> accessed 16 June 2009.

[2] There is a discussion in current literature about how many processes of globalisation occurred throughout the entire history of humanity. As the objective of this study focuses on the economic aspects of this phenomenon, the previous period that also had a high level of economic integration was from 1870 to 1914. J. Osterhammel and N. P. Petersson, *Globalisation: A Short History* (Princeton University Press 2005).

[3] Developed and developing countries' nomenclature was not used by that time. Developed countries were commonly referred as industrialised nations, whereas developing countries were referred as 'the rest of

developing countries were still colonies of the industrialised world, having their interests limited and controlled by industrialised countries' necessities.

Even though there was a high level of international trade, tariffs were still a barrier in the 'golden age' of liberalism before 1914. Trade was conducted on a bilateral basis rather than on a multilateral agreement, which demonstrates the absence of any significant institutionalisation of intergovernmental collaboration in the period of 1870-1914. There was neither an international institution to control the international financial system. Thus, the main facilitator of economic integration was the adoption of the gold standard. The gold standard allowed the convertibility of a domestic currency to a specific amount of gold, eliminating the risk of foreign exchange.[4]

The free flow of capital was unidirectional, i.e. from industrialised countries to the 'rest of the world'. It was easy to classify countries as capital importers and capital exporters. In sum, the premises of the economic integration that happened between 1870 and 1914 were stipulated by the industrialised nations, it becoming easy for them to identify their economic interest and match it with the policies embraced and enacted by them in a global scale.

The current process of globalisation (1970 to present) is much more complex than the previous one. In terms of free flow, the current period has a free movement of trade and capital supported by the lowering of trade barriers and the liberalisation of exchange and capital control.[5] The development of new technologies has also contributed to the free flow of capital and trade through the improvement of communication (e.g., Internet and Email) and transfer of resources (e.g., electronic banking and worldwide transfer of funds). However, people are not allowed to move in the same way as capital and trade.[6]

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the world'. 'The rest of the world' encompassed independent non-industrialised nations as well as many colonies of the industrialised countries.

[4] J. Ravenhill, 'The Study of Global Political Economy' in J. Ravenhill (ed.), *Global Political Economy* (Oxford University Press 2007) 8-9.

[5] Osterhammel (n 2) 143.

[6] A. Mcgrew, 'The Logics of Economic Globalization' in in J. Ravenhill (ed.), *Global Political Economy* (Oxford University Press 2007) 291.

Consequently, nowadays labour's mobility is more limited than capital's mobility; which reflects constraints on policies of migration. The limitation of labour's mobility is a remarkable difference from the previous period of globalisation. In terms of capital and trade, in both periods there was a high level of flow, even though with completely different characteristics since trade tariffs were not reduced in the first period of globalisation and capital performed a unidirectional movement: from industrialised to 'the rest of the world'.

Focusing on the premises of the current process of globalisation, what we see is a completely different scenario from the previous period: (i) developing countries are not anymore colonies of the industrialised world; (ii) there are international institutions to control the international financial system and the international trade; (iii) countries adopt floating exchange rates; and (iv) multinationals dominate the international trade. What are the facts that led to a so different scenario between the first and the last process of globalisation? In order to answer this question it is necessary to examine the historical facts that happened between the start of the First World War (1914) and 1970, which will be denominated the 'inter-globalisation' period.

In 1914, the outbreak of the First World War jeopardised the economic integration of the world. It was the end of the liberal argument that economic interdependence could grant a peaceful period among nations. As a result, many industrialised nations only achieved economic integration at the same level of pre-First World War in the 1970s.[7]

With the start of the First World War, the international gold standard broke down with a speculative attack on sterling. The end of the gold standard caused a misalignment of currencies around the world creating a barrier to international trade. Notwithstanding the difficulties brought by the end of the gold standard, the US raised its tariffs to high levels, which was answered by the European countries with retaliations, imposing more

[7] Ravenhill (n 4) 11.

obstacles on the international trade system. These measures reduced the value of world trade by two-thirds between 1929 and 1934.[8]

The apex of the crisis of the liberal economic model is represented by the Great Depression in 1930 in which an international financial crisis triggered the collapse of both international lending and the international gold standard.[9] Governments were unable to agree on a viable international financial system. Consequently, the main characteristic of the inter-globalisation period is the absence of a consensus to establish a new economic order around the world.

An opportunity to create an international financial system only arose in the early 1940s, when the US and the UK policymakers began to plan the organisation of the post-war international monetary and financial system. US policymakers did not want to see a return to the classical liberal international economic order of the pre-1930s period. Instead, they hoped to find a way to settle liberal multilateralism with the domestically orientated priorities to fight unemployment and encourage social welfare that had emerged in the New Deal.[10]

In 1944 a new economic regime was agreed. The new consensus was reached at the United Nations Monetary and Financial Conference, in the village of Bretton Woods, New Hampshire. There, forty-four governments agreed on the principles that would guide the international monetary system in the post-war years. The Bretton Woods participants sought to re-establish a world of international currency stability. John Maynard Keynes from the UK and Harry Dexter White from the US guided the discussions.[11]

[8] ibid 12.
[9] E. Helleiner, 'The evolution of the International Monetary and Financial System' in J. Ravenhill (ed.), *Global Political Economy* (Oxford University Press 2007) 215.
[10] ibid 219.
[11] ibid.

The new regime would have to reconcile market-oriented policies with prerequisites of domestic policies such as stability and full employment. The architects of Bretton Woods needed to find a way to settle domestic and international policies since the Great Depression had offered contradictory lessons about economic closure. On one hand, economic closure had precipitated the Great Depression and exacerbated its effects; on the other hand, an open economy could destabilise domestic economy, affecting the money supply and obstructing full employment. It was necessary to find a new balance between domestic and international policies. Therefore, instead of what happened before the First World War when economies needed to adjust themselves to global pressures, the global economy would need to adjust itself to local necessities. A global market should exist and be enforced by multilateral agreements but local governments would control the market's power.[12]

The influence of developing countries on the Bretton Woods negotiations and on the nature of the institutions that emerged was insignificant.[13] The Bretton Woods system created two multilateral organizations (the International Monetary Fund - IMF and the International Bank of Development and Reconstruction - IBRD, an institution of the World Bank Group) and one standing conference (GATT) in order to enforce economic stabilisation;[14] however developing countries were at the margin of the decision process. The IMF would supervise and support the fixed exchange rates regimes and act as a lender of last resort.[15] Its capacity to lend comes primarily from the contribution of members, whereas the World Bank can borrow from the private sector to finance its lending.[16] The IBRD main function was to help European countries to recover from the war. Only later, its focus changed to developing countries. The Bretton Woods members did not achieve an agreement about an International Trade Organisation - ITO since the major players (the UK and the US) were not sure about how the after war trade would

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[12] H. M. Schwartz, *States Versus Markets: History, Geography, and the Development of the International Political Economy* (Macmillan 2000) 192-93.
[13] C. Thomas, 'Globalization and Development in the South' in J. Ravenhill (ed), *Global Political Economy* (Oxford University Press 2007) 419.
[14] ibid 420.
[15] Schwartz (n 12) 191.
[16] Helleiner (n 9) 221.

be configured and any concession/agreement at that time might damage their trade position. Thus, only later in 1947, fifty countries signed in Havana the General Agreement on Trade and Tariffs.[17]

The main features agreed at the Bretton Woods conference were: (i) a financial order underpinned on the 'embedded liberal' ideology in which market allocation was limited by political process; (ii) currency convertibility for current account payments; (iii) gold-dollar standard; (iv) an adjustable exchange-peg rate regime; (v) control of capital movements; and (iv) establishment of international financial institutions. The Bretton Woods conference managed to establish a new world consensus on how the international monetary system should work. The Bretton Woods International Monetary Regime stood until the US suspended the convertibility of the US dollar into gold in 1971.[18]

The aftermath of the Bretton Woods collapse was the privatisation of the financial markets, which is one of the main characteristics of the current process of globalisation. The growth of financial markets surpassed the cross-border trade of goods. It is worth noting that the Bretton Woods architects (Keynes and White) endorsed an international financial order in which governments could control cross-border private financial flows, and public international institutions would have a key function in allocating short-term and long-term capital at the world economy. Today, as discussed next, the opposite situation is configured at the international level: enormous sums of private capital flow around the world quite freely and the size of these flows surpasses the lending activities of the IMF and World Bank.[19]

The end of the Bretton Woods system caused a new ideology to emerge: neoliberal policies. These policies are based on the assumption that global economic integration through free markets is the most effective route to promote growth.[20] The neoliberal

[17] Schwartz (n 12) 194.
[18] Helleiner (n 9) 221-22.
[19] ibid 233.
[20] Thomas (n 13) 424.

economic agenda reflected ideas of the virtue of the free market combined with small regulatory states, which were implemented by Reagan and Thatcher in the 1980s.[21] Market intervention was only conceived to supply a range of public goods that could not be provided through competitive profit seeking and to enforce rules of competition.[22] The market-oriented policy based on the neoliberal ideas was conceived to be suitable to both developed and developing countries.[23]

The facts listed above revealed the economic policies that led to the development of an integrated financial market. In fact, the main economic policy that granted the development of a global financial market was the end of exchange control, since it allowed the free flow of private capital around the world. However, it is interesting to note that the original idea was to control private financial flows, rather than leave them free as occurs today.

Another relevant aspect is how developing countries were inserted into the global economy. During the first period of globalisation, most developing countries were just colonies of the imperialist world and their economic roles were restrained to the supply of raw materials requested in the process of industrialisation. Later, in the inter-globalisation period, developing countries remained at the margin of the economic and political process that reshaped the world economy. Only recently the position of developing countries started to change: developed countries became conscious that to maintain the current economic order, developing countries needed to be inserted into it. From this perspective, different policies were designed by developed countries and international organisations to change the position of developing countries in the international economy.

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[21] R. Wade, 'Financial Regime Change?' (2008) 53 New Left Review 1, 1-6.
[22] ibid.
[23] Since the adoption of neoliberal policies, new policies have been enacted, however, the ideology behind it remains the same: free market with small intervention can promote growth.

1.2. The impact of globalisation on tax policies

Domestic aspects of tax policies have guided policymakers when discussing tax reforms until recently. Policymakers' major concerns were related to the internal constraints of a tax system such as administrative efficiency, raising of tax revenue and possible impact of reforms on economic growth. However, the phenomenon of globalisation has changed the economic facts that supported policymakers' decisions. Nowadays policymakers need not only to regard the internal dimension of tax reforms, but also to consider the international aspects of national tax policies, which mean how to use tax policies to gain competitiveness and to influence the international movement of capital.[24]

Most characteristics of tax systems were developed in a period around the Second World War or shortly after. The international economic relations among countries were very different from today since the underpinning economy had a different dynamic. As already described in the previous section, between 1945 and 1970, there were: (i) trade restrictions since many countries protected their domestic markets by using quantitative restrictions such as high trade tariffs and quotas; (ii) capital movement barriers curbing the development of multinationals' operations and international finance; (iii) individual mobility limitations due to restrictions on migration and high travelling costs; (iv) limited amount of portfolio investment; and (v) tax havens had a marginal role in the movement of capital, only being used in evading taxes and in laundering money from illegal activities.[25] In this scenario, policymakers were quite free to choose the features of a tax system and the tax rates of individual income tax, corporate tax, trade tariffs and excise taxes. The concern with the movement of capital and the attractiveness of foreign investment did not exist. Policymakers focused on features of the national economy to plan tax reforms.

[24] V. Tanzi, *Policies, Institutions and the Dark Side of Economics* (Edward Elgar Publishing 2000) 215.
[25] ibid 216-218.

The present situation is considerably different. With the process of globalisation, i.e. after 1970, the international economic relations of countries have become more open, following the market oriented policies implemented by the neoliberal ideology. In this new economy: (i) trade tariffs were reduced; (ii) capital movement barriers were removed enhancing the activity of multinationals' operations and the availability of international finance; (iii) travelling costs were reduced, but restrictions to migration did not change except in specific regions such as the European Union; (iv) the volume of portfolio investment surpassed all other types of foreign investment; and (v) tax havens have an essential function on the movement of capital, being used not only for illegal activities but also by multinational enterprises to structure their business around the world.

The current economy is centred on financial flows across countries. The magnitude of capital flows in many countries has surpassed not only the volume of foreign trade but also their GDP.[26] In the new global economy, the tax policy of a country can have a significant impact on other countries' tax policies, making policymakers face a fundamental dilemma when defining tax policies: the trade-off between raising tax revenue and gaining competitiveness to attract foreign investments. Globalisation has changed the way policymakers structured tax reforms, since the international aspects of national tax policies became a crucial element.

From a political perspective, the cross-border effect of tax policies has a major impact on state's sovereignty. State sovereignty has been challenged in this new integrated economy. Although globalisation has collaborated to create an economic integration among countries, national political sovereignty has increasingly come into conflict with this new economy. The problem is that the limit of economic markets no longer corresponds to national territories and thus, the taxation of economic activities requires the involvement of more than one jurisdiction.[27] National tax policies are now affected

[26] The comparison of countries' GDP with financial flows is performed in Chapter III.
[27] V. Tanzi, *Taxation in an Integrating World* (Brookings Institution 1995) xv.

by other countries' tax policies, which compel the design of tax policy to reflect the international environment.

The global scenario, therefore, can be described as economically integrated, in which there is a remarkable mobility of resources through trade and investment (e.g. FDI and portfolio investment), but politically fragmented, where traditional territorial borders are maintained. Jeffery explained this situation as an evolution from economic nationalism to international economic integration. According to him, an important characteristic of economic integration is that it has not been even or uniform in the rate, nature or extent of assimilation. This uneven process has derived from the variations among countries in their compliance to adapt to the new changes through the national and international law making processes. In this process of adaptation, there are two main issues that might be considered by countries when determining their tax policies: (i) certain matters should be dealt at the international level; and (ii) matters that must be regulated at the national level should be consistent with the world economy.[28] This bifocal perspective of tax policies helps to understand how domestic and international tax rules are related to each other.

Regarding matters regulated at the national level, there are two crucial external influences on developing countries' tax systems that made their domestic laws consistent with the international environment: (i) tax reforms conducted by international organisations; and (ii) negotiation of tax treaties. During the post Second World War period, economic policy of many developing countries involved a strong role for the state and a high priority given to industrialization, diversification and modernization of the economy. For tax policy, this economic policy was implemented through tariff protection for domestic industry, input subsidies and favourable tax regimes for industry.[29]

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[28] R. J. Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation* (Kluwer Law International 1999) 13-21.

[29] M. Stewart, 'Global Trajectories of Tax Reform: Mapping Tax Reform in Developing and Transition Countries' (2002), 29 University of Melbourne Public Law Research Paper <http://ssrn.com/abstract=319200> accessed May 2009, 38.

During the 1980s due to the debt crisis in developing countries, in order to lend money, international organisations such as the IMF and the World Bank imposed some conditions on developing countries' economic policies. Some conditions were related to tax reforms and, consequently, developing countries had to adjust their tax systems to the requirements imposed by the international organisations. In the 1990s, the aim of tax reforms implemented by these international organisations changed following new tendencies in the world economy and the fact that the old model of tax reform failed in many developing countries. Today the overarching goals of tax reform are the opposite of the previous period, i.e. a 'broad based' corporate tax that encourages savings and operates in an open market economy; an increased reliance on consumption taxes, such as the value added tax; and the elimination of trade-tariffs.[30]

The current tax reform recognises the difficulty of taxing capital in an integrated global economy, but does not propose any global solution or a better understanding of what is going on in developing countries' tax systems. The assumptions of the current tax reforms are based on the impact of globalisation on developed countries' tax systems.

In practical terms, developing countries usually accepted the interference of the IMF and the World Bank in their economies, implementing the tax policies suggested since they needed foreign investment to compensate the shortage of internal savings. The shortage of capital also induced developing countries to enact laws that offered tax exemptions to foreign investors. Developing countries, therefore, have engaged themselves in tax competition for foreign direct investment, i.e. productive investment that would bring economic benefits despite the tax incentives being offered.

Another point is that the coordination of the interaction of developing countries' domestic tax laws was not included in the scope of the tax reforms conducted by the IMF and World Bank. This coordination was left to the development of tax treaties.

[30] ibid 39.

Thus, the second fact that has influenced the adaptation of developing countries' domestic tax laws to the international environment was the negotiation of tax treaties.[31]

Tax treaties, as explained in the next section, were developed by reference to developed countries' tax laws and countries willing to negotiate them had their domestic tax laws adapted. For instance, it was necessary to develop an individual income tax and a corporate income tax, otherwise it would be impossible to avoid double taxation since this concept is based on the imposition of comparable taxes in two states in respect of the same income and in the hands of the same person. Therefore, without a comparable income tax system between developed and developing countries, the flow of capital would be barred by the imposition of unparalleled taxes which tax treaties were not prepared to deal with. Thus, the tax treaty was the instrument elected by developed countries to deal with the problem of double taxation that emerged in an integrated global economy.

Regarding matters dealt with at the international level, since the 1920s the allocation of taxing rights is controlled by tax treaties. Even though the current process of globalisation has exacerbated the cross-border tax spillovers due to the volume of economic transactions taking place in more than one jurisdiction, the concern with double taxation is not recent and the first tax treaty was made in 1899 between Prussia and the Austro Hungarian double monarchy.

The concern with allocation of taxing rights acquired an effective global dimension in the 1920s when the League of Nations started to address this matter. By that time, the international financial market was much less complex and the concerns on the allocation of taxing rights were simplified to the allocation of tax revenue since the international movement of capital had a different dynamic: it flew from 'industrialised countries' to 'the rest of the world'.

[31] ibid 11.

The allocation of taxing rights involves, in practice, the decision on how to tax the foreign income of residents and the source income of non-residents since in both situations there is more than one jurisdiction involved which can claim the right to tax certain income. The problem arises when both jurisdictions claim the right to tax the same income in the hands of the same legal person, characterising juridical double taxation. Double taxation inhibits the flow of capital, discouraging an efficient allocation of investments.

There are two different alternatives to avoid double taxation by enacting: (i) unilateral tax policies; and/or (ii) bilateral tax policies, i.e. tax treaties. The first alternative is dealt with at the national level; whereas the second one is dealt at the international level. The provisions of a tax treaty override the conflicting measures provided in the domestic legislation, which means that when a tax treaty is signed, the methods used to relieve double taxation will be the ones established in the treaty and not the rules established in the domestic legislation. There is no need for the domestic law to be harmonised with the tax treaty. In fact, the more outrageous the provisions of the internal law, the better the starting position for negotiating treaties.[32] Both unilateral and bilateral tax policies limit the exercise of taxing rights of sovereign jurisdictions. Accepting those rules, national tax systems recognised some limitations on their scope of application.

Unilateral tax policies allow countries to relieve double taxation by enacting rules that recognise a tax credit or a tax deduction for the amount of tax paid abroad or, alternatively, exempts foreign income from domestic taxation. On the other hand, tax treaties avoid double taxation by first distributing the allocation of taxing rights between source and residence countries and when the previous division allows both states to tax, the credit and the exemption method can be applied. Although both unilateral and bilateral tax laws can relieve double taxation, tax treaties have played a core function in determining the international allocation of taxing rights. Tax treaties, therefore, have not

[32] J. F. Avery Jones, 'The David R. Tillinghast Lecture: Are Tax Treaties Necessary?' (1999-2000) 53 Tax Law Review 1, 3.

only influenced domestic laws but also assumed a dominant position in determining the allocation of taxing rights at the international level.

Tax treaties emerged as the main instrument used internationally to avoid double taxation by allocating taxing rights between the source and the residence countries. The bilateral aspect of how taxation is dealt with at the international level has made it necessary to have more than 1,400 separate tax treaties in order to make the international tax system to work.[33] In fact, the loose network of bilateral tax treaties proved an inadequate mechanism for coordinating tax jurisdiction. The allocation of taxing rights promoted by tax treaties in which, basically, business profits could be taxed at the source, whereas returns of investment were primarily taxed at the residence of the investor, concealed the disagreement between major capital importers and capital exporters. [34] A global approach was never considered in the original debate of international double taxation, the bilateral approach remaining the only measure accepted worldwide. Thus, analysing the historical background of tax treaties will shed some light on how we have been thinking about international taxation and the problems that emerged in its evolving process.

1.3. The use of tax treaties to allocate taxing rights

The idea of examining the background of international tax treaties[35] is to make clear how developed and developing countries have been thinking on international taxation. The objective is not to point out specific problems of tax treaties but to understand how tax treaties work from a broader perspective, demonstrating the line of reasoning that has guided the current discussion between developed and developing countries.

The basic ideas of a tax treaty started with the studies developed by the International Chamber of Commerce. Organised in 1920, this organisation emphasised the problem of

[33] ibid 1.
[34] S. Picciotto, *International Business Taxation: A Study in the Internalization of Business Regulation* (Weidenfeld & Nicolson 1992) xiv.
[35] The expression Double Tax Convention ('DTC') is also referred as tax treaty in the body of this study, suggesting the same meaning.

double taxation in the international scenario. In its organisational meeting, influenced by the American vision, the Chamber suggested taxation by both residence and source with residence deferring some taxing rights to source, while retaining a 'right to claim the difference between the tax paid and the home tax.' [36]

In the years that followed, the International Chamber of Commerce developed resolutions regarding double taxation that were to be voted on at the 1923 Rome Congress and were to become the draft of a model tax treaty. The Rome Resolutions incorporated classification and assignment rule of categories of income, restating the ideal of non-discrimination and proposing the allocation of business profits to source nations based on objective mechanisms. Because of disagreements between the American Committee and the British Committee (i.e. the Americans accepted taxation by both source and residence; while the British maintained that all taxation should be residence-based), the International Chamber of Commerce could not achieve a consensus and a committee of economists was appointed by the League of Nations to conduct research on double taxation.[37]

It is worth noting that even though both US and UK were capital exporters, they had diverging positions on the allocation of taxing rights. The American position was influenced by Adams' work, which admitted source taxation as an appropriate meaning of the benefit principle of taxation; administrative advantages; and as an alternative to reconcile the debtor nation position with the creditor nation position. On the other hand, the British Committee did not admit source taxation and argued that all taxation should be residence based, focusing on its own economic situation as the major capital exporter in the world.[38] For instance, in 1855 the UK outflow of capital was 700 million dollars which corresponded to almost 80% of the total stock of foreign assets held worldwide.[39]

[36] M. J. Graetz and M. M. O'Hear, 'The "Original Intent" of U.S. International Taxation' (1996-97) 46 Duke Law Journal 1021, 1066-67.
[37] ibid 1070.
[38] ibid 1072.
[39] M. Obstfeld and A. M. Taylor, 'Globalisation and Capital Markets' in M. D. Bordo, A. M. Taylor and J. G. Williamson (eds), *Globalisation in Historical Perspective* (The University of Chicago Press 2003) 141-42.

In 1923 the League of Nations invited four economists (Professor G. W. J. Bruins of the Netherlands, Professor Luigi Einaudi of Italy, Prof. Edwin R. A. Seligman of the United States and Sir. Josiah Stamp of Great Britain) to prepare a report on how to avoid international double taxation.[40] The report prepared by the economists was based on the doctrine of economic allegiance:

> A part of the total sum (of taxes) paid according to the ability of a person ought to reach the competing authorities according to his economic interest under each authority. The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that liability should be divided among the tax districts according to his relative interests in each.[41]

The 1923 Report suggested four factors to determine economic allegiance: (1) where the result is physically or economically produced; (2) where the final product of the economic process is located; (3) where the rights over the income produced can be exercised; and (4) where the income is consumed or disposed of. Some authors regard factors 1 and 4 as the primitive idea that led to the source and residence principles of taxation.[42] By that time, the report already admitted that to allocate the exact proportion of economic allegiance to each category of income is a very difficult task.[43]

Considering that the only way to prevent double taxation is through concessions made by the source and the residence countries, the report of the four economists presented the following alternatives: (i) the residence country would allow a deduction of the tax paid abroad on its income tax levied on foreign income earned by a resident; (ii) the source country would exempt non-residents from taxation of income produced from sources within its territory; (iii) a convention would divide the taxing rights between the source and the residence states, recognising the primary right of the source (limited by

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[40] N. Tadmore 'Source Taxation of Cross-Border Intellectual Supplies: Concepts, History and Evolution into the Digital Age' (2007) January *Bulletin for International Taxation* 2, 4.

[41] M. B. Carrol, *Prevention of International Double Taxation and Fiscal Evasion* (League of Nations, 22nd ed, June 1939) 13.

[42] Tadmore (n 40).

[43] Carrol (n 41) 14.

certain parameters) and the residual right of the residence state; or (iv) also by convention, the source country would keep the right to tax wholly certain categories of income, for instance, income connected to property rights, but would exempt other categories of income; thus, the residence country would recognise the tax paid abroad as a deduction from its income tax with respect to those categories of income, while it would fully tax the other categories of income.[44]

The economists' report concluded that the best alternative would be the second one, which is the exemption of income from non-residents by the source state. It also recognised that some countries would be reluctant to abandon source taxation and in those cases the fourth alternative was advisable, with some adjustments proposed in the third one. A very interesting point is that the economists believed that by increasing the level of industrialisation in developing countries, they would be willing to renounce source taxation.[45] Another reason in favour of residence taxation was that it would ensure taxation based on the ability to pay principle, by the application of progressive income taxes on the world-wide income of a resident taxpayer.[46]

There were differences between the ideas developed previously in the International Chamber of Commerce and the ones presented by the four economists in the 1923 Report. While the first broadly admitted source taxation, the second clearly preferred residence taxation. The conceptual difference in these approaches is a consequence of the distinct lines of argument sustained by the American Professors: Seligman and Adams. Prof. Seligman preferred a pure theoretical vision, which can be synthesised in the economic allegiance doctrine; whereas Prof. Adams was pragmatic and sensitive to political and administrative problems and chose not to base his ideas on a single theory but on a mix of arguments that leaned toward the technical aspects of a problem.[47] In other words, Prof. Seligman defended residence taxation based on economic allegiance

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[44] ibid.
[45] ibid 15.
[46] A. Cockfield, 'Purism and Contextualism within International Tax Law Analysis: How Traditional Analysis Fails in Developing Countries' (2007) 5 *e-Journal of Tax Research* 2, 203 <http://www.atax.unsw.edu.au/ejtr/content/issues/previous/paper2_v5n2.pdf> accessed 18 May 2009.
[47] Graetz (n 36) 1075.

doctrine, while Prof. Adams recognised the interests of debtor countries and suggested an alternative that considered political arguments rather than pure economic theory. The emphasis on residence taxation by the 1923 Report can also be justified by the fact that only capital export countries manifested their opinion on this report, since Prof. Einaudi never made any contribution, and by that time Italy was the only one of the four countries (UK, US, Italy and Netherlands) that was a net capital importer.[48]

The outcome of the 1923 Report was a model that distinguished between taxes on global income and all other taxes. The former were levied only by residence country, whereas the latter were to be split between source and residence countries, according to the economic allegiance doctrine. Moreover, contrary to what was suggested by the International Chamber of Commerce, the 1923 Report attributed the right to tax interest and dividends to residence countries. [49]

Even though the 1923 Report envisaged a model tax treaty, its development was reassigned to the Committee of Technical Experts who elaborated a new report in 1925. The objective of this new report was to transform the 1923 Report into a more balanced proposal, i.e. a proposal that attributed taxing rights not only to residence countries but also to source countries. The classification of taxes as global income and other taxes was substituted by a classification of personal and impersonal taxes and the right to levy the former attributed to residence countries, while the right to levy the latter attributed to source countries. Explaining the division of taxing rights, the technical experts argued that they had no intention of theoretical coherence and, therefore, practical purposes were their major concern.[50] Even though the 1925 Report said it considered the outcome of the previous report, it was not an important influence on impersonal taxes[51], since the right to tax them was fully attributed to source countries.[52]

[48] J. F. Avery Jones, 'The History of the United Kingdom's First Comprehensive Double Taxation Agreement' (2007) British Tax Review 1, 2.
[49] Graetz (n 36) 1077.
[50] ibid 1077-80.
[51] Impersonal taxes were levied on: immovable property; industrial, commercial or agricultural income; shipping; directors' fees; earned income; dividends and interests.
[52] Avery Jones (n 48) 3.

The 1925 Report was further developed into a model treaty by an enlarged committee of experts meeting in 1926, 1927 and 1928. In these meetings, the US was represented by Prof. Adams assisted by Mitchell B. Carrol, who later contributed to the development of the threshold (i.e. the permanent establishment concept) that allows source countries to tax active business income.[53]

In October 1928, a Bilateral Convention for the Prevention of Double Taxation in the Special Matter of Direct Taxes and three other model conventions dealing with succession duties, administrative assistance in tax matters and judicial assistance in the collection of taxes were drafted. The 1928 models set the fundamental elements of current tax treaty models.[54]

The next model convention was drafted in 1943 and was called the Mexico model. It promoted taxation at the source, being recognised as the first attempt by the developing world to write a model treaty that reflected their particular interests. Residence taxation was admitted but residence countries had to provide a credit of the taxes paid abroad even if limited to the proportion of the tax due at home. Later on, in 1946, the Fiscal Committee of the League of Nations met in London and elaborated a new model which became known as the London model. Contrary to the source taxation tendency expressed in the Mexico model, the London model benefited residence taxation expressing the economic interest of capital exporting countries. The differences between these two models, i.e. the Mexico and the London model demonstrate what was going to be perpetuated as the opposite view of developed and developing countries in the allocation of taxing rights. Nowadays these differences of economic interests are identified in the OECD and UN model tax conventions.[55]

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[53] Graetz (n 36) 1082.
[54] J. Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study* (Canadian Tax Foundation 2003) 40–43.
[55] ibid 44-45.

In the 1950s, the Organisation for European Economic Co-operation (OEEC) assumed the role of drafting a tax model convention. It set up a Fiscal Committee which elaborated a model that was published in 1963, called the 'Draft Double Taxation Convention on Income and Capital.'[56] This model reflected the London Draft, which means it benefited residence taxation over source taxation. In fact, this model was aligned with the economic interest of the European member states of the OEEC. Subsequently, the OEEC developed into the Organisation for Economic Co-operation and Development (OECD) and the 1963 Draft became known as the OECD Model. The 1963 Draft was later revised and published in 1977 when it became the Model Tax Convention on Income and on Capital. Later, the OECD Model was updated in 1992, 1994, 1995, 1997, 2000, 2003, 2005 and 2008.

Only in the mid-1960s did the United Nations get involved with the problem of double taxation, understanding its relationship with the flow of foreign investment to developing countries.[57] The Economic and Social Council of the United Nations (ECOSOC) set up an Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries in 1968. The Ad Hoc Group was joined by tax experts from developed and developing countries. The outcome of the Ad Hoc Group was the UN Model Convention between Developed and Developing Countries (UN Model) published in 1980. Even though the UN model aimed to protect developing countries' economic interests in the international flow of capital, the way the discussion was conducted acclaimed the same line of reasoning adopted in the OECD Model. Consequently, the UN Model provided very limited variations from the OECD Model. These variations refer to the increased allocation of taxing rights to the source country. In practice, therefore, the two models are quite similar since the UN model was based on the structure of the OECD model, reproducing many articles. Even though the differences are quite subtle, they are connected to the different objectives of each model.

[56] R. Rohatgi, *Basic International Taxation* (vol. 1, 2nd ed., Richmond Law & Tax 2005) 65.
[57] ibid 66.

According to paragraph 7.7, article 1 of the OECD Commentary, the main purpose of the OECD Model is to promote, by eliminating double taxation, the exchange of goods and services and the movement of capital and persons, as well as to prevent tax avoidance and evasion.[58] On the other hand, the Introduction of the UN Model Double Taxation Convention explains that the prevention of double taxation, the main effects of which are harmful to the exchange of goods and services and to the movement of capital and persons, is desirable to promote a greater inflow of foreign investment to developing countries.[59] Thus, both Models aim to promote movement of capital by eliminating double taxation, however the UN Model is focused on a specific issue: the inflow of foreign investment to developing countries.

Both OECD and UN Models are structured on classification and assignment rules also called distributive rules.[60] According to these rules, income, profit and capital are placed in categories under a schedular system and taxing rights over them are distributed to one or both contracting states. One way to categorise the multiple sub-classification of income is by dividing it into active and passive income. Active income corresponds to business profit and is usually attributed to source countries, whereas passive income corresponds to returns of investments, e.g. dividends, interest and capital gains and is usually attributed to the residence country, having the source country the right to levy a limited withholding tax. Each category of income, therefore, has a rule that allocates either an exclusive or a limited taxing right to the two countries. The state which was not attributed a taxing right can either exempt or attribute credits for the tax paid abroad.[61]

The disputed allocation of taxing rights between source and residence countries reflected in the UN and OECD Model viewed investment of a flow of capital from a

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[58] OECD, 'OECD Commentary on the Model Conventions of 1977 and 1992' (incorporating the changes of 1994, 1995, 1997, 2000, 2003, 2005 and 2008) in K. van Raad (ed.), *Materials on International & EC Tax Law*, vol.1 (International Tax Center Leiden 2008) 67.
[59] United Nations, *Introduction to the UN Model Convention*, <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002084.pdf> accessed12 June 2009.
[60] Rohatgi (n 56) 68.
[61] ibid 68.

home to a host state.[62] A passage from the Introduction of the UN Model, quoting the Fiscal Committee of the Organisation for Economic Co-operation and Development, sustains this argument:

> Existing treaties between industrialized countries sometimes require the country of residence to give up revenue. More often, however, it is the country of source which gives up revenue. Such a pattern may not be equally appropriate in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue sacrifice would be one-sided.[63]

The analysis of the history of tax treaties reveals what underpins the current debate about international taxation between developed and developing countries: allocation of taxing rights. Even though the development of the first tax treaty was concerned with capital import countries and granted source taxation on 'impersonal income'; in their evolving process, tax treaties reduced the right of source countries, the division of taxing rights described in the 1923 Report becoming similar to the one adopted in modern tax treaties. This means that in the evolution of tax treaties there was an increased allocation of taxing rights to residence countries connected to the fact that most developed countries preferred it due to their economic position as capital exporters. Therefore, the allocation of taxing rights between source and residence has guided the debate between developed and developing countries.

To this extent, the allocation of taxing rights in tax treaties represents the division of tax base aligned with countries' economic interest. Developing countries are assumed to be capital importers, benefiting from source taxation, whereas developed countries are considered capital exporters, benefiting from residence taxation. From this angle, it seems that balancing the taxing rights between source and residence countries would solve the main problem of international taxation involving developed and developing

[62] Picciotto, 'International Business Taxation' (n 34) 3.
[63] OECD, *Fiscal Incentives for Private Investment in Developing Countries: Report of the OECD Fiscal Committee* (Paris 1965) para165.

countries. Consequently, the fair allocation of taxing rights between source and residence countries has been already discussed in the literature, based on the theory of inter-nation equity.[64] The justifications of source and residence taxation in this theory is under development so that this study opted for framing its contribution in a more pragmatic way, i.e. by identifying what is the effective interest of developing countries in international taxation, and, as a consequence, if source taxation really enlarges their tax base. In a sense, the hypothesis adopted is guided by the assumption that countries should be able to tax in their own interest, not on equity content.

In this regard, globalisation has impacted on the thresholds that underpin these assumptions regarding the debate about allocation of taxing rights in tax treaties. The first challenge brought by globalisation refers to the flow of capital: how is the flow of capital between developed and developing countries? Are developing countries still capital importers? Are developed countries still capital exporters? Is allocation of taxing rights the fundamental issue between developed and developing countries when discussing international taxation? All these questions need to be addressed in order to understand the effective interest of developing countries in international taxation.

The current assumptions regarding international taxation and developing countries have also further impact on their involvement with other tax policies promoted at the international level: the OECD's work on harmful tax competition, as introduced in the next chapter.

[64] According to Musgrave, inter-nation equity involves the question on what underlying principles should justify source taxation on non-residents' income derived from local investments. R. A. Musgrave and P. B. Musgrave, 'Inter-nation equity' in R. M. Bird and J. G. Head (ed.) *Modern Fiscal Issues: Essays in Honour of Carl S. Shoup* (University of Toronto Press 1972) 63-85.

Chapter II. The effective meaning of harmful tax competition

2.1. Introduction

Another aspect of international taxation discussed at the international level is harmful tax competition, i.e. tax havens and preferential tax regimes, aiming only to regulate offshore centres in which financial and other services activities are located. But why has the legal debate focused on these aspects? This chapter will examine the evolving process of the legal debate on harmful tax competition in order to understand the reasons that shaped it and the position adopted by developing countries in this debate.

The expression 'tax competition' has been used to designate so many different processes in the literature that the first task will be to examine its concept. In order to do that, the economic and legal approaches to tax competition will be compared. The comparison will make clear the different paths taken by the economic and legal literature. Next, the historical relationship between tax havens and developed countries will be explored to contextualise the evolutionary discourse of tax competition in the legal approach. The cornerstone ideas that underpin the legal approach will become clear, providing the missing arguments necessary to understand the position of developing countries in relation to harmful tax competition.

2.2. The meaning of tax competition

Globalisation has increased the interaction between countries' economies and policies. In the tax field, this signifies that policies, which have been historically developed and focused on domestic issues, now are also affected by other countries' tax policies. This reflects the fact that capital is extremely mobile nowadays, making countries consider the trade-off between raising tax revenue and attracting foreign investment. This situation has raised the concern about tax competition. But what is tax competition?

Tax competition can refer to many different types of competition. Therefore, it is crucial to understand the different processes that tax competition can refer to. In fact, it is interesting to note that many studies in the economic and legal area have examined the phenomenon of tax competition without making clear that there are different processes of tax competition. This absence of awareness causes the misleading use of results of one type of tax competition to justify another completely different process.

Tax competition can refer to different types of investment, taxes and incentives. Economic studies have focused on the process that countries lower their corporate income taxes to attract the real activity of companies which means that they are focused on productive investment made through foreign direct investment and its impact on corporate tax.[65] That is, most economic studies are interested in the real movement of productive investment. On the other hand, the legal debate[66] is interested in a different phenomenon: tax competition for taxing rights, i.e. competition for having income reported in a particular country in order to avoid taxes, without any associated movement of production.[67] Thus, outcomes of economic studies cannot be used to justify the legal debate since they refer to different types of tax competition. The economic literature about tax competition illustrates the argument presented here since it is based on the analysis of how corporate income taxes have been lowered to attract the real activity of firms.[68] The legal discussion[69] on tax competition is centred on the

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[65] R. Griffith and A. Klemm, 'What Has Been the Tax Competition Experience of the Last 20 Years?' (2004) 28 Tax Notes International (Special Supplement) 1299.

[66] Here the expression 'legal debate' is associated to the OECD's legal approach of tax competition. This association is explained in detailed in the next paragraphs.

[67] Griffith and Klemm (n 65) 1300.

[68] M. P. Devereux and R. Griffith, 'The Impact of Corporate Taxation on the Location of Capital: A Review' (2002) 9 Swedish Economic and Policy Review 79; M. P. Devereux, B. Lockwood and M. Redoano, 'Do Countries Compete Over Corporation Tax Rates? (2002) 642 Warwick Economic Research Papers 2; M. Devereux, R. Griffith and A. Klemm, 'Corporate Income Tax and International Tax Competition (2002) 35 Economic Policy 451; J. R. Hines 'Lessons from Behavioural Responses to International Taxation' (1999) National Tax Journal 305; J.R. Hines 'Corporate Taxation and International Competition' in A. J Auerbach, J. R. Hines Jr. and J. Slemrod (eds.), *Taxing Corporate Income in the 21st Century* (Cambridge University Press 2007) 268; L. Bretscher and F. Hettich, 'Globalisation, Capital Mobility and Tax Competition: Theory and Evidence for OECD Countries' (2002) 18 European Journal of Political Economy 695; M. Keen and A. Simone, 'Is Tax Competition Harming Developing Countries more than Developed? (2004) 28 Tax Notes International: Special Supplement 1317.

studies developed by the OECD about harmful tax competition, which are focused on tax havens and preferential tax regimes offered to financial and other service activities. In fact, 'harmful tax competition' defined by the OECD refers to the competition for the allocation of taxing rights without the movement of productive investment.[70]

Despite the fact that the legal discussion about tax competition is centred on the allocation of taxing rights without the movement of productive investment, some particular authors have focused on the use of tax incentives to attract foreign direct investment.[71] In this case, outcomes from economic studies were used to support further assumptions on the legal debate. However, the outcomes from the economic literature on tax competition for productive investment are inconclusive since there are many factors that impact on the decision of where to invest, making it hard to attribute to taxation the merits on determining investments' allocation.

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[69] The expression legal debate, legal discussion and legal discourse are used interchangeably in the body of this study and they refer to the OECD approach to tax competition.

[70] OECD, 'Harmful Tax Competition: An Emerging Global Issue' (1998) <http://www.oecd.org/dataoecd/33/0/1904176.pdf> accessed 03 July 2009 [hereinafter 1998 Report]; OECD, 'Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee of Fiscal Affairs: Progress on Identifying and Eliminating Harmful Tax Practices' (2000) <http://www.oecd.org/dataoecd/9/61/2090192.pdf> accessed 03 July 2009 [hereinafter 2000 Report]; OECD, 'The OECD's Project on Harmful Tax Practices: The 2001 Progress Report' (2001) <http://www.oecd.org/dataoecd/60/5/2664450.pdf> accessed 03 July 2009 [hereinafter 2001 Report]; OECD, 'The OECD's Project on Harmful Tax Practices: The 2004 Progress Report' (2004) <http://www.oecd.org/dataoecd/60/33/30901115.pdf> accessed 03 July 2009 [hereinafter 2004 Report]; OECD, 'Harmful Tax Practices: 2006 Update on Progress in Member Countries' (2006) <http://www.oecd.org/dataoecd/1/17/37446434.pdf> accessed 14 July 2009 [hereinafter 2006 Report on Harmful Tax Practices]; OECD, *Tax Co-operation: Towards a Level Playing Field - 2006 Assessment by the Global Forum on Taxation* (OECD Publishing 2006) [hereinafter 2006 Report on Tax Co-operation]; OECD, *Tax Co-operation: Towards a Level Playing Field - 2007 Assessment by the Global Forum on Taxation* (OECD Publishing 2007) [hereinafter 2007 Report]; OECD, *Tax Co-operation: Towards a Level Playing Field - 2008 Assessment by the Global Forum on Taxation* (OECD Publishing 2008) [hereinafter 2008 Report]; OECD, *Tax Co-operation: Towards a Level Playing Field - 2009 Assessment by the Global Forum on Taxation* (OECD Publishing 2009) [hereinafter 2009 Report]; OECD, *Tax Co-operation: Towards a Level Playing Field - 2010 Assessment by the Global Forum on Taxation* (OECD Publishing 2010) [hereinafter 2010 Report]; OECD, *The Global Forum on Transparency and Exchange of Information for Tax Purposes: Information Brief* (OECD Publishing 2011) [hereinafter 2011 Report]. While the first five documents were developed by the OECD's Committee on Fiscal Affairs and other sub-divisions of the OECD (e.g. Forum on Harmful Tax Practices and Special Section on Tax Competition), which includes only OECD members; the last six documents available as published editions were elaborated by the OECD Global Forum on Taxation which includes both OECD and non-OECD economies. The distinction between the objectives of these documents is presented in the body of this text.

[71] Y. Margalioth, 'Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries' (2004) 23 Virginia Tax Review 161; A. Nov, 'The "Bidding War" to Attract Foreign Direct Investment: The Need for a Global Solution' (2006) 25 Virginia Tax Review 835.

To this extent, Griffith and Klemm demonstrate the inconclusive findings of the economic literature by summarising the empirical results of different studies about tax competition in which countries lower their corporate income taxes to attract the real activities of firms. First, they classified the empirical studies as direct and indirect. Indirect studies looked for the responsiveness of investment to tax rates, i.e. the sensitivity of firms to changes in tax systems; whereas direct studies examined the interdependence in tax rates between jurisdictions. Examining the indirect studies, Griffith and Klemm concluded that although tax policy is important on the allocation of productive investment, the studies did not provide enough evidence either to measure the impact of taxation or to prove the existence of a process of tax competition. In addition, exploring the direct studies, Griffith and Klemm highlighted the fact that there are other processes besides tax competition that can lead to the interdependence of corporate tax rates among jurisdictions: (i) tax mimicking[72]; (ii) political yardstick competition[73]; and (iii) common intellectual trends[74]. Due to the fact that all these different models can predict the same behaviour response, i.e. interdependence in tax setting, the evidence provided by direct studies can only prove the existence of interdependence in tax rates, however the cause of this interdependence remains unclear. Griffith and Klemm could not conclude, therefore, that tax competition is the most relevant process in driving corporate income tax interdependence. In sum, putting together the outcomes of the indirect and direct studies, Griffith and Klemm demonstrated that it remains unclear: (i) how important is taxation on the allocation of

[72] Tax mimicking occurs when voters evaluate the performance of the government by comparing their tax rates to the ones in nearby countries, leading to interdependence in tax setting.

[73] Political yardstick competition takes place when spending policies in one country affect residents of another country, which also leads to interdependence in tax setting.

[74] Common intellectual trends could also lead to interdependence in tax setting even in the absence of tax competition when, for instance, a persuasive study on the optimal choice of corporate tax rates is adopted by policymakers in different countries. It is very interesting to note the report made by Tanzi about the implementation of the IMF tax reforms: 'One aspect that might surprise economists involved for the first time in tax reform missions is the extent to which countries are influenced by what happens in other countries. To me, it was a great surprise to discover, in my earliest experiences with tax missions, that policymakers were far less interested in the latest academic thinking than in what other (and specially more successful) countries were doing, or had done. Almost without exception, they requested information about level, structure, and administration of taxes in other countries. Very rarely, if ever, were they interested in the latest academic thinking.' V. Tanzi, 'The IMF and Tax Reform' (1990) 90/39 IMF Working Paper 5.

productive investment; and (ii) the reason why countries adopt similar corporate tax rates.[75]

Most studies analysed by Griffith and Klemm are underpinned by developed countries' data. When examining tax competition in developing countries, this phenomenon remains even more blurred since there are only a few studies about it and developing countries represent a much less homogeneous group than developed countries, which makes it even harder to justify the allocation of productive investment by taxation. Thus, even though developing countries have been offering tax incentives to attract FDI[76], the importance of those incentives and their efficiency remains unclear. One example of the inconclusive importance of tax incentives to attract FDI is the fact that OECD member countries are the home countries for about 85% of the world's multinational enterprises.[77]

Tax competition can refer to different processes. While the economic debate defines tax competition as the process that countries lower their corporate tax rates to attract productive investment; the legal discussion characterises tax competition as the process that countries compete for the allocation of taxing rights without the movement of productive investment. Tax competition is not a unique process, but a complex phenomenon that can refer to different situations, depending on the characteristics of the process being investigated.

2.3. Is tax competition good or bad?

Another approach to tax competition is whether it is a positive or negative phenomenon. From this perspective there is also a different understanding between the economic and legal debate. The economic debate considers tax competition as a positive thing when

[75] Griffith and Klemm (n 65) 1311-14.
[76] M. Klemm and A. Simone, 'Is Tax Competition Harming Developing Countries More Than Developed? (2004) 28 Tax Notes International 1317.
[77] United Nations, UN Conference on Trade and Development, World Investment Report 1999: FDI and the Challenge of Development.

adopting the Leviathan argument in which tax competition limits the government's tendency to raise tax rates by forcing the state to adopt more efficient policies, besides limiting private interest groups. In other words, tax competition would enhance the efficient allocation of capital and a fair level of taxation. On the other hand, the economic debate can also consider tax competition as a destructive process when there is a 'race to the bottom' situation. In this situation, countries engage in 'bidding wars' in order to compete for mobile activities, ultimately resulting in no tax at all on mobile capital. The 'race to the bottom' situation may require states to: (i) shift to other revenue sources, taxing less mobile activities and particularly labour more heavily; and (ii) force a reduction in public expenditure to a suboptimal level. In this situation all countries would be worse off due to the fact that capital would deviate from an efficient allocation; and a fair level of taxation.[78]

The concepts of bad and good tax competition argued by the economic debate are underpinned by political-economic theories rather than different types of investment. It does not matter the type of investment but the dynamics of the competition to configure a beneficial or 'race to the bottom' situation.

Notwithstanding the theoretical debate on good or bad tax competition, empirical evidence of tax competition for FDI has not proved the 'race to the bottom' situation. Countries still levy corporate tax on FDI and, as already mentioned, it is hard to link the lowering of corporate tax rates to the phenomenon of tax competition. So, the destructive characteristic of tax competition still needs to be proved on corporate taxation.

The situation is quite different when examining portfolio investment, since most developed countries exempt, for instance, interest derived from non-residents' portfolio investment based on the argument that if one country starts to tax at the source, the capital will flow to another jurisdiction since the cost of capital will increase. Here there

[78] H. J. Ault, 'Tax Competition: What (If Anything) To Do About It?' in P. Kirchhof, M. Lehner, A. Raupach and M. Rodi (eds) *International and Comparative Taxation: Essays in Honour of Klaus Vogel* (Kluwer Law International Ltd 2002) 2.

might be a ‘race to the bottom’ situation, however in practice this conclusion is disguised by the fact that the exemption of non-residents’ portfolio interest at the source does not mean that interest will not be taxed, but that this income will be taxed only at the residence country. The argument here is that interest is still taxed but not by the source country; what happens is just a reallocation of taxing rights and not a real ‘race to the bottom’ situation where capital is not taxed at all.

The legal debate about whether tax competition is positive or negative adopts completely different parameters. The distinction between what is a bad (‘harmful’) tax competition and what is a good (‘harmless’) tax competition is based on legal concepts rather than economic theories. Actually, economic theory is not completely separate from the legal debate, however it is not the cornerstone argument that sustains the distinction between harmful and harmless tax competition. For instance, the OECD Report on Harmful Tax Competition established as a primary step to identify a tax haven a ‘no or only nominal tax on income’, which is a typical condition in a ‘race to the bottom’ situation; though the Report detached itself from the economic argument when other characteristics are required to confirm the identification of a tax haven and a preferential tax regime (e.g. lack of effective exchange of information, lack of transparency, etc.). Furthermore, the legal debate has restricted the analysis of harmful tax competition to financial and other service activities.

While economists adopt economic theories to verify if tax competition is positive or negative, lawyers rely on legal concepts that are limited to situations in which financial and other service activities are located in tax havens and preferential tax regimes. The legal approach tries to regulate only the specific situation described, leaving aside other situations that can also be characterised as harmful tax competition, as argued by the economic debate. Therefore, having in mind the fact that the legal debate is focused on a specific type of tax competition, the next section will examine in detail its characteristics to find out the reasons why the legal debate has taken this path.

2.4. The legal debate on harmful tax competition

The legal debate about tax competition, as already mentioned, is guided by the OECD's definition of harmful tax competition, which is focused on the meanings of tax haven and preferential tax regime. The flaws of these definitions have concentrated the major critiques to the OECD's approach of harmful tax competition in the legal literature. However, in order to understand the driven reasons of the OECD's approach it is necessary to examine the historical relationship between developed countries and tax havens.

2.4.1. Historical aspects of tax havens and preferential tax regimes

The historical perspective of the relationship between developed countries and tax havens and preferential tax regimes will demonstrate the reasons that shaped the concept of harmful tax competition adopted by the OECD. The core idea of the OECD's concept is connected to tax havens and preferential tax regimes. Therefore, it is necessary to investigate the causes that encourage their development. To this extent, as demonstrated next, the major cause associated with the existence of tax havens and other offshore centres is the deregulation of the financial market promoted by developed countries. In fact, the distinction between onshore and offshore transaction represents a cornerstone idea to understand the diffusion of tax havens and other preferential tax regimes and their acceptance by sovereign states.[79]

The involvement of developing countries with tax havens and preferential tax regimes occurred only later in time since it was the deregulation promoted basically by developed countries that enhanced the development of offshore centres, including tax havens. Consequently, the relationship between developing countries and tax havens has been explained based on developed countries' experience. In a sense, there is no clear

[79] R. Palan, 'Offshore and the Structure Enablement of Sovereignty' in M. P. Hampton and J.P. Abbott (eds.), *Offshore Finance Centres and Tax Havens* (Macmillan Press Ltd 1999)19.

understanding in the current literature about the impact of tax havens on developing countries' economies in the context of globalisation.

2.4.1.1. The relationship between developed countries and tax havens

The relationship between tax havens, preferential tax regimes and developed countries can be explained through the evolution of the international financial market. In its evolving process, developed countries supported the expansion of tax havens and other offshore centres to enhance the international flow of capital. Developed countries intended to use these legal devices to reconcile the figure of the sovereign state with mobile economic activities.[80]

The use of tax havens to avoid tax is not a new phenomenon and it emerged in the 1920s and 1930s mainly to protect wealthy families in the interwar period. For instance, British families used the Channel Islands and the Isle of Man; Americans preferred the Bahamas and Panama; and Continental Europeans opted for jurisdictions such as Liechtenstein, Monaco, Switzerland and Luxemburg. Usually, the choice of these tax havens was justified by their exemption of foreign source income.[81]

Later, i.e. after 1945, the tax shelters started also to be exploited by multinationals due to the remarkable increase of FDI. At that time, tax authorities were less worried about avoidance of corporate tax and there were no legal and administrative devices to control it. However, multinationals quickly discovered the benefits offered by different jurisdictions as well as their network of tax treaties for deferral taxation on profits and other income from subsidiaries incorporated abroad.[82]

Due to the constant increase of FDI in the 1950s, new jurisdictions started to offer tax benefits to attract these investments. The tax benefits were offered by intermediate

[80] ibid.
[81] Picciotto, International Business Taxation' (n 34) 118.
[82] S. Picciotto, 'Offshore: The State as Legal Fiction' in M. P. Hampton and J.P. Abbott (eds.), *Offshore Finance Centres and Tax Havens* (Macmillan Press Ltd 1999) 51-52.

jurisdictions rather than the place where the productive investment was made. So, at this stage, small jurisdictions stand out by offering different tax advantages. Most of these small jurisdictions had a colonial heritage with the major developed countries. The colonial legacy contributed to their development as tax havens since they had similar legal systems, that allowed them to benefit from the mother countries' tax treaties and a monetary system also tied to the mother country.[83] Even today, some 'special jurisdictions' are tax havens connected to the UK, the US and the Netherlands: Overseas Territory of the United Kingdom (Bermuda), Dependency of the British Crown (Guernsey, Isle of Man, Jersey) and External Territory of the United States (US Virgin Islands).

In the 1960s, other jurisdictions started to offer different types of incentive in addition to taxation to attract foreign investment. These new incentives represented a more relaxed financial regulation that withdrew some legal prerequisites on offshore financial transactions. Some highly regulated countries were not only tolerating but also supporting the deregulation of offshore transactions. Thus, the development of the unregulated offshore financial market can be attributed to onshore regulators that helped to create a situation that they could not properly control.[84] But why did the offshore financial market develop? In order to answer this question it is necessary to examine some facts.

The major growth in the international financial market occurred in the 1960s due to the restrictions on access to domestic capital markets for foreign investment. At that time, the US imposed restrictions to foreigners on borrowing in the US market and on American multinationals borrowing to invest abroad. Thus, American multinationals had to find a way to finance themselves abroad. This situation encouraged the development of the Eurocurrency markets.[85]

[83] ibid 53.
[84] ibid 54.
[85] Picciotto, 'International Business Taxation' (n 34) 120.

Eurocurrency is a deposit or an unsecured loan held externally from its country of origin, and denominated in a currency different from the official currency of the country where it is held. For instance, an American multinational holding a deposit of US dollars in a London bank is a Eurocurrency deposit. The Eurocurrency market is segregated from the domestic market and different regulation applies to it. Neither the country where the deposit is held, nor the country of the deposit's currency regulates this market, which means that the Eurocurrency market is kept outside the control of any single state, being unregulated. [86]

Thus, even though the offshore markets could not be directly regulated, the monetary authorities responsible for the major international currencies could have controlled it indirectly. In practice, however, monetary authorities from major capitalist countries preferred to abstain from regulating it. This passive behaviour might be justified by the external support required by these offshore centres and by their own interest in maintaining semi-autonomous and partially-controlled centres in preference to the growth of centres which might be harder to control. Consequently, monetary authorities accepted a limited control over offshore financial transactions in which a fiscal control was excluded. The monetary authority's partial control over offshore transactions did not involve the fiscal authority, keeping tax avoidance and evasion completely out of control.[87]

The deregulation of the international financial market was not idealised in the international monetary system agreed at the Bretton Woods Conference. On the contrary, by that time, the Bretton Woods architects (Keynes and White) endorsed an international financial order in which governments could control cross-border private financial flows, and public international institutions such as the IMF would have a key function in allocating short-term and long-term capital to the world economy.[88] The

[86] M. Hampton, *The Offshore Interface: Tax Havens in the Global Economy* (Macmillan Press Ltd 1996) 41-2.
[87] Picciotto, 'International Business Taxation' (n 34) 120-21.
[88] Helleiner (n 9) 233.

offshore financial market contributed to the end of the fixed exchange rate system based on the US dollar and to the final collapse of the Bretton Woods system.

The major capitalist countries were interested in allowing monetary and banking controls to be operated with a differentiation between purely domestic and internationally oriented financial transactions.[89] This differentiation encouraged not only tax havens but also other jurisdictions with firm regulation to enact offshore rules. In this sense, the UK, the US and Japan offered special regulation to foreigners. The initial attitude toward offshore activity adopted by the UK and the US was divergent, i.e. while the UK has tolerated offshore financial centres and used them strategically to reintroduce London as the centre of the global financial market, the US initially engaged in a complicated battle with offshore centres but later concluded that a better strategy would be to bring offshore activity to its own offshore centre located onshore.[90] Thus, while the UK since the beginning promoted measures that encouraged the development of offshore activities, the US changed its position during the process and ended in establishing the International Banking Facility in New York, in 1980. Japan adopted similar measures to the US, introducing the Japanese Offshore Market in Tokyo, in 1986.[91]

These offshore financial centres, therefore, are located not only in tax havens but also in highly regulated jurisdictions. From this perspective, it becomes clear that offshore financial transactions do not take place only on an island in the middle of the ocean. Instead, offshore financial transactions can be conceived and executed in the traditional financial centres such as London and New York. It is the absence of regulation of these countries that allow offshore financial transactions to take place. Thus, it is the absence of regulation that defines an offshore transaction, which implies that there is no clear definition of this type of transaction. Palan clarified the difficulty on defining offshore

[89] Picciotto, 'International Business Taxation' (n 34) 121.
[90] Palan (n 79) 33.
[91] Hampton (n 86) 63.

transactions by saying that the distinction between offshore and onshore finance is conceptual rather than empirical. [92]

The identification of offshore transactions in practice is very hard since almost any state can offer avoidance possibilities in relation to the regulations of another jurisdiction; the possibility of avoidance (absence of regulation) rises from the interaction of different types of regulation.[93]

Following this line of reasoning, it becomes clear that the strategy adopted by the OECD to curb harmful tax competition by identifying tax havens and some types of preferential tax regimes is inconsistent due to two main arguments: first that the definition adopted cannot apply to all types of tax havens and preferential tax regimes, and second that the legal devices targeted are only part of the problem, not the entire cause. Regarding the first argument, Picciotto said that 'the broadest definition of a tax haven would include any country whose tax laws interact with those of another so as to make it possible to produce a reduction of tax liability in that other country'. The second argument, i.e. that tax havens are only part of the problem, is also sustained by Picciotto when he argued that the effective problem lies not with the havens' (lack of) regulations, but in the improper, unproductive or unreasonable regulation being avoided.[94] In a sense, the use of tax havens is encouraged by flexible regulation enacted by countries. The liberalisation of exchange control promoted by developed countries in the 1970s contributes to this argument.[95]

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[92] Palan (n 79) 21-2.
[93] Picciotto, 'Offshore: The State as Legal Fiction' (n 82) 61.
[94] Picciotto, 'International Business Taxation' (n 34) 132.
[95] The quotation below illustrates the relationship between financial deregulation and taxation. It refers to the dialogue between UK officer (Mr. Foulkes) and the chief executive of Lloyds Bank International Limited (Mr. Whittle), presented at the Foreign Affairs Committee, on Monday, 26th April, 1982:
'856. Mr. Whittle, can I return to the Bahamas? Can you tell us the purpose of your off-shore banking operation in the Bahamas? (Mr. Whittle) Yes. As you know, the Bahamas is what is known as a tax haven: that is to say, there are no local taxes. Therefore, it is used by us and, of course, many other banks as a centre for booking certain operations. They are put on the books there, and financed from outside, and that is the main use of it at the moment. We are not allowed to do banking in the Bahamas.
857. Earlier, when I was asking you about Argentina, you said you were very patriotic, and so was the bank. Do you not think that this kind of bank operation not only harms the United Kingdom revenue, but also harms the other countries in the Caribbean? (Mr. Whittle) I do not think it in any way harms the United Kingdom revenue. Taxes are paid when they are due on any monies which accumulate there. The

To this extent, it becomes evident that tax havens are only one form of offshore centre. There are other forms of offshore centres located in highly regulated jurisdictions. Developed countries supported the development of offshore financial centres. Thus, it is very arbitrary to attribute the responsibility of harmful tax competition entirely to certain individual jurisdictions identified by the OECD as tax havens. The problem is systemic and can only be tackled by adopting a broader perspective on the interaction of different tax systems.[96]

From this broader perspective, focusing on developed countries, what became clear is the importance of these offshore centres (including tax havens) for the development of the international financial market. The offshore centres were required to reconcile the state with mobile economic activities.[97] Offshore centres are used not only for tax avoidance but also to manage global operations of multinational enterprises.[98] Developed countries, therefore, might not be interested in eliminating these legal devices, but only in finding a better away to control them. Thus, the relationship between tax havens and developed countries is not based only on conflicting interests.

The problem involving offshore centres (including tax havens) is the fact that even though they supported the development of the financial market and the way multinational enterprises operate nowadays, they also contributed to the erosion of residence taxation. Tax havens allow capital to be invested in any part of the world without any further control, which makes its identification hard, unless investors properly inform their foreign income to national tax authorities. In this regard, tax havens allow increased opportunities of tax avoidance and evasion. Even though tax avoidance represents situations expected and permitted by tax systems of high tax

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Inland Revenue are perfectly well aware of what is happening, and if the profits which accumulate there are used in any way, they are subject to the United Kingdom tax in the normal way. I do not quite understand how that could affect the Caribbean, in what sense?' House of Commons, *Caribbean and Central America: Minutes of Evidence* (Foreign Affairs Committee, vol. 47-xii, 1982) 253.

[96] Picciotto, 'International Business Taxation' (n 34) 133.

[97] Palan (n 79) 19.

[98] ibid 26.

jurisdictions, tax evasion is prohibited and erodes in an unexpected way the countries' tax base. Thus, having in mind the concept of harmful tax competition, in a sense, what the OECD members proposed was some kind of regulation to control the erosion of their tax base, through rules that aim to ensure residence taxation.

The historical analysis of the relationship between developed countries and offshore regimes showed that tax havens and other preferential tax regimes are not anomalies in the international tax system but legal devices that were enforced by developed countries to encourage the development of the financial market. Developed countries were aware that tax havens have been used to avoid their tax and financial regulations, even though they did not control their development. Whether developing countries' relationship with tax havens follows the same pattern is not evident, as examined next.

2.4.1.2. The relationship between developing countries and tax havens

As already mentioned, the involvement of developing countries with offshore centres occurred later in time since it was the deregulation promoted basically by developed countries that enhanced the development of offshore centres, including tax havens.

Initially, developing countries were averse to the inflow of foreign investment since it was considered by many countries as a new form of colonialism or even imperialism.[99] This attitude only started to change after the 1970s. In fact, a remarkable acceptance of foreign investment in developing countries only occurred in the last two decades of the 20th century when a dramatic increase in FDI arose in a worldwide scale.[100] Nowadays there is a common consensus that FDI is beneficial for economic development, leading developing countries to compete against each other to attract it. For instance, research conducted by Keen and Simone involving 40 developing economies, between early 1990s and early 2000, confirmed this tendency by demonstrating that in this period there

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[99] A. Easson, 'Tax Incentives for Foreign Direct Investment- Part I: Recent Trends and Countertrends' (2001) 55 Bulletin for International Taxation 267.
[100] ibid.

was an increased offer of tax incentives by developing countries in the form of tax holidays, reduced corporate taxes, tax breakers for exporters and free trade zones.[101]

The most common forms of tax incentives used by developing countries are: tax holidays, investment allowances and credits, reduced corporate taxes, tax breakers for exporters and free trade zones. Developing countries feel bound to offer these tax incentives in a way that they are at least as attractive as those offered by their neighbours and other competing jurisdictions.[102] This situation creates a dynamic game, settling a specific form of tax competition among developing countries for productive investment.

The use of tax incentives to attract FDI by developing countries has been the dominant argument about tax competition and developing countries in the current tax literature. From this angle, it becomes clear the limited interest of developing countries in the OECD's work since those tax inducements were not included in this organisation's concept of harmful tax competition. The OECD explained in the 1998 Report that this specific aspect of tax competition would be addressed in a future work, even though until nowadays no progress has been made.[103] In a sense, after examining the historical relationship between tax havens and developed countries, the exclusion of tax incentives related to FDI from the OECD concept of harmful tax competition is understandable. While those FDI tax inducements reflect the erosion of source taxation, the OECD's project on harmful tax competition targeted the erosion of residence taxation. Consequently, rules that aim to ensure residence taxation are out of the scope of developing countries' tax policies.

The relationship between tax havens and developing countries is not entirely clear in the literature since developing countries' economic interests are justified only in terms of inflows, specifically FDI. It is necessary, therefore, to update the analysis of the

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[101] Keen and Simone (n 68) 1323.
[102] A. Easson, 'Tax Incentives for Foreign Direct Investment- Part II: Design Considerations' (2001) 55 Bulletin for International Taxation 365.
[103] OECD '1998 Report' (n 70) 8.

international flow of capital in order to understand the effective interest of developing countries in tax havens and preferential tax regimes. From the current perspective, the limited interest of involvement of developing countries in the combatting of harmful tax competition promoted by the OECD is evident.

2.4.2. The OECD concept of harmful tax competition

Since 1998 the OECD has been publishing reports about Harmful Tax Practices and, subsequently, about Tax Co-operation towards a Level Playing Field. The analysis of the Reports allows a critical view on how the debate on harmful tax competition has evolved and the current position of the OECD.

Until 2011, eleven important documents have been published by the OECD: (i) the 1998 Report; (ii) the 2000 Report; (iii) the 2001 Report; (iv) the 2004 Report; (v) the 2006 Report on Harmful Tax Practices; (vi) the 2006 Report on Tax Co-operation; (vii) the 2007 Report; (viii) the 2008 Report; (ix) the 2009 Report; (x) the 2010 Report; and (xi) the 2011 Report.[104] While the first five documents were developed by the OECD's Committee on Fiscal Affairs and other sub-divisions of the OECD (e.g. Forum on Harmful Tax Practices and Special Section on Tax Competition) which include only OECD members; the last six documents were elaborated by the OECD's Global Forum on Taxation which includes both OECD and non-OECD economies. The parallel work of the OECD on these two fronts demonstrates the strategy adopted by this organisation to involve OECD non-member countries, as discussed next.

The initial idea of the OECD Reports was to define harmful tax competition. The 1998 Report addressed harmful tax practices in the form of tax havens and preferential tax regimes in OECD members and non-member countries, restraining the discussion to geographically mobile activities such as financial and other service activities.[105] Thus, the definition of harmful tax competition was founded upon the concepts of tax haven

[104] OECD (n 70).
[105] OECD, '1998 Report' (n 70) 3.

and preferential tax regime and to the situation where these two regimes were used by financial and other service activities.

As already mentioned, the concept adopted in the legal debate differs significantly from the phenomenon of tax competition addressed in the economic debate. What is the effective meaning of harmful tax competition? What is the OECD aiming at with these harmful tax policies? The next sections will answer these questions.

2.4.2.1. Tax havens

The primary criterion established by the OECD to identify a tax haven was: a jurisdiction that imposes no income taxes or only nominal income taxes and 'offers itself as a place to be used by non-residents to escape tax in their country of residence'. This crucial characteristic needed to be evaluated with other key factors in order to confirm the existence of tax haven: (i) the existence of laws or administrative practices which prevent the effective exchange of information with other jurisdictions; (ii) lack of transparency in the operation of the legislative, legal or administrative provisions which also would prevent effective exchange of information; and (iii) the absence of a requirement that the activity be substantial which allows the attraction of investments that are purely tax driven.[106] Thus, the non-taxation (or only imposition of nominal income taxes) of income is the first step to determine those situations in which an analysis of the other criteria is required.

The necessity of combining the initial criterion with other key factors leaves the definition of a tax haven without a precise technical meaning, depending on particular circumstances to identify a jurisdiction as a tax haven. The OECD was aware of the imprecise meaning of tax haven.[107] The OECD's awareness contributed to the understanding that the case by case analysis to identify a tax haven was not a negative

[106] ibid 22-5.
[107] ibid 20.

fact from this organisation's point of view, even though this fact has been criticised by the literature, as discussed next.

Another aspect of the 1998 Report was to clarify that it was not its objective to explicitly or implicitly suggest that there was some general minimum effective rate of tax to be imposed on income below which a country would be considered engaging in harmful tax competition.[108] This point was reinforced in the other OECD Reports, making clear that countries are free to determine the characteristics of their tax systems. The OECD, therefore, does not force countries to tax income.

The four cornerstone criteria described in the 1998 Report to identify a tax haven have changed in importance in the following reports produced by the OECD. The first significant modification was introduced in the 2000 Report where the interest in cooperation to eliminate harmful tax practices gained significance.[109] According to this new criterion, tax havens that made a public political commitment to adopt a schedule of progressive changes to eliminate harmful tax practices would not be included in an OECD List of Uncooperative Tax Havens. This list would be reviewed periodically in order to grant that old and also new harmful tax practices were avoided. In practice, the interest in cooperation overcame the other criteria since if even fulfilling the criteria established in the 1998 Report a tax haven would not be included in the OECD list of uncooperative tax havens if it demonstrated interest in cooperation to eliminate the condemned tax practices. In fact, the interest in cooperation to eliminate the condemned tax practices can be translated as the willingness to improve transparency and exchange of information. The cooperation did not mean to force a country to raise tax rates since it goes against the OECD's principle that all jurisdictions are free to determine the characteristics of their own tax system according to their own public interests.

In the 2001 Report, the substantial activity criterion to identify a tax haven was abolished by the OECD due to the fact that the determination of whether local activities

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108 ibid.
109 OECD, '2000 Report' (n 70) 18.

are sufficiently substantial is difficult.[110] From then on, regarding the previous changed introduced by the 2000 Report, there were only two remaining factors to confirm the existence of a non-cooperative tax haven: (i) the existence of laws or administrative practices which prevent the effective exchange of information with other jurisdictions; and (ii) lack of transparency in the operation of the legislative, legal or administrative provisions which would also prevent effective exchange of information.

In 2001, there was a political change in the United States that impacted on the acceptance of the OECD rules on harmful tax competition. Until 2000, the Clinton administration opted for a supportive role in relation to the OECD's initiative, even though it did not assume pro-active conduct. At the beginning of 2001, with the election of a Republican President, the Bush administration adopted an opposite position, preferring to solve issues involving tax havens through bilateral talks than by working through the OECD.[111] However, after the terrorist attacks of September 11th, the focus on money laundering shifted from anti-drugs to anti-terrorism. Thus, policies to combat international tax evasion and avoidance gained the support of the United States.[112]

With the inclusion of the cooperation criterion in the characterisation of a tax haven, there are in fact two ways to analyse the position of a jurisdiction: first as a tax haven, in case of the fulfilment of the characteristics prescribed in the 1998 Report modified by the 2001 Report; and second by the subsequent classification of the tax haven as cooperative or uncooperative. The subsequent classification of a tax haven as cooperative or uncooperative in fact affects the underlying main characterisation of a country as a tax haven, since a cooperative tax haven is a jurisdiction that has agreed to eliminate harmful tax practices in the near future, which means to eradicate: (i) laws or administrative practices which prevent the effective exchange of information with other

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110 OECD, '2001 Report' (n 70) 10.

111 T. M. Hoffman, 'The Future of Offshore Tax Havens' (2001) 2 Chicago Journal of International Law 511, 511-20.

112 A. S. Bachus, 'From Drugs to Terrorism: The Focus Shifts in the International Flight Against Money Laundering After September 11, 2001' (2004) 21 Arizona Journal of International & Comparative Law 835; and S. S. Nelson, 'Regulating Money Laundering in the United States and Hong Kong: A Post 9-11 Comparison' (2007) 6 Washington University Global Studies Law Review 721.

jurisdictions; and (ii) lack of transparency which would prevent exchange of information. In the absence of these two factors, the only remaining characteristic of a tax haven is the gateway criterion, i.e. a jurisdiction that imposes no income taxes or only nominal income taxes. This implies that a cooperative tax haven will not be a tax haven anymore according to the conditions described in the 1998 Report, modified by the 2001 Report, when the two characteristics described are completely fulfilled. Even though there is this distinction between tax havens and cooperative tax havens, in practice, most countries maintain a list of jurisdictions classified as tax havens, ignoring the cooperation criterion.

From a historical perspective, therefore, the list of non-cooperative tax havens evolved in the following way: in 2000, the OECD identified 38 jurisdictions as tax havens according to criteria it had established in the 1998 Report.[113] However, from 2000 to 2002, 31 jurisdictions made public political commitments to implement the OECD's standards of transparency and exchange of information.[114] Only 7 jurisdictions did not make commitments to transparency and exchange of information at that time and were identified in 2002 by the OECD's Committee on Fiscal Affairs as uncooperative tax havens.[115] All of these jurisdictions subsequently made commitments and were removed from the list of uncooperative tax havens.[116] Besides that, the OECD has changed its criteria of classification of un-cooperative tax havens. Since 2009, as discussed next, the 'black list' includes only countries that have not committed themselves to the

[113] Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Cyprus, Dominica, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Liechtenstein, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama,
Samoa, San Marino, Seychelles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, US Virgin Islands and Vanuatu. OECD, 'Jurisdictions Committed to Improving Transparency and Establishing Effective Exchange of Information in Tax Matters' (2000) <http://www.oecd.org/document/19/0,3746,en_2649_33745_1903251_1_1_1_1,00.html> accessed 12 June 2011.

[114] OECD, 'List of Unco-operative Tax Havens' (2009) <http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_1,00.html> accessed 17 July 2009.

[115] Andorra, The Principality of Liechtenstein, Liberia, The Principality of Monaco, The Republic of the Marshall Islands, The Republic of Nauru and The Republic of Vanuatu.

[116] OECD (n 114).

international agreed tax standard. Even though the criteria were modified, the outcome is the same: there is no jurisdiction in the 'black list'.

In sum, the tax haven is one of the crucial concepts that have guided the discussion about harmful tax competition presented by the OECD. As demonstrated, a tax haven has no technical meaning and the factors used to identify it have changed over time. An overview of the evolving concept of tax havens showed how the OECD's position was modified, i.e. starting from a more radical approach, suggesting changes in tax systems and ending with a discourse focused on transparency and exchange of information. The primary criterion, however, made clear that the original intent of the OECD was to identify places used by non-residents to escape tax in their country of residence. Thus, the concept of tax havens developed by the OECD refers to jurisdictions that threaten residence taxation, increasing opportunities of international tax avoidance and evasion.

2.4.2.2. Preferential tax regimes

The other crucial concept in the definition of harmful tax competition was the preferential tax regime. While the identification of a tax haven included the analysis of OECD members and non-members tax systems, the detection of harmful preferential tax regimes was initially limited to OECD members. The process of identification included four key factors, eight complementary factors and three economic considerations. Preferential tax regimes can provide benefits for the location of portfolio investments as well as foreign direct investment. However, the OECD's approach limited the discussion to financial and other service activities which means that preferential tax regimes created to encourage productive investment were not included in the concept of harmful tax conception.

The four key factors to identify a harmful preferential tax regime are: (i) no or low effective tax rates; (ii) 'ring-fencing' of regimes which meant regimes that were partially or fully isolated from the domestic economy, restricting the benefits to non-resident investors who could not access the domestic markets; (iii) lack of transparency; and (iv) lack of effective exchange of information.[117] The method of identification was similar to the one used for tax havens: the initial criterion (i) needed to be combined with one or more other key factors described in this paragraph.[118] Exclusively no or low effective tax rates was not enough to identify a harmful preferential tax regime.[119]

Based on the factors described in the 1998 Report, a list of harmful preferential tax regimes were published in the 2000 Report, where 47 preferential regimes were identified in member countries.[120] Consequently, OECD members had to remove the harmful feature of such regimes and the results of their actions were published in the 2001 Report, updated by the 2006 Report on Harmful Tax Practices.

In analysing the described process to identify a harmful preferential tax regime, what we see is a similar sequence of steps as those described to identify a tax haven. Here there is also no technical meaning of harmful preferential tax regime and, consequently, as the process of identification is flexible, the effective elimination of such regimes remains unclear. Furthermore, there is also the fact that preferential tax regimes designed for other types of activities rather than financial services were excluded from the analysis which created a loophole in the concluding results.

[117] OECD, '1998 Report' (n 70) 25-30.

[118] ibid 26.

[119] Complementary factors assisted in identifying harmful preferential tax regimes. They were: (i) an artificial definition of the tax base; (ii) failure to adhere to international transfer pricing principles; (iii) foreign source income exempt from residence country tax; (iv) negotiable tax rate or tax base; (v) existence of secrecy provisions; (vi) access to a wide network of tax treaties; (vii) regimes that are promoted as tax minimisation vehicles; and (viii) a regime that encourages purely tax-driven operations or arrangements. Ibid 30-4.

Furthermore, there were three economic considerations in the process of identifying a harmful preferential tax regime. These economic effects are not easily identified even though they can help to guide the process of recognition of harmful preferential tax regimes. The economic considerations were presented as questions: (i) Does the tax regime shift activity from one country to the country providing the preferential regime, rather than generate significant new activity?; (ii) Is the presence and level of activities in the host country commensurate with the amount of investment or income?; and (iii) Is the preferential tax regime the primary motivation for the location of an activity? The OECD acknowledged that it was not easy to answer these questions and the first list of harmful preferential tax regimes did not assess the economic considerations. OECD, '2000 Report'(n 70) 12.

[120] The preferential regimes were listed by category (e.g. insurance, financing and leasing, fund managers, banking, headquarter regimes, distribution centre regimes, service centre regimes, shipping and miscellaneous activities) and some regimes were included in more than one category. Ibid. 12-14.

By that time, the holding company regime was not analysed. In fact, the holding company regime was only analysed in the 2006 Report on Harmful Tax Practices.

The literature, consequently, has focused its critiques on the arbitrary concepts of tax haven, preferential tax regime and the restriction of the analysis to financial and other service activities since productive investments and also portfolio investment such as interest have been excluded from the concept of harmful tax competition developed by the OECD.

Littlewood adopted this line of criticism to the OECD's approach to harmful tax competition, explaining that the organisation's manner of operation has been opaque and arbitrary which resulted in a flawed definition of tax haven and preferential tax regime. These flawed definitions allowed some categories of tax havens and preferential tax regimes to escape from the OECD's definition.[121]

Avi-Yonah also agreed that some tax regimes that also represent tax havens or preferential tax regimes were excluded from the OECD's analysis. He emphasised this situation by explaining the concept of a production tax haven, i.e. a 'jurisdiction that grants a tax holiday to foreign production facilities located therein, but still leaves an income tax on domestic corporations and individual residents' as well as a preferential tax regime where an exemption is granted to interest paid to non-residents. Thus, according to Avi-Yonah an alternative approach to harmful tax competition is necessary. He advocated that the distinction between harmless and harmful tax competition might be drawn between general reductions that apply to all taxpayers (domestic and foreign), and specific reductions that are offered only to non-resident taxpayers. In Avi-Yonah's view, therefore, the OECD made no systematic effort to distinguish on a normative basis between harmful and beneficial tax competition.[122]

Based on the critiques presented, it can be concluded that there is no clear understanding in the literature pointing to the fact that the OECD is in fact not discussing tax

[121] M. Littlewood, 'Tax Competition: Harmful to Whom?' (2005) 26 Michigan Journal of International Law 411.
[122] R. S. Avi-Yonah, 'Globalisation, Tax Competition, and The Fiscal Crisis of the Welfare State' (2000) 113 Harvard Law Review 1573.

competition for productive investment, i.e. the erosion of source taxation. The OECD used the term tax competition to approach the problem of international tax avoidance and evasion from the perspective of its members, i.e. the erosion of residence taxation. Thus, assuming this line of reasoning, a question is raised: What was the involvement of non-member countries in this project? The outcome of this analysis will enlighten the main question of this study which refers to the position of developing countries in the international tax system.

2.4.3. The dialogue with non-member countries

Even though the criteria that limited the scope of the OECD's work on harmful tax competition corresponded to the interest of its member countries, the OECD always tried to extend the project to non-member countries. The first Reports about harmful tax practices were developed by the Committee on Fiscal Affairs and other sub-groups where only member countries participated.[123] The OECD was aware of the risk that a failure to address the harmful tax practices in non-member countries in parallel with the work in member countries would cause a shift of the targeted activities to economies outside the OECD area, attributing to them competitive advantage and limiting the effectiveness of the OECD's original plan. Therefore, since the beginning of the OECD's project, non-member economies were encouraged to engage themselves and to agree with the principles established by the OECD to curb harmful tax competition, even though they were excluded from the development of the rules.[124]

The OECD's interest of engaging non-OECD countries was to protect its objective rather than to help 'non-member' countries to protect themselves from these harmful tax practices. Furthermore, another peculiar aspect of the OECD effort to engage non-members refers to the fact that tax havens, offshore finance centres and developing countries were treated as one single group: 'non-members', even though their economies and interests in the OECD's work are substantially different.

[123] OECD, '1998 Report', '2000 Report', '2001 Report', '2004 Report', and '2006 Report on Tax co-operation (n 70).
[124] OECD, '2000 Report' (n 70) 22.

Beyond the agreement of some tax havens[125] on collaborating with the OECD by increasing transparency and exchange of information in order to avoid their inclusion in the list of non-cooperative tax havens, the engagement of developing countries has been limited. Parallel to the work developed by the Committee of Fiscal Affairs where only members determined the rules, the OECD developed the Global Forum on Taxation in order to improve the dialogue as well as the participation of other countries, besides tax havens and other offshore centres.

The Global Forum on Taxation was established as a multilateral framework where the OECD carried out dialogues on tax issues with non-OECD economies. The Global Forum has involved itself in the discussion of harmful tax competition from a different perspective: rather than identifying tax havens and preferential tax regimes, the Global Forum has tackled harmful tax competition by focusing on effective exchange of information and transparency. Since 2000, the Global Forum has been working on these issues and its first proposal was the development of the Model Agreement on Exchange of Information on Tax Matters (Model Agreement)[126]. The objective of this agreement is to promote international cooperation in tax matters through exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes.[127]

The association between harmful tax competition and the Model Agreement relies on the fact that the lack of transparency and effective exchange of information are the key criteria in determining harmful tax practices. The Model Agreement represents the

[125] Most countries classified as tax havens are small islands classified as: Overseas Territory of the United Kingdom (Anguilla, Bermuda, British Virgin Islands, Montserrat and Turks and Caicos Islands), Kingdom of the Netherlands (Aruba and the Netherlands Antilles), Dependency of the British Crown (Guernsey, Isle of Man and Jersey), and External Territory of the United States (US Virgin Islands).
[126] This Model Agreement is also referred as Tax Information Exchange Agreements (TIEA).
[127] OECD, 'A Progress Report on Jurisdiction Surveyed by the OECD Global Forum Implementing the International Agreed Tax Standard' (2009) <http://www.oecd.org/dataoecd/50/0/42704399.pdf> accessed 17 July 2009, [hereinafter 2009 Report].

standard of effective exchange of information for the purposes of the OECD's initiative on harmful tax practices.[128]

The segregation of developing countries from tax havens and offshore financial centres, i.e. transforming the non-member status into two different groups, is necessary to identify the effective participation of developing countries in the Global Forum. The development of the Model Agreement, which congregates the main characteristics accepted as the international tax standard, was executed by the OECD Working Group on Effective Exchange of Information (the Working Group). The Working Group was composed of representatives from OECD Member countries and from delegates from eleven tax havens: Aruba, Bermuda, Bahrain, Cayman Islands, Cyprus, Isle of Man, Malta, Mauritius, the Netherlands Antilles, the Seychelles and San Marino.[129] Thus, the representativeness of developing countries at the initial stage of this project did not occur. The involvement of non-members here means in fact the participation of tax havens.

In 2006, the Global Forum on Taxation prepared a progress report assessing the implementation of the OECD's standards of transparency and exchange of information in 82 economies. The set of 82 economies was composed by two different groups of countries: (i) 54 'Participating Partners'[130] which corresponded to countries that committed themselves to the principles of transparency and effective exchange of information established in the Model Agreement; and (ii) 28[131] 'Invitees'[132] which were

[128] OECD, '2006 Report on Tax Co-operation' (n 70) 7.
[129] ibid.
[130] The group of Participating Partners was composed of: Anguilla, Antigua and Barbuda, Aruba, Australia, Bahrain, Kingdom of, Belize, Bermuda, British Virgin Islands, Canada, Cayman Islands, Cook Islands, Cyprus, Czech Republic, Denmark, Dominica, Finland, France, Germany, Gibraltar, Greece, Grenada, Guernsey, Hungary, Iceland, Ireland, Isle of Man, Italy, Japan, Jersey, Korea, Malta, Mauritius, Mexico, Montserrat, Nauru, Netherlands, Netherlands Antilles, New Zealand, Niue, Norway, Panama, Poland, Portugal, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and The Grenadines, Samoa, San Marino, Seychelles, Slovak Republic, Spain, Sweden, The Bahamas, Turkey, Turks and Caicos Islands, United Kingdom, United States, US Virgin Islands and Vanuatu.
[131] China, Hong Kong and Macao presented data separately even though accounted as one country.
[132] The group of Invitees was represented by: Andorra, Argentina, Austria, Barbados, Belgium, Brunei, China, Costa Rica, Guatemala, Hong Kong (China), Liberia, Liechtenstein, Luxembourg, Macao (China),

represented by countries invited only to contribute to the factual assessment and to attend the Global Forum meeting. The group of Participating Partners was composed of OECD members and tax havens (according to the tax haven criteria as described in the 1998 OECD report). The second group, i.e. Invitees, gathered tax havens, other financial centres and only a few developing countries (Argentina, China, Russian Federation and South Africa) with a substantial economy, not identified as tax havens or offshore financial centres.

As a result, though the set of 82 countries gave the initial impression that non-OECD economies were interested in getting involved, in analysing the data what becomes evident is the commitment of only OECD countries, tax havens and other offshore financial centres. Moreover, not all OECD countries had committed themselves to the principles established by the Model Agreement since Belgium, Liechtenstein, Luxembourg and Switzerland had only participated as Invitees.

After the 2006 Report on Tax Co-operation, the Global Forum prepared two other progress reports (2007 Report and 2008 Report), following the same line as the first one. Comparing the information displayed in the three reports what we see are very subtle changes regarding the number of countries participating. The number of Participating Partners remained the same, i.e. 59, whereas the number of Invitees increased by one due to the contribution of Chile in the 2008 Report. The most significant change was the endorsement of the principles of transparency and effective exchange of information by Argentina, China, Hong Kong (China), Macao (China), Russian Federation, South Africa and United Arab Emirates.

In 2008, due to the global financial crisis, the G20 reinforced the necessity of transparency and exchange of information for tax purposes in order to strengthen regulation of the financial sector. The importance of the task developed by the Global Forum was highlighted and its work was adopted as a standard model to guide all the

Malaysia, Marshall Islands, Monaco, Philippines, Russian Federation, Singapore, South Africa, Switzerland, United Arab Emirates and Uruguay.

discussions involving this subject. The problems involving transparency and exchange of information for tax purposes were attributed to tax havens and non-cooperative jurisdictions. Thus, the solution was to engage as many jurisdictions as possible to the principles established in the Model Agreement. The outcome of such proposal resulted in the publication of a new report by the OECD Global Forum, updating the 2006, 2007 and 2008 Reports on Tax Co-operation towards a Level Playing Field, and adopting a new format: the report (2009 Report) would now present the summary assessment for each country with respect to acceptance and implementation of the OECD standard.[133]

The 2009 Report presents three categories where countries can be classified as: (i) jurisdictions that have substantially implemented the internationally agreed tax standard; (ii) jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented it; and (iii) jurisdictions that have not committed to the internationally agreed tax standard. The first assessment performed based on this new classification was published on the 2nd April, 2009. The 2009 Progress Report identified: 40 countries that have substantially implemented the internationally agreed tax standard;[134] 38 tax havens and offshore financial centres that have committed to the internationally agreed tax standard, but have not yet substantially implemented it;[135] and 4 countries that have not committed to the internationally agreed tax standard.[136] From

[133] G20, 'Declaration on Strengthening the Financial System, London' (2009) <http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf> accessed 23 July 2009; G20, 'G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets' (WG2: Final Report, 29 March 2009) <http://www.g20.org/Documents/g20_wg2_010409.pdf> accessed 23 July 2009.

[134] Argentina, Australia, Barbados, Canada, China, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Guernsey, Hungary, Iceland, Ireland, Isle of Man, Italy, Japan, Jersey, Korea, Malta, Mauritius, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Russian Federation, Seychelles, Slovak Republic, South Africa, Spain, Sweden, Turkey, United Arab Emirates, the United Kingdom, the United States and the US Virgin Islands.

[135] Tax havens according to criteria established in the 1998 Report: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Dominica, Gibraltar, Grenada, Liberia, Liechtenstein, Marshall Islands, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, St Kitts and Nevis, St Lucia, St Vincent and The Grenadines, Samoa, San Marino, Turks and Caicos Islands and Vanuatu. Other offshore financial centres: Austria, Belgium, Brunei, Chile, Guatemala, Luxembourg, Singapore and Switzerland.

[136] Costa Rica, Malaysia (Labuan), Philippines and Uruguay.

the sample of countries examined, only 6 jurisdictions[137] were identified as developing countries not also classified as tax havens or offshore financial centres.[138]

In the most recent report published on the 25th May, 2011, the number of jurisdictions that have substantially implemented the internationally agreed tax standard reached the figure of 82 countries, remaining only 8 tax havens[139] and other financial centres[140] classified as jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented it. All jurisdictions surveyed by the Global Forum have committed to the internationally agreed tax standard.[141] The increased number of jurisdictions that have substantially implemented the internationally agreed tax standard occurred due to the modification of the threshold that defined it. Before April 2009, a country was considered to have substantially implemented the standard of exchange of information for the purposes of this Global Forum assessment if it had in place signed agreements or unilateral mechanisms that provided for exchange of information to standard with at least 12 OECD countries.[142] After April 2009, the OECD started to accept as jurisdictions that have substantially implemented the internationally agreed tax standard, jurisdictions which had signed agreements with at least 12 jurisdictions, whether OECD or other jurisdictions.[143] The downgrade of the threshold encouraged tax havens and other financial centres to sign TIEA in order to improve their classification. However, regarding the involvement of new countries, also in this updated list, only a few jurisdictions could be identified as developing countries not also classified as tax havens or offshore centres.[144]

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137 Argentina, China, Mexico, Russia Federation, South Africa and Turkey.
138 OECD, 'A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard: 2nd April, 2009' (2009) <http://www.oecd.org/dataoecd/38/14/42497950.pdf> accessed 15 June 2011.
139 Montserrat, Nauru, Nieu, Panama and Vanuatu.
140 Costa Rica, Guatemala and Uruguay.
141 OECD, 'A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard: 25th May, 2011' (2011) <http://www.oecd.org/dataoecd/50/0/43606256.pdf > accessed 15 June 2011.
142 OECD, '2009 Report' (n 70) 18.
143 OECD, '2010 Report' (n 70) 9.
144 Same countries as n (134) plus Brazil.

Notwithstanding the progressive changes implemented by the Global Forum, in September, 2009, during the Mexico Global Forum Meeting, a new structure for the Global Forum was proposed. One of the main adjustments consisted of the openness of membership to all OECD and non-OECD jurisdictions that commit to implementing the standards on transparency and exchange of information for tax purposes. From this angle, it seems that all members will participate on an equal footing. However, the main rules that guide the work of the Global Forum were settled before by the OECD's work. Thus, the direction of the work on transparency and exchange of information for tax purposes was defined by the interest of OECD countries. It will be hard for new members to change the path of the work that has been done previously.

Another relevant outcome of the Mexico Global Forum Meeting was the introduction of the Peer Review Report. This new report is based on two-phase review of each jurisdiction's legal and regulatory framework (Phase 1) and practical implementation (Phase 2) of the standards on transparency and the exchange of information for tax purposes.[145] The objective is to improve the assessment of countries' implementation of the international tax standard. However, the meaning of international tax standard remains the same based on: (i) exchange of information on request where it is 'foreseeably relevant' to the administration; (ii) enforcement of the domestic laws of the treaty partner; (iii) no restrictions on exchange caused by bank secrecy or domestic tax interest requirements; (iv) availability of reliable information and powers to obtain it; (v) respect for taxpayers' rights; and (vi) strict confidentiality of information exchanged.[146] Therefore, even though the criteria for assessment of the international tax standard might have improved, it is not entirely clear whether the international tax standard is the right answer to combat international tax evasion and avoidance. The international tax standard was the answer established by the OECD. It is necessary first to understand how international tax avoidance and evasion might be affecting developing countries to later examine the efficiency of the international tax standard from the perspective of developing countries.

[145] OECD, '2010 Report' (n 70) 10.
[146] ibid 15.

In sum, the limited involvement of developing countries in the OECD's work on harmful tax competition might be explained by how this subject has been approached. For developing countries, tax competition was associated with the idea of competition for productive investment (inflows of FDI), which in fact was not covered by the approach established by the OECD. It was necessary to examine what was the effective meaning of harmful tax competition to understand developing countries' position. To this extent, this chapter demonstrated that the concept of harmful tax competition developed by the OECD refers in fact to the combat of international tax avoidance and evasion and, consequently, to the erosion of residence taxation. From this angle, it becomes clear that the real issue in order to involve developing countries in this debate is to understand how international tax avoidance and evasion are affecting them.

2.5. Conclusion

The analysis of harmful tax competition was necessary to demonstrate what its effective meaning is. The OECD detached the term tax competition from its economic meaning, using it to address the problem of international tax avoidance and evasion.

To this extent, this chapter pointed out that the limited involvement of developing countries in the OECD's work on harmful tax competition is in fact a problem of perspective since it is not entirely clear what is the interest of developing countries in combating international tax avoidance and evasion.

In order to identify the interest of developing countries in combating international tax avoidance and evasion, first it will be necessary to comprehend their interest in the international flow of capital to then verify whether the measures implemented until now also work from their perspective.

Chapter III. The international flow of capital

3.1. Objective of this chapter

This chapter will provide new economic premises to reconsider international taxation. The legal debate has focused mainly on allocation of taxing rights between source and residence countries. However, the international flow of capital has substantially changed in the recent past. It is necessary, therefore, to evaluate the relevance of FDI and Portfolio Investment in order to understand countries' interests in international taxation since source and residence taxation are applied differently to income derived from these flows.

The economic analysis that has guided the discussion about the application of source and residence principles in tax treaties was focused on only two groups of countries: developed and developing countries. However, nowadays it is also necessary to analyse the position of this new group of players: tax havens, since their participation in the international flow of capital has remarkably increased in the recent past. Moreover, another traditional assumption that has oriented the application of source and residence principles is the characterisation of developing countries as capital importers and developed countries as capital exporters. The current flow of capital among countries is much more complex than this simple assumption, presenting different characteristics associated with the financial assets that underlay them. The characterisation of countries as capital importers and capital exporters needs to consider their positions in terms of Portfolio Investment and FDI.

The idea of this study is to analyse the characteristics of the international flow of capital among developed countries, developing countries and tax havens in order to identify new economic premises that can push the international tax debate to another frontier, i.e. rather than focusing on the allocation of taxing rights that emphasises only tax problems from the perspective of source and residence principles to understand the complexity of international taxation from a global perspective based on the interaction of different bilateral transactions. This new perspective will be used to update the legal debate.

In the traditional framework of developed and developing countries' relationship, also referred as the North-South model,[147] the North dominated the South economically because of the Southern structural dependence on Northern trade and finance.[148] Regarding trade aspects, the unbalanced interaction between the two groups derived from the fact that the South was represented by poor developing countries which specialised in the production and export of a narrow range of primary commodities while the North was represented by rich industrialised economies which specialised in the production and export of manufacturing goods.[149] From the financial perspective, the traditional framework was based on a similar argument of dependence between North and South: the major direction of the flow of capital has been from the North to the South characterising developing countries as capital importers and developed countries as capital exporters.

This standard perspective of trade and finance in relation to developed and developing countries is out of date. Both groups of countries have gone through several structural changes during the period of globalisation transforming the nature of interactions between them from one of unidirectional dependence to multifaceted interdependence.[150] In this regard, the current aspects of the trade relationship are better understood since many developing countries export not only a narrow range of primary commodities but also manufactured goods. The financial aspects are more complicated since studies have adopted different premises to investigate in a consistent manner the evolving movement of capital between developed and developing countries, pointing out diverse outcomes. Even though the new perspective has been broadly accepted, i.e. that the nature of interactions between developed and developing countries corresponds

[147] R. Findlay, 'The Terms of Trade and Equilibrium Growth in the World Economy' (1980) American Economic Review, Vol. 70 (June) 291.
[148] C. Akm and M. Ayhan Kose, 'Changing Nature of North-South Linkages: Stylized Facts and Explanations' (2007) IMF Working Paper WP/07/280, 13.
[149] ibid.
[150] ibid 14.

to a multifaceted interdependence, its effective meaning on finance (i.e. flow of capital) is not entirely comprehended hampering the application of this new perspective to other discussions such as international taxation.[151] Furthermore, it is not possible to comprehend entirely the financial aspects of the relationship between developing and developed countries without considering the position of tax havens. This signifies that in order to understand the current profile of the international flow of capital and for them to adopt new premises to re-discuss international taxation it is necessary to examine the financial flows from the perspective of three groups of countries: developed, developing and tax havens.

The new arguments introduced in the discussion of international taxation are based on a qualitative analysis of the flow of capital between developed, developing countries and tax havens. Main trends on the flow of capital will be compared and their theoretical and practical importance debated. However, it has to be clear that the objective here is not to predict an exact value of total flows and stocks per group of countries, but only to offer a plausible estimate of measures that can reflect what is going on among these groups of countries in terms of financial flows to extrapolate those findings to the legal debate.

3.2. Methodology

In this section, the methodology adopted to analyse the international flow of capital and the stocks of foreign assets and liabilities is described, presenting the following main elements: (i) types of data required; (ii) sources of data available; (iii) limitations of the data available; (iv) alternative sources of data of stocks of foreign assets and liabilities; and (v) classification of countries and premises of the analysis performed.

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[151] Economic studies have already challenged the traditional assumption of North/South flows, based on the Lucas Paradox which examined the lack of flows from rich to poor countries. R. Lucas, 'Why Doesn't Capital Flow from Rich to Poor Countries?' (1990) 80 American Economic Review 92. This question has been constantly examined by the economic literature. L. Alfaro, S. Kalemli-Ozcan and V. Volosovych, 'Why Doesn't Capital Flow from Rich to Poor Countries?' (2005) 11901 NBER Working Paper Series 1. L. Alfaro, S. Kalemli-Ozcan and V. Volosovych, 'Capital Flow in a Globalized World: The Role of Policies and Institutions?' (2005) 19011 NBER Working Paper Series 1.

In order to investigate the international flow of capital among countries, there are two important sources of data: (i) look at economic transactions of an economy with the rest of the world; and (ii) look at the stock of foreign assets and liabilities that a country accumulates over the years. The difference between the two sets of data is that the first one provides information only about economic transactions among nations, i.e. economic flows that reflect the creation, transformation, exchange, transfer or extinction of economic value which involves changes in ownership of goods and/or financial assets, the provision of services or the provision of labour and capital;[152] whereas the second one provides the value and composition of the stock of an economy's financial assets and liabilities at a specific date such as year-end. A change in stocks during a year can be attributed to: (i) transactions (flows); (ii) to valuation changes reflecting adjustments in exchange rates, prices, etc.; (iii) or to other adjustments.[153] In other words, while the first set of data reflects only the value of economic transactions; the second alternative compiles the value of economic transactions plus other variables such as revaluations arising from price changes and/or exchange rate changes and other changes in the volume of assets (e.g. write-off claims, reclassification of assets, etc.).[154]

From a tax perspective what really matters is the net position of a country in each type of flow, i.e. the difference between inflows and outflows of each financial asset held by the country. The annuals flows, however, can vary significantly between two consecutive years, making it hard to identify a consistent trend in the period analysed. On the other hand, even though stocks do not reflect merely the inflows and outflows of capital, as explained in the previous paragraph, they can provide a reliable estimation of the accumulated flows received by a country. The difference between the stocks allows us to understand whether the country has a tendency to import or to export capital in the long-term. Hence, the analysis of the annual flows as well as the stocks of foreign assets and liabilities held by countries will provide complementary information to analyse the financial transactions among developed, developing countries and tax havens.

[152] IMF, *Balance of Payments Manual* (5th Edition, IMF 1993) 6. Hereinafter referred as 'BOPS Manual'. <http://www.imf.org/external/np/sta/bop/BOPman.pdf> accessed 25 November 2008.
[153] ibid 7.
[154] IMF, *Monetary and Financial Statistics Manual* (IMF, 2000) 94. <http://www.imf.org/external/pubs/ft/mfs/manual/index.htm> accessed 25 November 2008.

The limitation of the analysis proposed in this chapter rests on the availability of data regarding the flows of capital among countries as well as the stocks of financial assets and liabilities held by them. The main source of these data is the International Monetary Fund (IMF).

The IMF publishes the International Financial Statistics (IFS), which compiles data from the IMF's different sources: the Balance of Payments Statistics (BOPS), Government Finance, etc. BOPS provide data on the annual flows of capital and stocks of foreign assets and liabilities (i.e. International Investment Position's data – IIP). The Balance of Payments is a statistical statement that systematically summarises, for a certain period of time, the economic transactions of an economy with the rest of the world,[155] while the IIP compiles a statistical statement of the value and composition of the stock of an economy's financial assets and liabilities at a specific date such as year-end.[156] BOPS' information is harmonised, which helps one to understand the linkages between flows and the stocks. The basic principle that underpins the Balance of Payments is that all entries should result in a consistent body of positive and negative values with a total sum of zero.[157] In the next paragraphs, the classification and standard components of the Balance of Payments and IIP will be briefly explained since the analysis of the international flows and stocks follows this classification.[158]

The standard components of the Balance of Payments are composed of two main groups of accounts: the current account which pertains to goods and services, income and current transfers; and the capital and financial account which pertains to (i) capital transfers and acquisition or disposal of non-produced, non-financial assets and (ii) financial assets and liabilities. The capital and financial account has two major

[155] IMF, 'BOPS Manual' (n 152) 6.
[156] ibid.
[157] ibid 38.
[158] Even though the quantitative analysis of stocks will use IMF data only indirectly, since the primary source of the present analysis is the database developed by Lane and Milesi-Ferretti, the backbone of their database is the IMF information and, therefore, the understanding of its classification and components is necessary.

components (the capital account and the financial account) in which assets represent claims on non-residents, and liabilities represent indebtedness to non-residents. All valuation changes and all other changes that do not reflect transactions in foreign assets and liabilities are excluded from the capital and financial account but reflected in the international investment position.[159]

To this extent, it is important to understand what claims on non-residents and indebtedness to non-residents of financial account represent in terms of flows and stocks[160]:

Table 3.1 – Countries Classification

Financial Account	Country's profile	Flow of Capital	Stocks' position	Income yield
Claims on non-residents	Capital exporter	Outflow (-)	Asset	Inflow
Indebtedness to non-residents	Capital importer	Inflow (+)	Liability	Outflow

The classification of standard components in the financial account and in the IIP is based on the following criteria: all components are classified according to type of

[159] IMF, 'BOPS Manual' (n 152) 38-40.

[160] Other relevant concepts that need to be understood are the meaning of resident and non-resident adopted in the context of the Balance of Payments. According to the BOP Manual, the concept of residence is based on the identification of the centre of economic interest of individuals and enterprises. The term enterprise is explained by the terms: corporation and quasi-corporation. To this extent, a corporation means a legal entity created for the purpose of producing goods or services for the market; whereas a quasi-corporation is an unincorporated enterprise that is operated as if it were a separate corporation with a complete set of accounts. Regarding the meaning of residence, an individual has a centre of economic interest and he is said to be resident in a country when he maintains, within the country, a dwelling or succession of dwellings treated and used by members of the household as their principal. An individual may cease being a resident when he works continuously for one year or more in a foreign country. On the other hand, an enterprise is said to have a centre of economic interest and, consequently, to be a resident of a country when it is engaged in a significant amount of production of goods and/or services there or when the enterprise owns land or buildings located there. The enterprise must maintain at least one production establishment in the country and must plan to operate the establishment indefinitely or over a long period of time. Based on the concepts described above, it becomes clear that the BOPS' concept of resident and non-resident will probably differ from the concepts adopted by countries' domestic tax legislations in certain situations. ibid 20-5.

investment or by functional subdivision (direct investment[161], portfolio investment[162], other investment[163], and reserve assets[164]). The positive aspect of this classification is that it will allow an analysis of the flows and the stocks of foreign assets and liabilities based on type of investment, which is necessary from a tax perspective since different principles are adopted, depending on the type of investment.

Another important component of the Balance of Payments is the net errors and omissions account.[165] Although the application of the main principle that underlies the entries in the Balance of Payments accounts is that all entries must achieve a net (conceptual) total of zero, in practice, the resulting balance will almost inevitably show a net credit or a net debit. That balance corresponds to the value reported in the net errors and omissions account. In other words, the value described in the net errors and omissions account is an offset amount to the overstatement or understatement of the recorder entries. For instance, if the net value of the entries is a credit, the 'balancing' value in the net errors and omissions account will be shown as a debit in the same amount.[166]

Notwithstanding the fact that the IMF is a useful source of data, most information is available from 1994 since the data in the IMF Balance of Payments Statistics are compiled and presented in accordance with the standard components of the fifth edition

[161] Direct Investment is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another country, owns 10% or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). ibid 86.
[162] Portfolio investment covers transactions in equity securities and debt securities, excluding any of the instruments included in the categories of direct investment and reserve assets. Debt securities are divided into bonds and notes, money market instruments and financial derivatives. ibid 91.
[163] Other investment covers short-and long-term trade credits; loans (including use of Fund credit, loans from the Fund and loans associated with financial leases); currency and deposits. ibid 95.
[164] Reserve assets cover transactions in assets that are considered by monetary authorities of an economy to be available for use in funding payments imbalances. The items covered are: monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (currency deposits and securities) and other claims. Valuations changes in reserve assets are excluded, along with counterparts to such changes. Also excluded are the allocations or cancellations of SDRs, the monetarisation or demonetarisation of gold and counterpart entries. These changes, which do not constitute transactions, are reflected in the international investment position. ibid 97.
[165] NEO concept is very important since it also represents a measure of capital flight discussed in the next chapter.
[166] ibid 38.

of the Balance of Payments Manual, (BPM5), which the IMF published in September 1993.[167] This means that although some series may have been backwardly revised in pre-1994 years, many are not, particularly for developing countries and tax havens. Therefore, the IMF will basically provide data from 1994 to 2007.

Despite the importance of the flow of capital for international macroeconomics, few studies have compiled a complete series of data that allow a consistent analysis of the magnitude and proportion of this flow between developed, developing countries and tax havens. Hence, to investigate the behaviour of the international flow of capital among these three groups of countries, data from the Balance of Payments compiled by the IMF will be used.

In relation to stocks, there were some previous studies that tried to improve the figures provided by the IMF and by other international organisations. Kennedy was one of the pioneers to investigate the stock of foreign assets and liabilities in 1980. He analysed a sample of 98 countries from 1962 to 1977. His objective was to interpret international financial relationships in the context of a comprehensive conceptual framework. He identified the difficulties of working with different sources of data and opted for accumulating annual capital flows to measure stocks of foreign assets and liabilities held by countries. His strategy had some shortcomings also recognised by the author, since the accumulation of annual capital flows from the Balance of Payments disregard two important components of the stock of foreign assets and liabilities: (i) revaluation of assets; and (ii) exchange rate changes.[168] Despite the limitation presented in his methodology, his attempt to measure the stock of foreign assets and liabilities shed light on the importance of research in this area and the difficulties imposed by asymmetries of data from different sources.

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[167] In 2009, the IMF published the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6). However, until 2012 data will be presented in IMF statistical publications on a fifth edition basis. IMF, 'IMF Committee on Balance of Payments Statistics Annual Report' (2009) <http://www.imf.org/external/pubs/ft/bop/2009/ar/bopcom09.pdf> accessed 21 February 2011.
[168] R. V. Kennedy, 'External Balance Sheets: Concepts and Empirical Approximation', (1980) 26 The Review of Income and Wealth, 253-91.

Sinn developed a more complete dataset, which comprised the annual net external asset positions for 145 countries for the period 1970-1987. The objective of his research was to explain the changes on the net exchange asset positions during the 1980s as well as the magnitude and the implications of such changes, which have been frequently misstated and misunderstood. His statistical methods to measure the stock of foreign assets and liabilities were more accurate than those used by Kennedy, since Sinn considered: (i) changes in asset prices; (ii) exchange rates; and (iii) consumer price level to interpret his results. The two main sources of data used by Sinn were: national statistical publications and statistics of international organisations. The data extracted from these sources (i.e. stock of foreign assets and liabilities) were presented by economy's sectors: central bank, deposit money banks, private households and enterprises, and public authorities. His focus was on sectors of the economy even though some information about type of investment can also be extracted from his database.[169]

Sinn found difficulties in understanding and interpreting data from international organisations, due to the lack of detailed information, however his main constraint was the missing data of developing countries. In order to overcome this obstacle he developed very interesting methods to estimate foreign assets held by the private sector. His assumption was that in some developing countries the private sector owns considerable amounts of external assets that do not appear in official statistics. Therefore, an alternative to estimate the private external assets of developing countries was to consider that part of the unrecorded capital flows was registered in the net errors and omissions account. A random part of the net error and omission account was used to estimate the private external assets of developing countries. In another alternative, he added to the random part of the net errors and omissions account the value of capital exports reported in the BOPS classified as 'other short term capital account'. The motive for adding this account is the assumption that it also represented an important channel for capital fight, i.e. unrecorded capital flows.[170] Sinn made a remarkable contribution to the estimation of the stock of foreign assets and liabilities when he developed these

[169] S. Sinn, *Net External Asset Positions of 145 Countries* (Kieler Studien, n. 24, Institut fur Weltwirtscharft an der Universitat Kiel, J.C.B. Mohr, 1990).
[170] ibid 63-8.

alternative methods to measure the stock of foreign assets in developing countries, since missing data, as already mentioned, is the main limitation in this area of research. His methods have been incorporated in recent studies, as presented in the next paragraph.

Lane and Milesi-Ferretti have also investigated the stock of foreign assets and liabilities and they published an outstanding contribution to this area of research in 2001. The objective of their study was to examine the impact of the integration of capital markets and the composition of international investments (i.e. equity and debt) in developed and developing countries. They constructed estimates of foreign assets and liabilities and their equity and debt subcomponents for a sample of 67 industrial and developing countries from 1970 to 1998. The figures were based on stock measures when available complemented by cumulative capital flows with appropriate valuation adjustments (i.e. market prices and exchange rates). The data were classified and presented by type of investment: FDI, Portfolio Investment and Debt.[171]

Comparing Lane and Milesi-Ferretti's study to Sinn's research, it can be noted that the structure of the data has been rearranged, i.e. from sectors of the economy (Sinn's perspective) to types of investment (Lane and Milesi-Ferretti's approach). Another important comparison between the two studies is the use of the account of net errors and omissions as an alternative to supply missing data. Lane and Milesi-Ferretti explained that this account measures (net) unrecorded transactions that could reflect errors of the current account, the financial account or both. If it reflects unrecorded trade transactions, we should adjust the current account accordingly. If it reflects unrecorded financial account transactions, we should add it to capital flows. However, they assumed, following Sinn's argument about capital fight, i.e. that not all outflows are reflected in official data, that net errors and omissions capture unrecorded capital flows, given the prevalence of capital flight in several developing countries for long periods of

[171] P.R. Lane and G. M. Milesi-Ferretti, 'The External Wealth of Nations: Measures of Foreign Assets and Liabilities for Industrial and Developing Countries', (2001) 55 Journal of International Economics, 263-94.

their sample. This signifies that net errors and omissions were treated as changes in the stock of debt assets held abroad by domestic residents.[172]

Lane and Milesi-Ferretti expanded the use of different sources of data: BOPS and IFS from IMF; World Bank's World Debt Tables and Global Development Finance (GDF); the OECD statistics on external indebtedness; the BIS's data on banks' assets and liabilities by creditor and debtor; and Sinn's data. The necessity of all these different sources of data to estimate the stocks of foreign assets and liabilities held by countries emphasises the complexity involved in this task, since data from different sources are not fully compatible, requiring further adjustments to provide information within a consistent framework. Besides that, Lane and Milesi-Ferretti cautiously designed methods to work with these data. For instance, regarding valuation issues, i.e. the impact of price and exchange rate changes, they adopted different methods, depending on the type of investment, which demonstrates the accuracy of their work[173]. The effort to develop this methodology to estimate the stock of foreign assets and liabilities contributes to the argument that the main limitation for research in this area derives from incompatible sources of data and missing information.

In February 2007, Lane and Milesi-Ferretti published a review of their 2001 work with improved estimates of the stock of foreign assets and liabilities.[174] The availability of IMF's IIP information[175] for a larger sample of countries and IMF's Coordinated Portfolio Investment Survey[176] (CPIS) contributed to the improvement of their database. As a result, country coverage and time coverage were enlarged, i.e. the new study was

[172] ibid 266.
[173] ibid 269-72.
[174] P. R. Lane and G. M. Milesi-Ferretti, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 - 2004', (2007) 73 Journal of International Economics, 223-250.
[175] An increased number of countries published their IIP (in the first study only 20 countries in their sample were publishing IIP, whereas in 2007 the number increased to 80 countries). This new data allowed them to use flows to extend the time series backwards, rather than accumulating flows and going forward. ibid 231.
[176] The CPIS covers the geographical allocation of portfolio investment of over 60 investor countries in over 220 destination countries.

extended to include 145[177] countries from 1970 to 2004, as well as more categories of investment were available to estimate the data: Portfolio Investment, subdivided into equity securities and debt securities; FDI; Other Investment (which includes debt instruments such as loans, deposits and trade credits); Financial Derivatives (new category) and Reserve Assets.

The 2007 database built up by Lane and Milesi-Ferretti represents a more consistent source of data to analyse the stocks of foreign assets and liabilities than the IMF's database because it was revised backward to 1970. Consequently, Lane and Milesi-Ferretti's database is going to be adopted to analyse the stocks of foreign assets and liabilities held by developed, developing countries and tax havens. The complete dataset is available online, which make it possible to access not only the figures, but also the identification of limitations inherent to the sample of countries selected by them.[178]

In sum, the analysis of the flows is based on the IMF Balance of Payments' data, whereas the analysis of the stocks is supported by Lane and Milesi-Ferretti's database.[179] Due to the fact that different sources are used, the sample of countries in each analysis will differ in a certain way. The size of the samples relies on the availability of data. To this extent, the sample of countries used to analyse the flows is composed of: 100 developing countries,[180] 22 high income OECD countries[181] and 28

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[177] Even though the sample was extended to encompass 145 countries, complete series of data are available for 91 countries; for 54 countries data are reported for shorter periods. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 230.

[178] <http://www.imf.org/external/pubs/ft/wp/2006/data/wp0669.zip> accessed 28 November 2008.

[179] It is important to note that the evolution of stocks will also allow some inferences about the inherent flows.

[180] Albania, Angola, Argentina, Armenia, Azerbaijan, Bangladesh, Belarus, Benin, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Burundi, Cambodia, Cameroon, Cape Verde, Chile, China, Colombia, Congo, Côte d'Ivoire, Croatia, Djibouti, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Fiji, Ghana, Guatemala, Guinea, Guyana, Haiti, Honduras, Hungary, India, Indonesia, Israel, Jamaica, Kazakhstan, Kenya, Kuwait, Kyrgyz Republic, Lao People's Dem.Rep., Libya, Lithuania, Macedonia, Madagascar, Malaysia, Mali, Mauritania, Mexico, Moldova, Mongolia, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Niger, Nigeria, Oman, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Romania, Russian Federation, Rwanda, Saudi Arabia, Senegal, Sierra Leone, Slovak Republic, Slovenia, Solomon Islands, South Africa, Sri Lanka, Sudan, Suriname, Swaziland, Syrian Arab Republic, Tanzania, Thailand, Togo, Trinidad and Tobago, Tunisia, Turkey, Uganda, Ukraine, Uruguay, Venezuela, Vietnam, West Bank and Gaza, Republic of Yemen and Zambia.

tax havens[182]. On the other hand, to analyse the stocks, the sample of countries extracted from Lane and Milesi-Ferretti's study is determined by: 109 developing countries[183], 22 high income OECD countries[184] and 14 tax havens[185].

But what are the criteria to classify countries as high-income OECD countries, tax havens and developing countries? High income OECD countries follow the World Bank's definition established at the World Development Indicators (April 2008) which define this group as those economies in which 2006 GNI per capita was $11,116 or more (Australia; Austria; Belgium; Canada; Czech Republic; Denmark; Finland; France; Germany; Greece; Iceland; Ireland; Italy; Japan; Korea, Rep.; Luxembourg; Netherlands; New Zealand; Norway; Portugal; Spain; Sweden; Switzerland; United Kingdom; United States). Even though Ireland, Luxembourg and Switzerland were classified in the high income OECD group, they were also classified as tax havens, according to the list provided next.[186] Consequently, these countries were accounted only in the tax haven group, having the high income OECD group composed of 22 economies.

There is no agreed-upon definition of tax havens. The list of tax havens presented next reflects countries with the following drivers: (i) no or nominal taxes; (ii) lack of

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[181] Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, the United Kingdom and the United States. The other OECD countries were classified as developing countries: Chile, Estonia, Hungary, Israel, Mexico, Poland, Slovak Republic, Slovenia and Turkey; and tax havens: Ireland, Luxembourg and Switzerland.

[182] Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Hong Kong, Macao, Costa Rica, Cyprus, Dominica, Grenada, Ireland, Jordan, Latvia, Luxembourg, Maldives, Malta, Mauritius, Netherlands Antilles, Panama, Seychelles, Singapore, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Switzerland and Vanuatu.

[183] 90 countries in common with the flows' sample, adding Algeria, Brunei Darussalan, Burkina Faso, Chad, Congo, Equatorial Guinea, Ethiopia, Gabon, Georgia, Iran, Malawi, Qatar, Taiwan, Tajikistan, Turkmenistan, United Arab Emirates, Uzbekistan, Yugoslavia and Zimbabwe.

[184] The same sample of 22 countries adopted in the flows' analysis.

[185] 13 countries in common with the flows' sample (Bahrain, Costa Rica, Cyprus, Hong Kong, Ireland, Jordan, Latvia, Luxembourg, Malta, Mauritius, Panama, Singapore and Switzerland), plus Lebanon.

[186] Switzerland and Ireland also have substantial domestic activity besides acting as tax havens. However, the scale that financial services are provided to non-residents is out of proportion to the size of their domestic economy. In fact, these tax havens can also be classified as Offshore Financial Centers. A. Zorome, 'Concept of Offshore Financial Centers: In Search of an Operational Definition' (2007) IMF Working Paper WP/07/87 1, 15.

effective exchange of information with foreign tax authorities; and (iii) lack of transparency. Different studies have adopted these drivers to identify tax havens. To this extent, the United States Government Accountability Office developed the GAO Report, in which a list of tax havens based on the combination of three other lists created by governmental, international and academic sources was presented. The outcome was a list of 50 jurisdictions (Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Dominica, Gibraltar, Grenada, Guernsey, Hong Kong, Ireland, Isle of Man, Jersey, Jordan, Latvia, Lebanon, Liberia, Liechtenstein, Luxembourg, Macao, Maldives, Malta, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, San Marino, Seychelles, Singapore, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Switzerland, Turks and Caicos Islands, US Virgin Islands and Vanuatu). The list was adopted by this study to identify countries as tax havens since it reflects the drivers above and it contains jurisdictions used by individuals and corporations to evade and avoid taxes.[187]

It is important to mention that some tax havens are also Offshore Financial Centers (OFC). Similar to the absence of definition of tax havens, there is no agreed-upon

[187] The GAO Report combined three different studies to identify tax havens: (i) the OECD's definition, (ii) National Bureau of Economic Research working paper (D. Dharmapala and J. R. Hines, Jr., 'Which Countries Become Tax Havens?' National Bureau of Economic Research, Working Paper 12802 <http://www.nber.org/papers/w12802> accessed 17 August 2011), and (iii) a US District Court order granting leave for the Internal Revenue Service to serve a 'John Doe' summons. Regarding the OECD's definition, currently (2010) there is no jurisdiction classified as uncooperative tax havens (A Progress Report on the Jurisdictions surveyed by the OECD Global Forum in implementing the Internationally Agreed Tax Standard - Progress made as at 3rd September, 2010, <http://www.oecd.org/dataoecd/50/0/43606256.pdf> accessed 17 August 2011). The GAO's Report was published in December 2008 and it explained that even though the majority of countries initially classified as tax havens had committed themselves to improve transparency and exchange tax information, in practice the OECD has not provided a clear picture of which countries are making real progress. This situation justified the inclusion in the GAO's Report of 38 jurisdictions listed in the 2008 OECD's list of cooperative and uncooperative tax havens. The effectiveness of the international standard to curb offshore finance is still not clear, therefore, the justification used by the GAO's Report to include not only uncooperative but also cooperative jurisdictions to identify a list of tax havens is in line with the objective of the present study.
The United States Government Accountability Office, 'GAO Report to Congressional Requesters. International Taxation. Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions' (2008), <http://www.gao.gov/new.items/d09157.pdf> accessed 10 September 2010.

definition of OFC. Notwithstanding, the IMF tried to develop a definition based on the following parameters: (i) jurisdictions that have financial institutions engaged primarily in business with non-residents; (ii) financial systems with external assets and liabilities out of proportion to domestic economies; and (iii) low or nil taxation; secrecy provisions; and lax regulation.[188] Based on the third parameter, it became clear that some OFC have also characteristics of tax havens. Another outcome from the IMF's definition is that there are not only regulatory aspects defining OFC, but also a macroeconomic feature (ii). Consequently, it is possible to identify OFC based on the comparison of financial assets and liabilities held by countries to their GDP. Zorome developed a study based on this argument and proved that 80% of the sample of OFC selected by the IMF have financial assets and liabilities on a scale that is out-of-proportion with the size of their domestic economies.[189] Considering the sample of tax havens selected by this study from the perspective of Zorome's outcomes, we can infer that a significant number of tax havens analysed here are also OFC (e.g. Bahamas, Bahrain, Barbados, Bermuda, Cayman Islands, Hong Kong, Cyprus, Guernsey, Ireland, Isle of Man, Jersey, Latvia, Luxembourg, Malta, Mauritius, Netherlands Antilles, Panama, Singapore, Switzerland, and Vanuatu).

Remaining countries were classified in the third group (i.e. developing countries' group) if they did not fulfil the criteria to be included in the other groups (tax havens and high income OECD countries). There are a vast number of developing countries with significant differences. However, the classification in subcategories would not add complementary information for the analysis performed. Thus, the developing countries' group represents a less homogeneous group than the high income OECD group. The adopted division in only three categories (developing countries, high income OECD and tax havens) is enough to obtain the outcomes required to perform the present analysis.

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[188] IMF: Monetary and Exchange Affairs Department, 'Offshore Financial Centers' (2000) IMF Background Paper, <http://www.imf.org/external/np/mae/oshore/2000/eng/back.htm> accessed 27 February 2011.

[189] Zorome (n 186), 14-7

It is essential to be aware that the outcomes of the analysis proposed in this chapter will reveal trends in the international flows and stocks held by these three groups of countries. Trends have to be evaluated with caution since they represent the average of the group, which can also be distorted by specific countries (i.e. outliers, in statistics terms). Thus, in the analysis of each group, countries that might be 'distorting' the trends will be identified and tested separately.

A last observation refers to the fact that the data analysed refer only to a sample of countries which means that the total values presented here do not reflect the entire world's data.[190] The samples, however, reflect the largest amount of information available for each group of countries. There were further limitations on the availability of information on tax havens since most of them do not provide information for the IMF and other international organisations. Thus, the outcomes of tax havens would be even more relevant if data of a larger sample were available.

3.3. Analysis of the database

The objective of this analysis is to identify the behaviour of the international flow of capital between developing countries, high income OECD countries and tax havens as well as the stocks of foreign assets and liabilities (i.e. cumulative position of these flows) held by these groups of countries. The economic data will shed some light on their national interest in the flow of capital and, consequently, it will contribute to rearrange the discussion on international taxation and developing countries.

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[190] McKinsey Global Institute has estimated that the World Financial Assets have soared from $12 trillion in 1980 to $195 trillion of dollars in 2007. D. Farrell, 'New Thinking for a New Financial Order' (2008) Harvard Business Review Sep. 2008, 26-7.

3.3.1. Flows of Capital from 1994 to 2007[191]

3.3.1.1. FDI

The table below summarises the main figures of the flows of FDI from 1994 to 2007.[192] All figures are presented in millions of US dollars. Figures provided in the table represent the average of each period.[193] In order to highlight the tendencies identified in the tables, charts are provided next.

Table 3.3.1.1. (a) – FDI Flows from 1994 to 2007

	I. FDI Inflows – Average		II. FDI Outflows – Average		III. Net of FDI flows – average	
Groups	**94-99**	**00-07**	**94-99**	**00-07**	**94-99**	**00-07**
High Income OECD	325,291	674,976	(451,170)	(851,354)	(125,879)	(176,378)
Tax Havens	69,489	214,896	(64,541)	(234,145)	4,947	(19,248)
Other developing countries	63,645	137,565	(7,235)	(38,095)	56,410	99,469
BCIMRS[194]	73,902	138,715	(6,664)	(38,527)	67,237	100,188
Total developing countries	137,547	276,279	(13,900)	(76,622)	123,648	199,657
Total of all Groups	532,326	1,166,151	(529,611)	(1,162,120)	2,715	4,031

[191] Complete dataset of the figures is provided in the Annexes.
[192] IMF, IFS, ESDS International, University of Manchester.
[193] The last line of the table presents the grand total values, which represents the total of averages. Averages were adopted to calculate each period figure since it can represent in a more accurate matter what happened in a certain period, avoiding the random selection of a specific year to represent a period which has the risk to be an outlier, providing distorted information.
[194] BCIMRS represents Brazil, China, India, Mexico, Russia and South Africa. Due to the fact that most investments in the developing world are concentrated in these countries located in four different continents, this study segregated them to demonstrate the concentration of investment in these few countries.

Chart 3.3.1.1. (a) – FDI Flows: distribution among groups

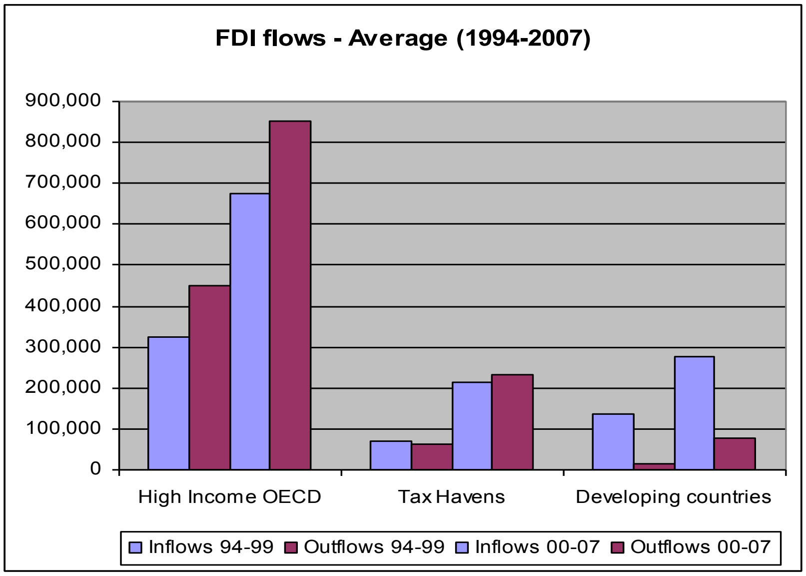
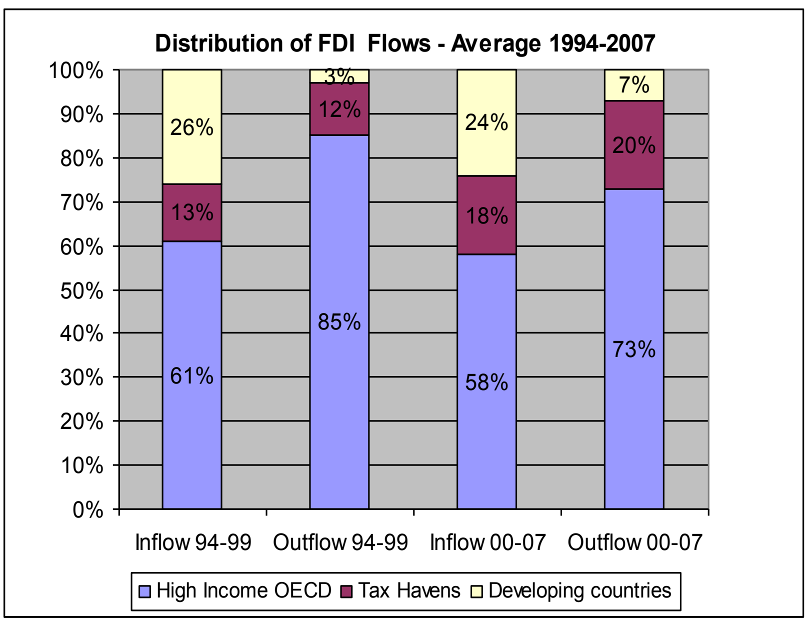


Chart 3.3.1.1. (b) – FDI Flows: percentage of each group in the total



The table above is subdivided in three items: (I.) Inflows of FDI; (II.) Outflows of FDI; and (III.) Net value of FDI (i.e. Inflows – Outflows). Data are presented by groups of countries already explained.[195] The group of developing countries is, however, divided in two, to emphasise the difference between the FDI received by large developing

[195] The list of countries included in each group is provided in footnotes 180 to 182.

economies (Brazil, China, India, Mexico, Russia and South Africa) and the other developing countries (94 economies).

The total amount of both inflows and outflows of FDI have remarkably increased from the first period (94-99) to the second one (00-07). In the first period the average of inflows and outflows were US$532,326 million and US$529,611 million per year, respectively; whereas in the second period the average increased to US$1,166,151 million and US$1,162,120 million. Developing an index that analyses the variation of total flows (inflows plus outflows of FDI) in relation to countries' GDP, we can infer that the proportion of the flows in relation to GDP is significant higher in the second period (2000-07) than in the first period (1994-99). The figures below make clear this argument:

Table 3.3.1.1. (b) – Variation of FDI Flows per GDP

Index [(Total flows)/GDP]/ [(Total flows 1994-99)/GDP 1994-99]*100	
Groups of Countries	2000-07
High Income OECD	150
Tax Havens	247
Developing countries	145
Total of all groups	160

The table above puts in evidence the overwhelming variation of flows per GDP in tax havens. The proportion of flows to GDP of the second period [2000-07] in relation to the first one [1994-99: base-year] increased by 147%, demonstrating that the rise in flows was significantly higher than the rise in GDP. Even though the other two groups [high income OECD and developing countries] also had a significant increase, the magnitude of the tax havens' figures is considerable higher. This situation might be explained by the fact that a significant number of tax havens in the sample are also OFC which macroeconomic feature refers to their financial assets and liabilities out-of-proportion to their domestic economics.

Regarding distribution of flows, what we see is a massive concentration of inflows and outflows in high income OECD countries, as represented in the charts. The net of FDI flows of this group demonstrates that outflows are higher than inflows, contributing to the argument that these countries export FDI to the other groups. Although the share of inflows received by them have not fluctuated significantly (61% to 58%); their share of outflows were reduced by more than 10% (85% to 73%). This reduction in the share of outflows of high income OECD countries was compensated by the increased participation of tax havens as exporters of FDI since they improved their share of outflows of FDI from 12% to 20% in relation to the total outflow of FDI. Therefore, one possible explanation to this situation might be the fact that high income OECD countries are exporting FDI to other countries through tax havens, as they are usually used as conduits, i.e. intermediaries.

Another interesting aspect regarding the flows of FDI in high income OECD countries is the fact that most FDI circulates only among their economies. The net balance of flows is considerably low when compared to the gross amount that flows in their economies. Therefore, their position as exporters of FDI to developing countries only represents a small fraction of the amount of FDI that circulates in their economies. Most FDI is allocated in their economies.

The group of tax havens represents the one with more significant changes since they not only increased in a substantial way their share of FDI inflows (13% to 18%) but also their share of FDI outflows (12% to 20%). The net values of FDI in tax havens are very low compared to the other groups (for instance, from 1994 to 1999 the net values compared to total inflows in high income OECD countries and developing countries were 39% and 90%, respectively; whereas in tax havens were only 7%), demonstrating a bilateral characteristic of flows received by them. The 'bilateral' characteristic of tax havens' flows might also be justified by the fact that they are working as intermediaries to the flow of FDI around the world. Another characteristic of tax havens' flows refers to the fact that their net flows became negative in the second period analysed (00-07) which implies that they inverted their tendency of importing more FDI to exporting it.

Going further on the analysis of tax havens, data demonstrated that a significant share of FDI is concentrated in Luxembourg [from 2000-07 Luxembourg received 61% of total inflows and 59% of total outflows on average]. These figures compared to the size of this country's domestic economies contribute to the argument that it might be working as conduit of FDI in Europe.

On the other hand, the inflows of FDI have slightly decreased to developing countries in percentage terms (26% to 24%) due to the reduction of share of inflows to BCIMRS. Regarding distribution of FDI, although the BCIMRS group represents only six developing countries in relation to the other group that gathers 94 developing economies, the former has received more inflows of FDI than the latter. This fact demonstrates a substantial concentration of FDI inflows in only a few economies since 1994, even though concentration has gone down during the period analysed. The outflows of FDI from developing countries are less expressive though it has increased in the last decade (from 3% to 7%). These data contribute to the argument that FDI flows in developing countries have become more bilateral. This signifies that the net balance of flows in developing countries is falling, which contributes to the argument that even though developing countries are still importing FDI, they are not exclusively importers.

What becomes clear from the analysis of FDI flows from 1994 to 2007 is that even though developing countries have maintained their position as capital importers of this type of investment, their net flow of FDI has decreased, demonstrating that they are not only importers of FDI but also exporters. Most FDI is still concentrated in high income OECD countries and the net of flows characterises them as capital exporters. However, only a reduced amount of FDI is exported to other countries when compared to the gross amount of FDI that circulates in high income OECD's economies. This signifies that most FDI circulates only in high income OECD economies, demonstrating that they do not only export FDI but also import a significant amount. The remarkable change refers to tax havens, which have significantly increased their share of FDI flows. To this extent, even excluding Switzerland and Ireland, which have considerable domestic economy, the size of the other economies classified as tax havens cannot justify the amount of FDI that flows to their jurisdictions. This situation indicates that they have been increasingly used as conduits to allocate FDI around the world. Considering this scenario, it is not possible anymore to think of the international flow of FDI based exclusively on developing countries and developed countries; it is also necessary to evaluate the position of tax havens as intermediaries of the flow, and consequently, how they have interfered with the direction of the flow.

3.3.1.2. Portfolio Investment

Following the same arrangement of data as the previous section, the table below summarises the main figures of the flows of Portfolio Investment[196] from 1994 to 2007.[197] All figures are presented in millions of US dollars. Figures provided in the table represent the average of each period. Charts are also provided to illustrate trends identified.

Table 3.3.1.2. (a) Portfolio Flows from 1994 to 2007

	I. Portfolio Inflow – average		I. Portfolio Outflow – average		III. Net of Portfolio	
Groups	**94-99**	**00-07**	**94-99**	**00-07**	**94-99**	**00-07**
High Income OECD	709,428	1,834,122	(598,567)	(1,268,129)	110,861	565,993
Tax Havens	89,118	365,523	(133,896)	(390,402)	(44,778)	(24,879)
Other developing country	22,784	36,550	(8,321)	(58,471)	14,463	(21,921)
BCIMRS	40,239	45,788	(7,339)	(27,359)	32,900	18,430
Total developing countries	63,023	82,338	(15,660)	(85,829)	47,363	(3,491)
Total of all groups	861,569	2,281,984	(748,124)	(1,744,361)	113,446	537,623

[196] Portfolio investment covers transactions in equity securities and debt securities; the latter are divided into bonds and notes, money market instruments and financial derivatives. It is different from the data of stocks that treat portfolio investment and other investments together; in the current section other investments (of which major categories are transactions in currency and deposits, loans and trade credits) are not covered.
[197] IMF, IFS, ESDS International, University of Manchester.

Chart 3.3.1.2. (a) Portfolio Flows: distribution among groups

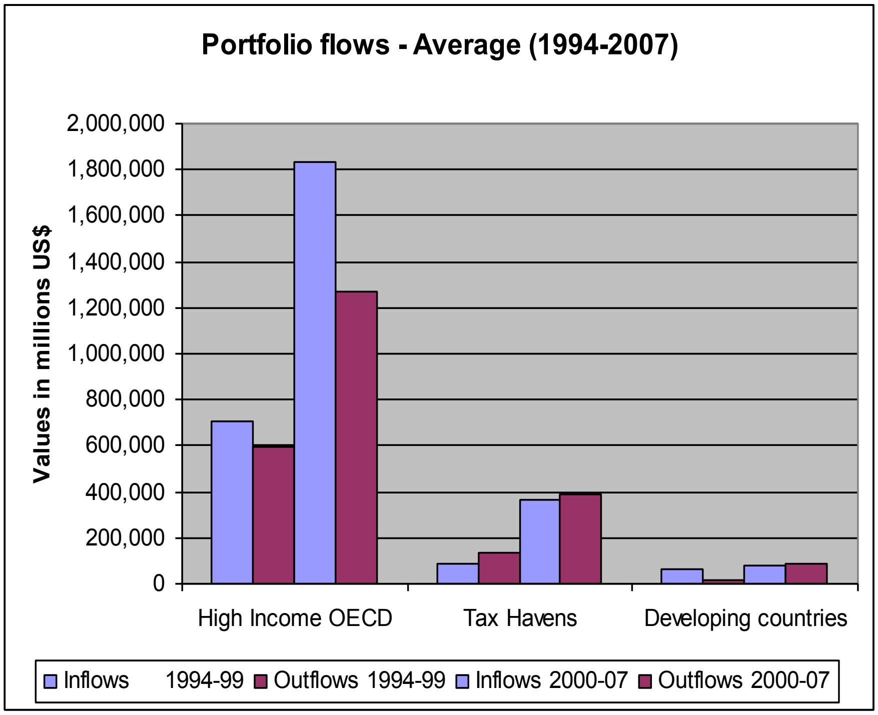
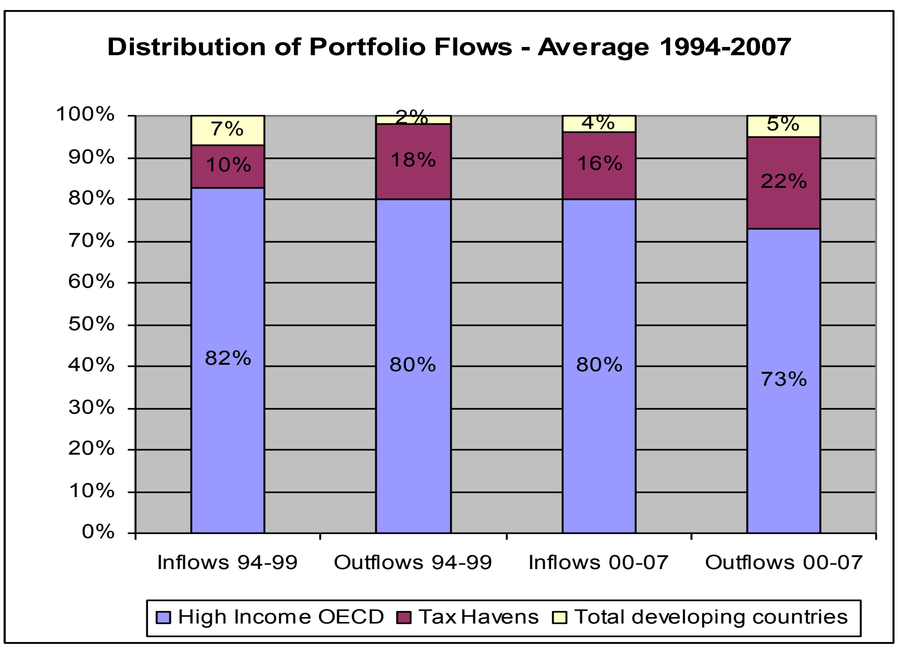


Chart 3.3.1.2. (b) Portfolio Flows: percentage of each group in the total



The table has the same structure of the table of FDI: (I.) Inflows of Portfolio Investment; (II.) Outflows of Portfolio Investment; and (III.) Net value of Portfolio Investment (i.e.

Inflows – Outflows). The total amount of both inflows and outflows of Portfolio Investment have increased remarkably from the first period (94-99) to the second one (00-07). In the first period the average of inflows and outflows were US$861,569 million and US$748,124 million, respectively; whereas in the second period the total increased to US$2,281,984 million and US$1,744,361 million. The index below allows the analysis of the variation of portfolio flows [inflows plus outflows] to GDP of the second period in relation to the first.

Table 3.3.1.2. (b) – Variation of Portfolio Flows per GDP

Index [(Total flows)/GDP]/ [(Total flows 1994-99)/GDP 1994-99]*100	
Groups of Countries	**2000-07**
High Income OECD	181
Tax Havens	250
Developing countries	133
Total of all groups	183

The outcomes demonstrate that the variation of flows to GDP significantly increased in the second period [2000-07]. It can be seen that the variation of flows was higher than the variation of GDP. Developing countries presented the lowest variation; whereas tax havens had the highest one, surpassing the average of all groups.

Focusing on the distribution, the flows of Portfolio Investment are significantly concentrated in high income OECD countries. The net of Portfolio Investment flows of this group has a positive value [inflows higher than outflows] in both periods, contradicting the traditional argument that classifies these countries as capital exporters. While the share of inflows received by them has not fluctuated significantly (82% to 80%); their share of outflows was reduced (80% to 73%). This reduction in the outflows of high income OECD countries was compensated by the increased participation of tax havens as exporters of Portfolio Investment since they improved their outflows from 18% to 22% in relation to the total outflow of Portfolio Investment. The charts clearly demonstrate these trends.

Developing countries are at the margin of these flows of investment. They have not only the lowest position in the inflows and outflows but also the flows are concentrated in the BCIMRS countries. These six countries have received more portfolio investment on average during the periods analysed than the other 94 developing economies. Moreover, developing countries have moved from a positive low net position to a negative low net position. However, due to their marginal position, it is very hard to make any consistent inference about their net values based only on flows. The analysis of stocks will provide a better overview of Portfolio Investment in developing countries.

Tax havens have significantly participated in the international flows of Portfolio Investment. During the first period [1994-99], tax havens inflows and outflows were US$89,118 million and US$133,896 million, whereas during the second period [2000-07], their inflows and outflows reached the averages of US$365,523 million and US$390,402 million, respectively. Their share of the flows as illustrated in the charts as well as the variation of flows to GDP put in evidence the relevance of their position on the international flow of Portfolio Investment. Even though any inference from net values is more consistent when based on stocks, it is worth noting the fact that their net flow values have the opposite direction of the net values of the total net flows. In other words, whereas inflows surpass outflows in the total net value; the net value of tax havens demonstrates that outflows were significantly higher than inflows. One question arises here: whether they are used only as conduits, net values would have to be residual. Therefore, the fact that official figures indicate higher outflows than inflows is suggestive that there might another explanation for those figures.

Portfolio Investment flows have shown tendencies that do not sustain the basic assumption of North/South flows, which characterises developing countries as capital importers and developed countries as capital exporters. As in the FDI flows, Portfolio Investments are very concentrated in high income OECD countries. However, Portfolio Investments have a different behaviour since all groups' total inflows significantly surpass outflows (last line of Table 3.3.1.2.(a)). Developing countries have not increased their participation in this type of investment flows, whereas tax havens have done that.

The gap between inflows and outflows has increased over time as well as the participation of tax havens, indicating that there might be a connection between these facts, which will be explored later.

In the next section, the stocks of foreign assets and liabilities held by developing countries, high income OECD countries and tax havens are examined in order to investigate whether the tendencies identified in the flows are confirmed by the stocks held by these countries since stocks represent, in a simplified manner, the accumulated flows over time. To this extent, it is also possible to make some inferences about the flows from movements in stocks.

3.3.2. Stocks of foreign assets and liabilities[198] from 1970 to 2004[199]

3.3.2.1. International Investment Position

The International Investment Position (IIP) of an economy is obtained by subtracting the external stocks of financial assets from the stocks of external liabilities. It represents the developments and trends in the performance of an economy vis-à-vis the rest of the world since it reflects what a country owns in relation to what it owes to other nations.[200] In this regard, the three tables presented next summarise the data requested to estimate the net position of high income OECD countries, tax havens and developing countries: the first table (A. Assets) provides the total stock of assets composed of FDI, Portfolio Equity, Portfolio Debt plus Other Investments, Financial Derivative and Total Reserve minus Gold Assets; the second table (B. Liabilities) introduces the stock of liabilities composed of the same types of investment as in the Assets table, except the Total Reserve minus Gold stock; and the third table (C.Net) presents the IIP, i.e. the net values calculated from the subtraction of the second table from the first table.

[198] As previously discussed, Lane and Milesi-Ferretti's dataset is used in this section since the IIP data from BOP is considerably incomplete until 2002, particularly data from developing countries. The missing data would compromise the outcomes of the analysis.
[199] Complete dataset of the figures is provided in the Annexes.
[200] IMF, 'BOPS Manual' (n 152) 106.

In the following discussion, measures of both assets and liabilities are described as stocks to emphasise that they represent total accumulated values and not current flows of capital.

The objective of this section is to complement the outcomes identified in the analysis of the flows. The present section will investigate how the IIP of each group of countries has evolved since 1970, i.e. the net position of countries represented by the difference between liability stocks and asset stocks. The results will contribute to the identification of new premises to reconsider international taxation from the perspective of these three groups of countries. All figures are presented in millions of US dollars and they represent the average of each period (i.e. each decade):

Table 3.3.2.1. (a) Total Assets of groups, per decade, from 1970 to 2004

A.1. Total Assets					
Groups	**70s**	**80s**	**90s**	**2000s**	**Growth from 1970 to 2000**
High Income OECD	1,088,225	4,632,650	15,451,703	31,642,399	29.1
Tax Haven	118,319	624,688	2,223,256	6,706,138	56.7
Developing countries	171,889	726,647	1,741,163	3,690,699	21.5
Total of all groups	1,378,432	5,983,985	19,416,122	42,039,235	30.5

Table 3.3.2.1. (b) Total Liabilities of groups, per decade, from 1970 to 2004

B.1. Total Liabilities					
Groups	**70s**	**80s**	**90s**	**2000s**	**Growth from 1970 to 2000**
High Income OECD	1,046,603	4,723,158	16,097,829	33,523,724	32.0
Tax Haven	81,368	486,123	1,775,513	5,898,437	72.5
Developing countries	277,265	1,080,963	2,706,776	4,639,989	16.7
Total of all groups	1,405,236	6,290,244	20,580,118	44,062,150	31.4

Table 3.3.2.1. (c) Net values of groups, per decade, from 1970 to 2004

C.1. IIP = Net value, i.e. Net = Liabilities (B.) - Assets (A.)				
Groups	**70s**	**80s**	**90s**	**2000s**
High Income OECD	(41,622)	90,508	646,126	1,881,326
Tax Haven	(36,951)	(138,565)	(447,743)	(807,702)
Developing countries	105,377	354,316	965,613	949,290
Total of all groups	26,804	306,259	1,163,995	2,022,915

An overview of the tables above allows the extraction of three different types of information about the stock of assets and liabilities that will define the IIP of those groups of countries: (i) the volume of stock of assets and liabilities; (ii) the distribution of those stocks; and (iii) the net value between assets and liabilities.

Analysing the volume of assets and liabilities showed in tables A and B, the outstanding trend identified is the increased growth of the amount of assets and liabilities. In the 70s, the averages of total assets and liabilities were US$1,378,432 million and US$1,405,236 million, achieving in the 2000s the averages of US$42,039,235 million and US$44,062,150 million, respectively. These figures suggest an incredible rate of growth.[201]

Regarding the distribution of stocks among those groups of countries, stocks are considerably concentrated in high income OECD countries. Developing countries received only a marginal value of the total amount of stocks that circulate among high income OECD countries. For instance, in percentage terms, i.e. comparing the averages of assets and liabilities held by developing countries from the 70s to 2000s to the averages of the total assets and liabilities, what is verified is a reduction in the participation of developing countries (in the 70s they held the average of 12% of total assets and 20% of total liabilities; in the 2000s, these percentages decreased to 9% and 11%, respectively). On the other hand, tax havens increased their participation on the

[201] It is important to note that part of the growth of financial assets and liabilities might be justified by the inflation rate of the period.

trade of financial assets and liabilities, since in the 70s they held the average of 9% of total assets and 6% of total liabilities; in the 2000s, these percentages reached the values of 16% and 13%, respectively. It is worth noting, therefore, that the stocks held by them confirm the increased participation of tax havens in the flows of investments, as examined in the previous section.

The last column of tables 3.3.2.1. (a) and (b) shows the growth of assets and liabilities from 1970s to 2000s. The growth of assets and liabilities held by tax havens is overwhelming, surpassing the growth of the other two groups. Another relevant aspect refers to the comparison between the rate of growth of assets and liabilities for high income OECD countries and developing ones. For high income OECD countries, the growth of liabilities surpassed the growth of assets; whereas for developing countries the opposite situation is verified, i.e. growth of assets has beaten the growth of liabilities. In a sense, this situation illustrates the fact that even though developing countries still sustain a debt position, which represents their past as debtors of the world, recently they have exported more capital than imported it, reversing the old trend of the past. In high income OECD countries, on the other hand, besides changing their position from creditors of the world to debtors, the rate of growth of liabilities has beaten the rate of growth of assets, which signifies that their position as debtors is in line with the current trend of inflows surpassing outflows. The tables below demonstrate this situation through the annual rate of change in stocks:

Table 3.3.2.1. (d) Annual rate of change in Asset and Liability Stocks

Annual rate of change of Assets			
Groups	**1975 to1985**	**1985 to 1995**	**1995 to 2004**
High Income OECD	0.16	0.13	0.07
Tax Haven	0.18	0.14	0.12
Developing countries	0.16	0.09	0.08
Total of all groups	0.16	0.12	0.08

Annual rate of change of Liabilities			
Groups	**1975 to1985**	**1985 to 1995**	**1995 to 2004**
High Income OECD	0.16	0.13	0.08
Tax Haven	0.20	0.14	0.13
Developing countries	0.15	0.10	0.06
Total of all groups	0.16	0.13	0.08

The net values described in table 3.3.2.1. (c) are in fact the IIP of those groups of countries. The net values reflect the difference between the stock of liabilities and the stock of assets. This analysis opted for presenting the difference between those values as positive when liabilities are higher than assets and as negative when assets are higher than liabilities.[202] The label net creditor and net debtor have been used by different authors to describe the net position of countries, according to algebraic sign. In the present analysis, positive values are associated with debt position, whereas negative values represent credit position. In this regard, the net figures suggest that tax havens represent the only group in which the stocks of assets are higher than the stocks of liabilities. This signifies that this group is financing other economies around the world, which can be high income OECD countries as well as developing countries since in these other groups the stocks of liabilities are superior to the stocks of assets. This outcome regarding tax havens is very intriguing since they are used mainly as conduits, which means that their net stocks ought to show a balanced position and not a creditor one. An interesting aspect in high income OECD group is the inversion in their position in the 1980s. This is probably due by the fact that in 1985 the US became a net debtor.[203]

[202] The reason for that is based on the argument that the stock of liabilities are composed of the inflow of capital derived in part from the net purchases or sales of domestic assets by non-residents, whereas the stock of assets are determined in part by the outflow of capital resulted from the net purchases or sales of foreign assets by residents. In other words, liabilities less assets represent the net investment in the country by non-residents.

[203] Sinn (n 169) 27.

Besides examining the algebraic sign of countries' stocks to identify their creditor or debtor position, inferences about countries' position can also be made by analysing the variation of stocks from time to time. The focus on this aspect allows us to capture subtle changes in countries' positions that cannot completely reverse their position, but, on the other hand, can indicate in the long-term a new tendency in countries' behaviour as capital importers or capital exporters. From this angle, developing countries' net position showed lower stocks in the 2000s (US$949,290 million) than in the 1990s (US$965,313 million). This fact can be interpreted as these countries changing their position from capital importers to capital exporters. The other two groups' variations of stocks follow the same direction of their position as net creditors or debtors, not revealing any new tendency, besides confirming what the algebraic signs have demonstrated: high income OECD countries as debtors and tax havens as creditors.

Table 3.3.2.1. (c) also put in evidence the increased value of the discrepancy (net values) over the period analysed. In the 70s the gap between stocks of assets and liabilities was US$26,804 million (2% of the total stocks of assets and liabilities). In the last decade analysed, the gap reached the figure of US$2,022,915 million (5% of the total stocks of assets and liabilities).

In addition, it is also necessary to recognise that the discrepancy represents the error in total stocks, which might be explained by badly reported data. However, analysing each group's net position we can infer how much each group contributes to this Error and if the discrepancy could be explained by other problems affecting the data, not only the general excuse of badly reported data. Of course that badly reported data is responsible for some part of the Total Error, but examining the net position of each group we might be able to provide some extra explanation about the discrepancy that has considerably increased in the recent past. To this extent, the behaviour of tax havens' stocks requires attention, since they better reported assets than liabilities, while developing countries and high income OECD have better reported liabilities. This evidence regarding tax havens' stocks contradicts with the traditional assumption that they work as mere conduits of the international flow of capital.

Another way to analyse the IIP of those groups of countries is comparing the data provided in the previous tables of this section with the GDP of these groups. This assessment will provide further evidence of the importance of the international trade of financial assets and liabilities to each group of countries. The next tables show, in percentage terms, the relationship between average of stocks (Assets and Liabilities) and average of the GDP of each group, in each decade.

Table 3.3.2.1. (e) Total Assets of groups from 1970 to 2004

A.2. Average of Total Assets/Average of GDP				
Groups	70s	80s	90s	2000s
High Income OECD	26%	45%	73%	119%
Tax Havens	127%	255%	371%	852%
Developing countries	9%	19%	33%	52%
B.2. Average of Total Liabilities/Average of GDP				
Groups	70s	80s	90s	2000s
High Income OECD	25%	46%	77%	126%
Tax Havens	88%	199%	296%	749%
Developing countries	15%	29%	51%	65%
C.2. Average of Discrepancy/Average of GDP				
Groups	70s	80s	90s	2000s
High Income OECD	1%	1%	3%	7%
Tax Havens	40%	57%	75%	103%
Developing countries	6%	9%	18%	13%

The figures show a remarkable increase on the volume of financial assets and liabilities traded in the world in relation to GDP. Developing countries' stocks have not surpassed the value of GDP, whereas stocks of assets and liabilities of high income OECD countries and tax havens have done so. This fact demonstrated that high income OECD countries and tax havens have shown a higher financial integration than developing countries.[204]

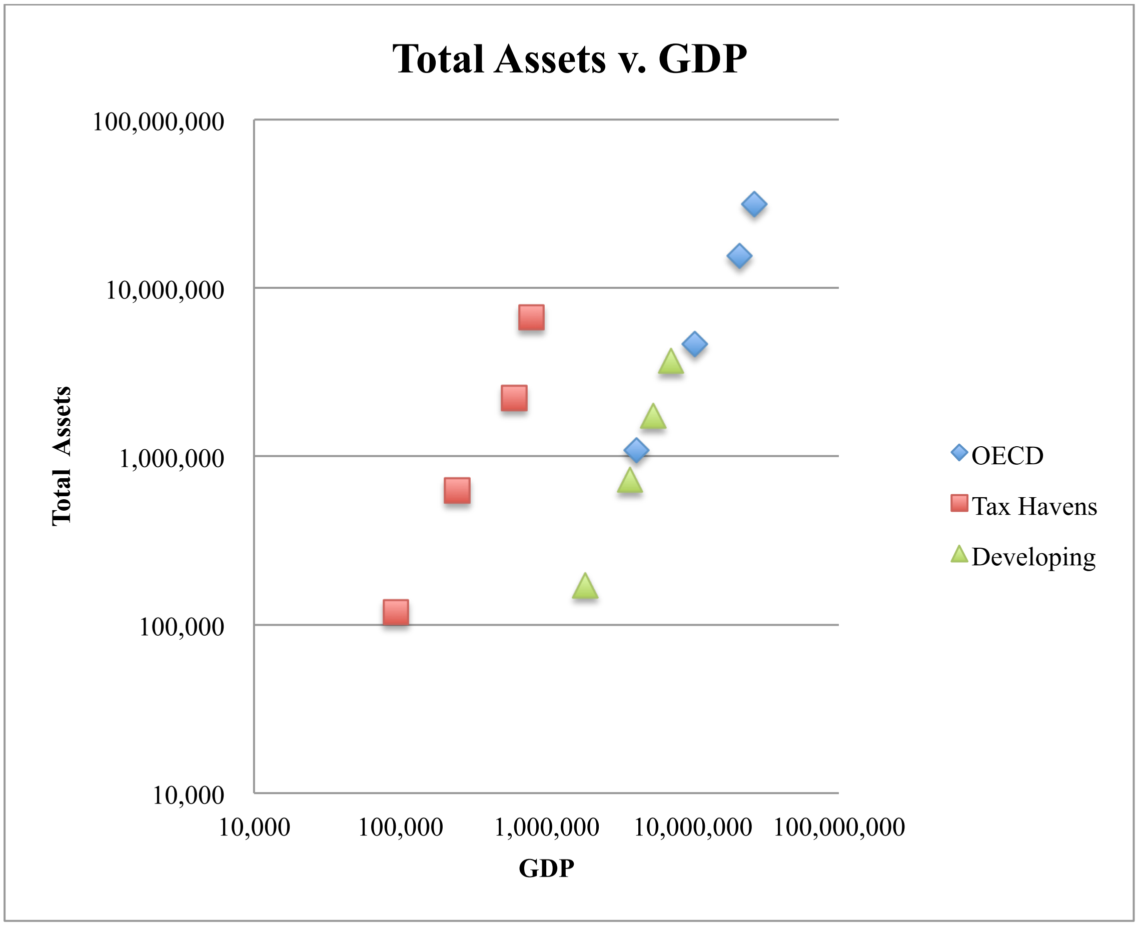
In order to make it easier to grasp the information provided in the previous table, the graphic below illustrates the variation of Assets Stocks per GDP in logarithmic scale[205],

[204] Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 234-35.

[205] The adoption of logarithmic scale for this graph is very useful since data cover a large range of values.

demonstrating that the growth of assets in relation to the growth of GDP was significantly higher in tax havens than in developing countries:

Chart 3.3.2.1. Growth of Total Assets v. Growth of GDP



Each spot represents the relationship between average of GDP and of stocks of assets held by each group of countries in four different periods: 70s, 80s, 90s and 2000s. That is the reason that there are four spots for each group of countries. Lower spots are associated with earlier periods; whereas higher spots reflect current periods. Examining the outcomes what we see is that until the 1980s, developing countries had higher stocks of assets than tax havens. In the 1990s, tax havens' stocks surpassed developing countries, increasing the margin of difference in the 2000s, despite the fact that the difference between their levels of GDP remained substantial. Comparing developing countries to high income OECD countries, what the graph highlights is the difference in magnitude between their figures, even though a logarithmic scale is adopted, which tends to reduce the values to a more manageable range to plot them into the graph. Furthermore, the graph also shows that assets growth was faster during the 70s and 80s.

Finally, an important consideration in relation to tax havens group needs to be addressed. The analysis of total assets and liabilities identified a discrepancy, which grand total in the 2000s (US$2,022,915 million) reflected the impact of tax havens' net asset position (US$807,702 million). If tax havens were not included in the grand total, the discrepancy would be significantly higher. On the other hand, the data used to analyse stocks had only 14 tax havens, out of a list of almost 50 countries. Following this line of reasoning, if more data on tax havens were available, it is reasonable to infer that the discrepancy would be lower.

From a tax perspective, the net values of stocks indicate the long-term interest of a country in the international flow of capital. However, as there are different methods of taxation depending on the financial asset involved, it is necessary to understand how the discrepancy is composed, i.e. how each type of asset (liability) is impacting on the net value. Thus, in the next sections, the stocks of FDI and Portfolio Investments will be examined in detail.

3.3.2.2. Stocks of FDI[206]

The graphs and tables below summarise the main figures of the stocks of FDI[207] in high income OECD countries, tax havens and developing countries (which are subdivided in BCIMRS and other developing countries).[208] All figures are presented in millions of US dollars and they represent the average of each period (i.e. each decade).

[206] Complete dataset of the figures is provided in the Data Appendix.

[207] According to Lane and Milesi-Ferretti's classification, FDI category includes controlling stakes in acquired foreign firms (at least 10% of an entity's equity), as well as greenfield investment. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 227.

[208] BCIMRS expression corresponds to Brazil, China, India, Mexico, Russia and South Africa; whereas other developing countries group is composed of 103 countries, as explained at the beginning of the chapter.

Chart 3.3.2.2. (a) Stocks of FDI Assets and Liabilities 1970-2004

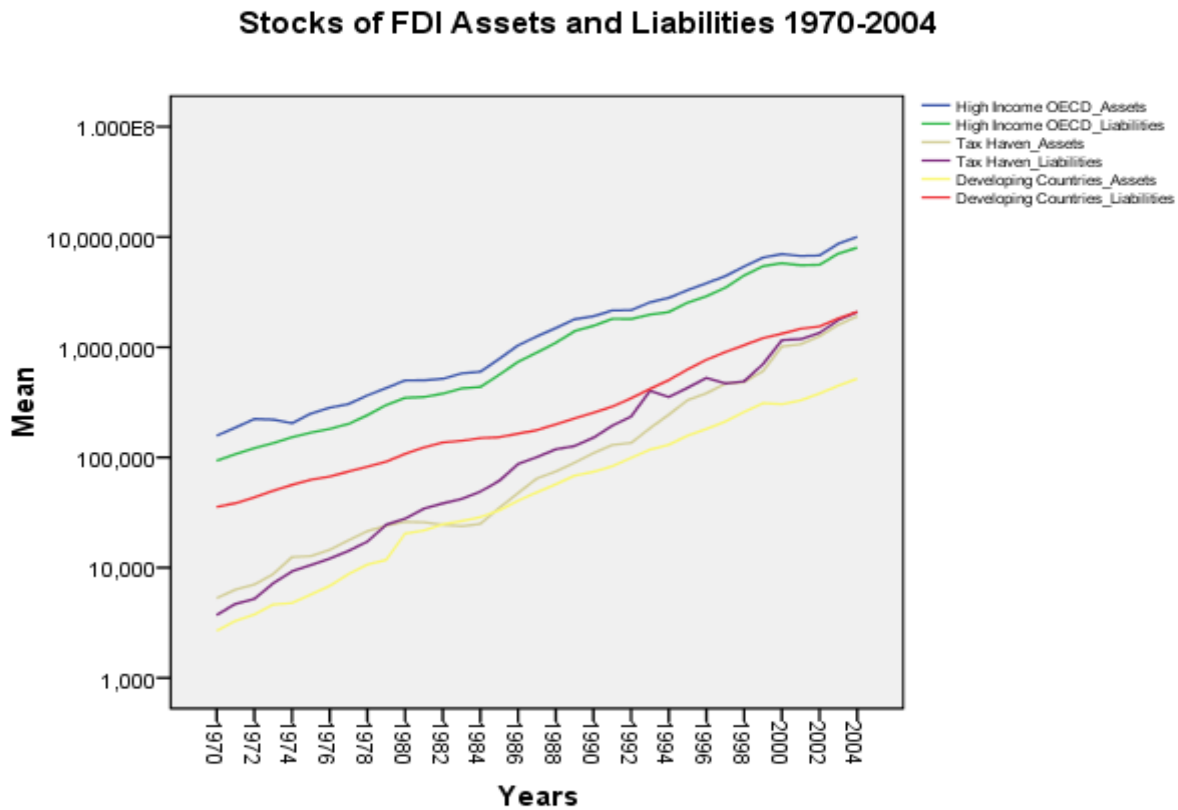


Chart 3.3.2.2. (b) Evolution of Net FDI Stocks 1970-2004

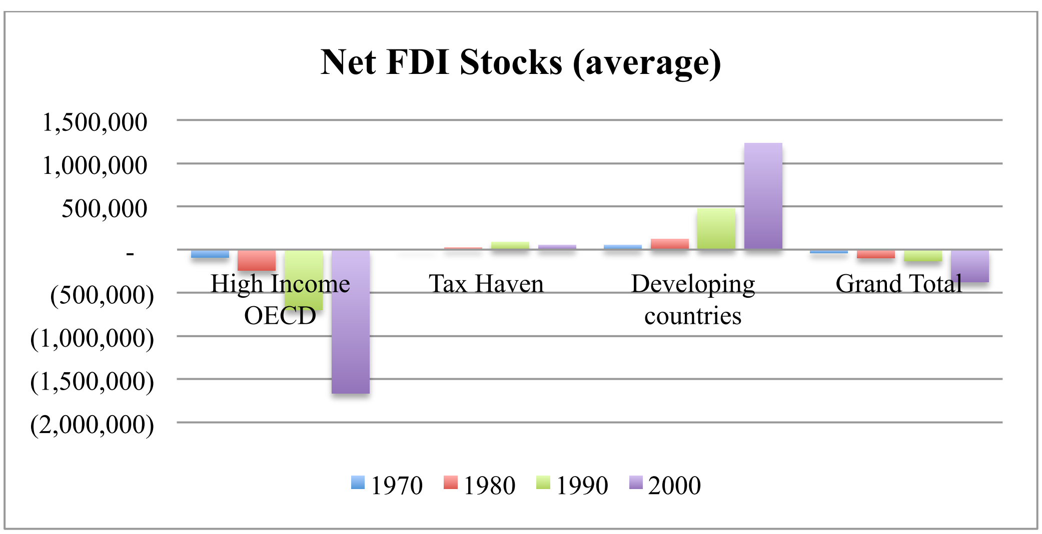


Table 3.3.2.2. (a) Stocks of FDI Assets

A. Stocks of FDI Assets (Average)				
Groups	**70s**	**80s**	**90s**	**2000s**
High Income OECD	262,412	906,625	3,501,960	8,057,203
Tax Haven	13,047	43,664	307,407	1,455,494
BCIMRS	3,810	19,224	80,808	213,265
Other developing countries	2,485	17,759	81,813	206,009
Total developing countries	6,294	36,983	162,621	419,275
Total of all groups	281,754	987,271	3,971,987	9,931,972

Table 3.3.2.2. (b) Stocks of FDI Liabilities

B. Stocks of FDI Liabilities (Average)				
Groups	**70s**	**80s**	**90s**	**2000s**
High Income OECD	170,173	663,470	2,805,722	6,393,567
Tax Haven	10,886	68,720	395,663	1,508,796
BCIMRS	22,164	52,956	275,097	830,740
Other developing countries	38,115	105,041	361,994	821,706
Total developing countries	60,278	157,997	637,091	1,652,446
Total of all groups	241,338	890,187	3,838,476	9,554,809

Table 3.3.2.2. (c) Net of FDI stocks

C. Net of FDI Stocks (Average)				
Groups	**70s**	**80s**	**90s**	**2000s**
High Income OECD	(92,239)	(243,155)	(696,237)	(1,663,636)
Tax Haven	(2,161)	25,056	88,256	53,302
BCIMRS	18,354	33,732	194,289	617,475
Other developing countries	35,630	87,282	280,181	615,697
Total developing countries	53,984	121,014	474,470	1,233,172
Total of all groups	(40,416)	(97,085)	(133,511)	(377,162)

The tables present figures of stocks of FDI: (A.) Assets; (B.) Liabilities; and (C.) Net Values. Graphs illustrate the meaning of the figures, putting in evidence the trends identified. At first glance, the data prove a remarkable increase in the total amount of FDI assets (from an average of US$281,754 million in the 70s to US$9,931,972 million in the 2000s) and liabilities (from an average of US$241,338 million in the 70s to US$9,554,809 million in the 2000s), even though the concentration in high income OECD countries was largely maintained over the periods analysed.

Examining the evolution of the groups, high income OECD countries concentrate most stocks of FDI Assets and Liabilities since 1970, though there was a light decrease in percentage terms (i.e. in the 70s their stocks of assets and liabilities represented on average 93% and 71%; while in the 2000s the percentages were 81% and 67%), which was in fact compensated by the significant increase of tax havens' position as holders of FDI assets and liabilities. The net values of FDI stocks held by high income OECD countries are negative since their stocks of assets are higher than liabilities over the entire period analysed. The magnitude of their net values are higher than the net values of the other groups, determining the grand total net values since 1970 as negative figures, which characterise them as capital exporters of FDI.

Tax havens represent the group that had more significant changes. These countries increased their stocks of both assets and liabilities not only in absolute figures (i.e. in the 70s their stocks of assets and liabilities were on average US$13,047 million and US$10,886 million; while in the 2000s US$1,455,494 million and US$1,508,796 million) but also in percentage terms, regarding the total stocks held by the other countries analysed in the sample (i.e. in the 70s their stocks of assets and liabilities represented on average 5%; while in the 2000s the percentages were 15% and 16%, respectively). In comparison to developing countries, tax havens have held higher stocks of assets; whereas stocks of liabilities have been higher in the developing countries even though the difference was reduced over time (Chart 3.3.2.2. (a) illustrates this point by showing the convergence between the lines that represent stocks of liabilities over time of these two groups). One interesting aspect that comes out from their net figures is the reduction between the last two periods (US$88,256 million in the 90s and US$53,302 million in the 2000s), which allow us to infer that they might be exporting some FDI in the last period. Tax havens play an important role in the structure of multinational corporations and, therefore, their position as exporters of FDI could also be explained by their participation in transactions of merger and acquisition, for instance.[209] Moreover, this situation is coherent with the behaviour of flows identified before.

Developing countries have maintained their position on FDI Assets (4% on average of the total stocks of FDI), but decreased their stocks of FDI liabilities, in relation to the total amount of stocks held by the other groups (i.e. in the 70s they had on average 25% of the stocks of FDI liabilities which in the 2000s decreased to 17%). The analysis segregated the position of 6 countries (Brazil, China, India, Mexico, Russia and South Africa) from the rest of the group of developing countries to demonstrate how highly concentrated the stocks of FDI are in these countries in comparison to the other 103 developing economies classified as 'other developing countries'. The net position of developing countries has a positive value in all periods analysed (Liabilities>Assets), showing that these countries have received more FDI from abroad than they have invested in other economies. Therefore, regarding FDI, developing countries are still capital importers.

The graphs facilitate the comprehension of data provided by tables. They draw attention to the concentration of FDI stocks in high income OECD countries and the increased importance of tax havens in the international trade of FDI assets and liabilities. The net values are also easily grasped by the distance between the lines of assets and liabilities for each group, which adopted a logarithmic scale due to the large range of values covered. Regarding this aspect, whereas the distance between the lines representing stocks of Assets and Liabilities of high income OECD countries and tax havens is very narrow; the distance between developing countries' lines is quite great, demonstrating the different level of stocks held by them. The last graph highlights the fact that the net negative values reflect the impact of high income OECD countries' net stocks.

The net values of stocks of FDI challenge the general trend described by Lane and Milesi-Ferretti in which liabilities tend to be better reported than assets. Thus, stocks of

[209] P. R. Lane and G. R. Milesi-Ferretti, 'Cross-Border Investment in Small International Financial Centers' (2010) IMF Working Paper WP/10/38 1, 5

FDI cannot explain the discrepancy identified in the sum of total assets and liabilities. In fact, the net negative value of FDI stocks decreases the discrepancy. Other types of investment might justify the discrepancy. Furthermore, the net values of FDI seem to be really residual in comparison with the stocks of assets and liabilities held by each group of countries. In absolute terms, the values representing the total of all groups (last line of table 3.3.2.2. (c)) are smaller than most net figures. Thus, these net values appear more reliable than net values from Portfolio Investment, as discussed next.

3.3.2.3. Stocks of Portfolio Equity[210]

The graphs and tables present the main figures of stocks of Portfolio Equity[211] held by high income OECD countries, tax havens and developing countries (which are subdivided in BCIMRS and other developing countries). All figures are presented in millions of US dollars and they represent the average of each period (i.e. each decade).

[210] Complete dataset of the figures is provided in the Annexes.

[211] According to Lane and Milesi-Ferretti's classification, portfolio equity holdings measure ownership of shares of companies and mutual funds below the 10% threshold that distinguishes portfolio from direct investment. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 226.

Chart 3.3.2.3. (a) Stocks of PI Equity Assets and Liabilities 1970-2004

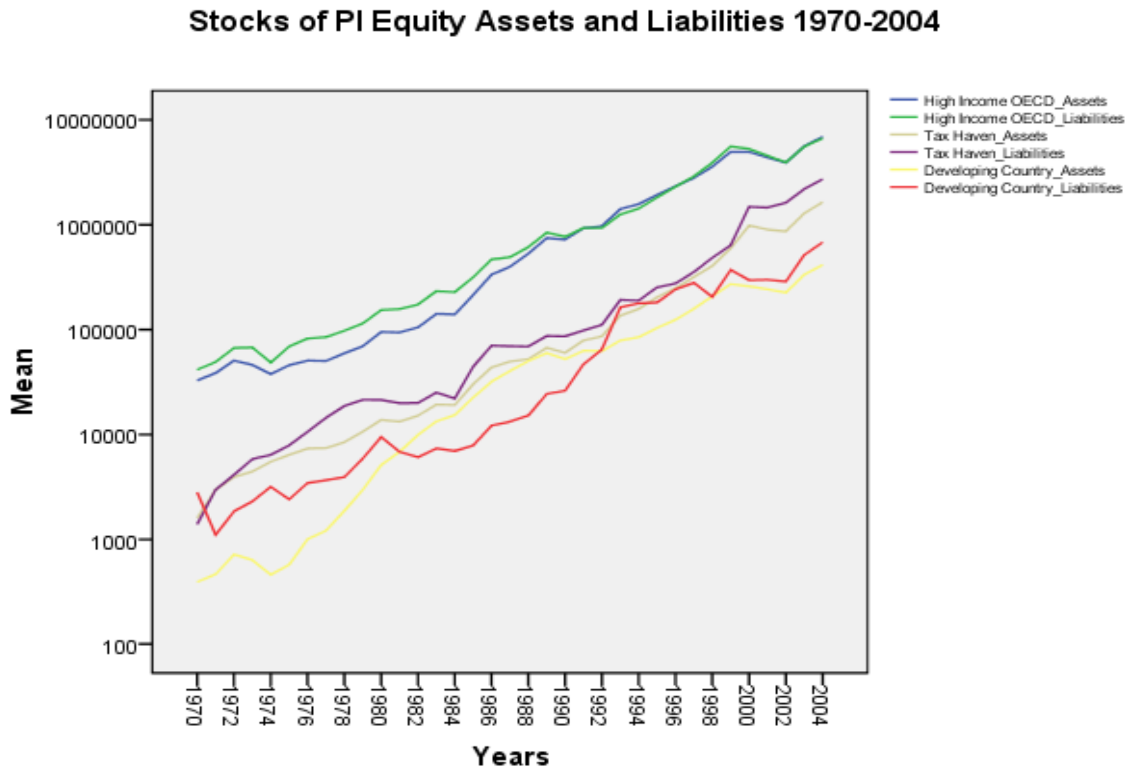


Chart 3.3.2.3. (b) Evolution of Net PI Equity Stocks 1970-2004

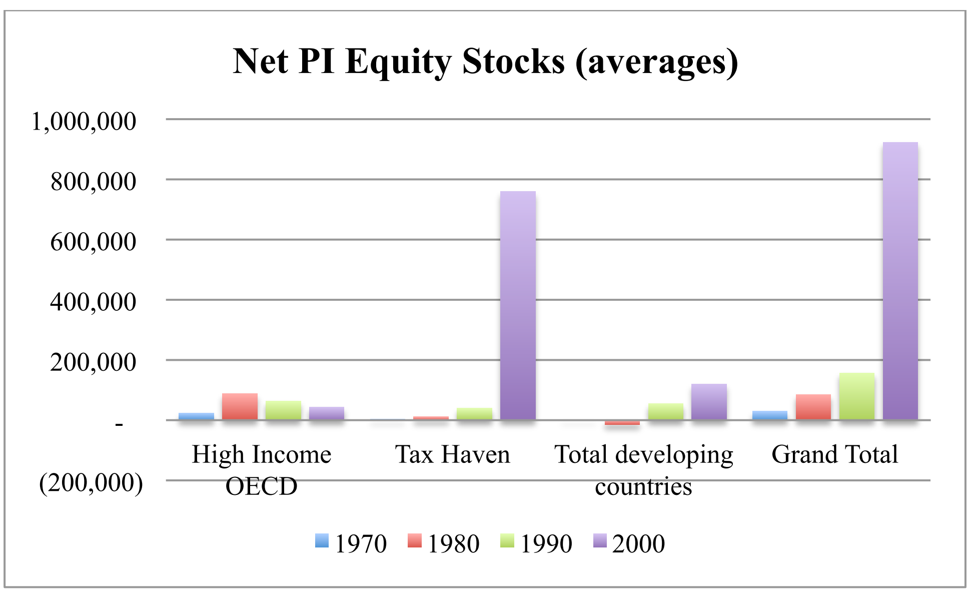


Table 3.3.2.3. (a) Stocks of PI Equity Assets

A. Stocks of PI Equity Assets (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	48,191	279,973	2,119,015	5,154,649
Tax Haven	5,885	32,396	229,101	1,136,001
BCIMRS	485	2,107	14,955	59,314
Other developing countries	547	23,453	105,950	236,034
Total developing countries	1,031	25,560	120,904	295,349
Total of all groups	55,107	337,929	2,469,020	6,585,998

Table 3.3.2.3. (b) Stocks of PI Equity Liabilities

B. Stocks of PI Equity Liabilities (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	72,297	367,718	2,181,746	5,198,079
Tax Haven	9,396	44,944	268,487	1,895,412
BCIMRS	2,737	5,876	88,322	239,754
Other developing countries	329	5,092	87,779	176,217
Total developing countries	3,066	10,968	176,101	415,971
Total of all groups	84,759	423,630	2,626,334	7,509,462

Table 3.3.2.3. (c) Net of PI Equity Stocks

C. Net of PI Equity Stocks (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	24,105	87,745	62,732	43,430
Tax Haven	3,511	12,548	39,386	759,412
BCIMRS	2,252	3,769	73,367	180,440
Other developing countries	(218)	(18,361)	(18,171)	(59,817)
Total developing countries	2,035	(14,592)	55,197	120,622
Total of all groups	29,651	85,701	157,314	923,464

The tables follow the same pattern introduced in the previous section, i.e. they present three types of information about the stock of portfolio equity: Assets (A.); Liabilities (B.) and Net values (C.). The graphs illustrate the trends identified.

At first glance, the data show an overwhelming increase in both stocks of assets (from an average of US$55,107 million in the 1970s to US$6,585,998 million in the 2000s) and liabilities (from an average of US$84,759 million in the 1970s to US$7,509,462 million in the 2000s). Its distribution is still concentrated in high income OECD countries, even though there was a light decrease in their figures when compared to the total amount of stocks held by the other groups (i.e. in the 70s their stocks of assets and liabilities represented on average 87% and 85% of total stocks; while in the 2000s the percentages were reduced to 78% and 69%, respectively). Tax havens have significantly raised their asset and liability positions (from 11% in the 70s to 17% and 25%, respectively, in the 2000s); whereas developing countries remained at the margin of this type of investment (i.e. in the 70s their stocks of assets and liabilities represented an average of only 2% and 4% of total stocks; while in the 2000s the percentages evenly increased to 4% and 6%, respectively). Thus, both asset and liability positions of developing countries are insignificant when compared to the total amount of portfolio equity available in the international market. There might be some major constraints (e.g. absence of capital market structure) that prevent this type of investment in developing countries.

The total net values of portfolio equity stocks have gradually increased until the end of the 1990s, as shown in the last line of table 3.3.2.3. (c). In the 2000s (last column), however, there was a significant increase due to the net position of tax havens. In fact, the net position of tax havens increased 216 times during the period analysed, putting in evidence their tendency as capital importers of Portfolio Equity. In this sense, tax havens' net position might be justified by their use as domicile of collective investment schemes (mutual funds, hedge funds) and multinational corporations which claims are held by foreign investors.[212] This trend is similar to the one identified in FDI stocks, which signifies that tax havens adopted a position of capital importers of equity.

[212] Lane and Milesi-Ferretti, 'Cross-Border Investment in Small International Financial Centers' (n 209), 5.

The net values of high income OECD countries decreased between the last two periods, which signifies that although these countries have imported Portfolio Equity for a long period, recently their position was inverted. On the other hand, developing countries' net values increased significantly (59 times), though at a lower degree than the average reached by tax havens. The increased net position of developing countries can be explained by the difference between assets and liabilities held by BCIMRS since in the other developing countries the values of assets are higher than the values of liabilities. It is very hard to predict the meaning of the net values of Portfolio Equity held by other developing countries since, as already mentioned, the absence of inflows (i.e. liabilities in terms of stocks) might be explained by the absence of a developed capital market.

Regarding the charts, the first one shows the evolution of the stocks of assets and liabilities as well as the proportion of net values of Portfolio Equity by demonstrating the distance between the two lines that represent stocks of assets and liabilities for each group. In high income OECD countries the two lines are almost completely overlaid; whereas in the two other groups the lines are separated and the liability lines are higher than the asset lines. The second graph highlights the impact of tax havens' net position on total stocks.

In sum, the evolution of Portfolio Equity stocks demonstrated that these stocks are highly concentrated in high income OECD countries. However, tax havens have considerably increased their position as holders of Portfolio Equity assets and liabilities over the period analysed. Developing countries, on the contrary, are still at the margin of this type of investment. Another interesting characteristic highlighted by the analysis is the diversified net position of stocks in each group of countries: high income OECD countries changed their position from capital importers to capital exporters due to the reduction of the net value of stocks; the subgroups of developing countries have opposite characteristics since whereas BCIMRS group is importing Portfolio Equity, the others are exporting it. At last, regarding the discrepancy, the net figures have a positive trend since liabilities are higher than assets. What is intriguing is that even though the IIP of tax havens is negative, showing the fact that their stocks of assets are higher than liabilities, in relation to equity (both FDI and Portfolio Equity), tax havens have held the opposite position (i.e. stocks of liabilities are higher than stocks of assets), which implies that they are importing equity.

From a tax perspective, the diversification of countries' position as capital importers and capital exporters of Portfolio Equity makes the justification of taxation based on the association of these economic characteristics with the principles of source and residence taxation more difficult. In fact, Portfolio Equity figures challenge the traditional assumption of North/South flows. Stocks are still concentrated in high income OECD countries showing that for this type of investment the North/North flows are what really prevail. In relation to developing countries, besides the positive net stock position of BCIMRS (Liabilities>Assets), 'other developing' countries assumed a net negative position (Liabilities<Assets). The limited amount of Portfolio Equity that circulates into developing countries' economies should also be regarded when evaluating their tax policies.

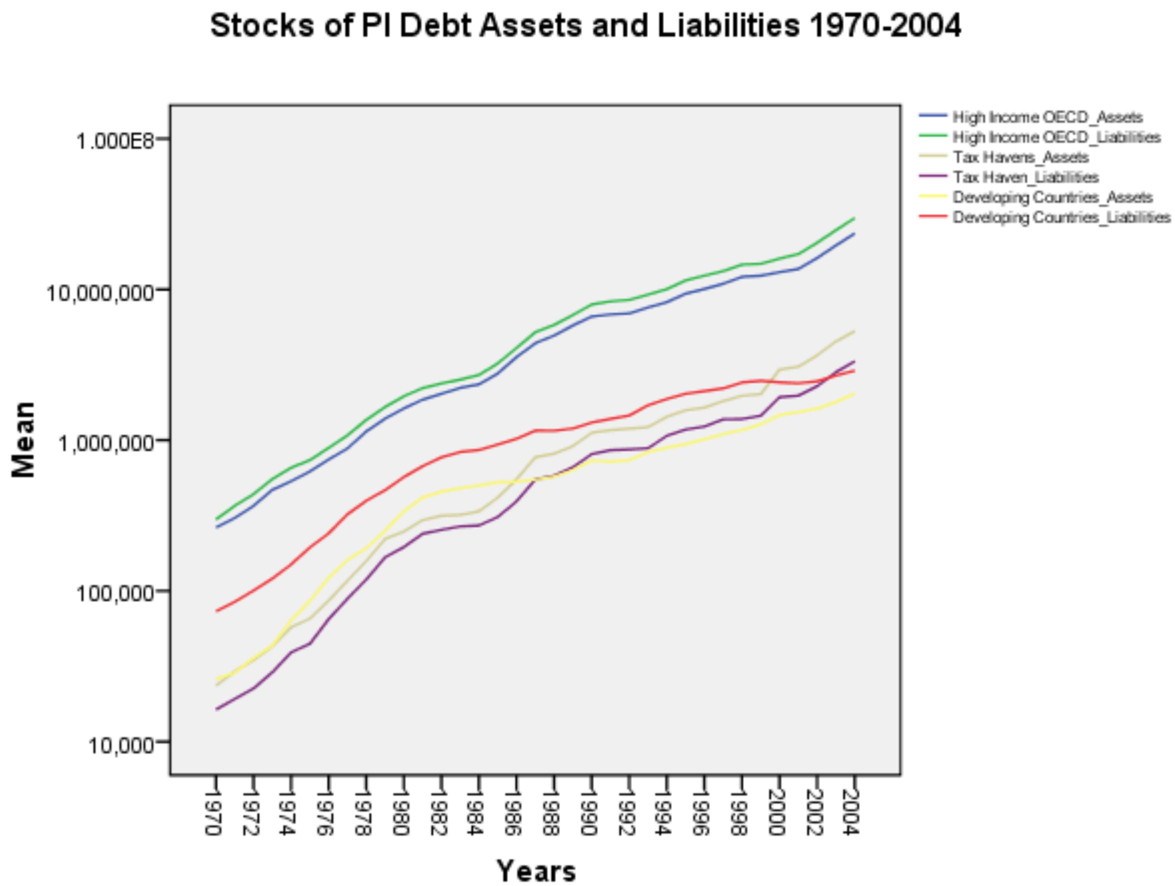
Furthermore, it is not possible to assess tax policy adopted by developing countries and high income OECD countries without regarding the position of tax havens. Their participation in the international trade of Portfolio Equity has increased substantially in the recent past. To this extent, even though the traditional assumption is that tax havens work as intermediaries, having their net position balanced, the figures of Portfolio Equity showed a substantial positive net position, which signifies that they might be acting as importers of Portfolio Equity.

3.3.2.4. Stocks of Portfolio Debt and Other Investments[213]

The graphs and tables present the main figures of the stocks of Portfolio Debt and Other Investments[214]. The presentation of data follows the same pattern introduced in the previous sections.

[213] Complete dataset of the figures is provided in the Data Appendix.

Chart 3.3.2.4. (a) Stocks of PI Debt Assets and Liabilities 1970-2004



[214] According to Lane and Milesi-Ferretti's classification, portfolio debt and other investments corresponds to debt securities (e.g. bonds) and other debt instruments such as loans, deposits and trade credits. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 225-29.

Chart 3.3.2.4. (b) Evolution of Net PI Debt Stocks 1970-2004

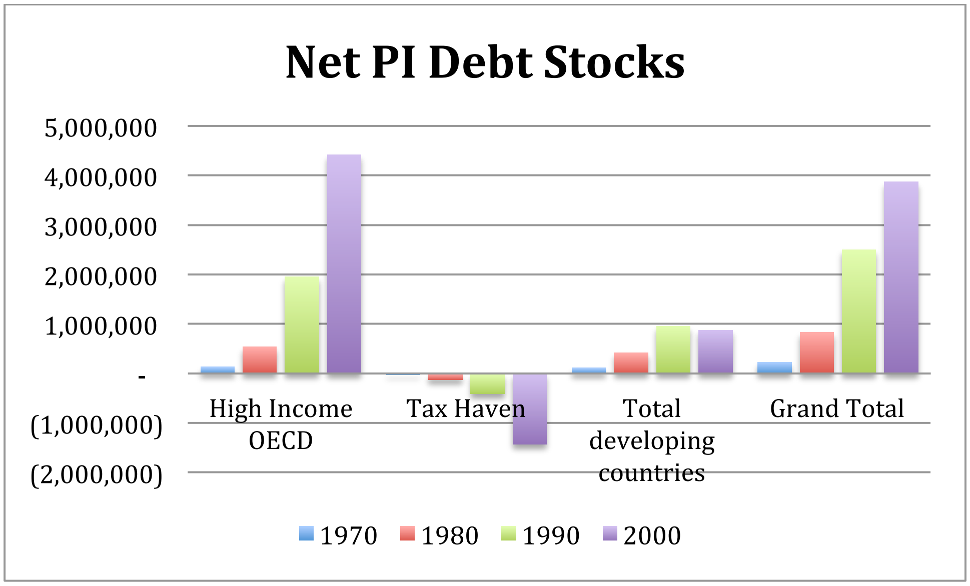


Table 3.3.2.4. (a) Stocks of PI Debt Assets

A. Stocks of PI Debt and Other Investments Assets (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	672,009	3,154,210	9,106,770	17,209,996
Tax Haven	83,584	498,421	1,516,882	3,896,500
BCIMRS	8,379	54,951	259,915	545,428
Other developing countries	92,463	445,665	681,527	1,146,473
Total developing countries	100,842	500,616	941,442	1,691,901
Total of all groups	856,435	4,153,247	11,565,094	22,798,397

Table 3.3.2.4. (b) Stocks of PI Debt Liabilities

B. Stocks of PI Debt and Other Investments Liabilities (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	804,137	3,691,971	11,056,980	21,629,026
Tax Haven	61,086	372,459	1,111,362	2,469,930
BCIMRS	68,725	276,009	639,539	883,402
Other developing countries	146,356	641,607	1,259,566	1,686,244
Total developing countries	215,081	917,616	1,899,105	2,569,646
Total of all groups	1,080,303	4,982,047	14,067,446	26,668,602

Table 3.3.2.4. (c) Net of PI Debt and Other Investment Stocks

C. Net of PI Debt and Other Investments Stocks (Average)				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	132,128	537,761	1,950,210	4,419,030
Tax Haven	(22,498)	(125,961)	(405,520)	(1,426,571)
BCIMRS	60,346	221,058	379,624	337,974
Other developing countries	53,892	195,942	578,039	539,772
Total developing countries	114,238	417,000	957,663	877,745
Total of all groups	223,869	828,800	2,502,352	3,870,205

The first outstanding characteristic of stocks of Portfolio Debt and Other Investments is their total amounts. The figures demonstrate that stocks of assets started from an average of US$856,435 million in the 1970s and reached the average of US$22,798,397 million in the 2000s; whereas stocks of liabilities reached even higher values, i.e. they increased from US$1,080,303 million in the 1970s to US$26,668,602 million in the 2000s. Thus, the volume of stocks of debt (represented by Portfolio Debt and Other Investment in which loans are included) compared to stocks of equity (composed by FDI and Portfolio Equity) is significantly higher. However, regarding their dispersion among groups of countries both debt and equity stocks present the same pattern in which stocks are extremely concentrated in high income OECD countries.

There are interesting trends in the evolving position of groups of countries in the period analysed. As already mentioned, stocks are highly concentrated in high income OECD countries. However, their participation on the total stocks of assets slightly decreased (from 78% in the 70s to 75% in the 2000s); while in relation to stocks of liabilities, their participation increased (from 74% in the 70s to 81% in the 2000s). Besides these light movements, they have concentrated more than 70% of the total stocks of Portfolio Debt since 1970. The US and the UK have held on average during the period analysed 45% and 40%, respectively, of the total debt assets and liabilities held by high income OECD countries. On extraction of the stocks of the US and the UK from the high income OECD group, the tendency is maintained, i.e. the net values remain positive indicating that stocks of liabilities held by the rest of the group surpass the stocks of assets. Therefore, even though these two countries have a significant impact on the sample, they do not distort the trend. The net positive values (Liabilities>Assets) were confirmed even not counting them in the group.

Developing countries, on the other hand, have not only held low stocks of assets and liabilities, but also both stocks decreased in percentage terms in relation to total stocks (i.e. in the 70s their stocks of assets and liabilities represented on average 12% and 20% of total stocks; while in the 2000s their shares of stocks were reduced to 7% and 10%, respectively). This signifies that although there was a remarkable growth in the trade of debt assets around the world, developing countries did not increase their participation. Moreover, unlike the equity stocks (FDI and Portfolio Equity), debt stocks are not concentrated in BCIMRS. The group of 'Other Developing Countries' composed of 103 countries have held higher stocks of debt since the 70s than the BCIMRS group. Moreover, the developing countries' more balanced position in terms of assets and liabilities might also impact their tax policies. For instance, their preference of methods to relieve double taxation might have changed over time since exemption of foreign income preserves capital import neutrality, whereas the recognition of credits ensures capital export neutrality.

The tax haven group reflects the same trend identified when analysing other stocks: they significantly increased their stocks of both assets and liabilities of portfolio debt (in the 70s their stocks of assets and liabilities represented on average 10% and 6% of total stocks; while in the 2000s their shares of stocks considerably increased to 17% and 9%, respectively). Focusing on assets, in the 90s tax havens' stocks surpassed the stocks held by developing countries (the former held US$1,516,882 million; while the latter held US$941,442 million) and in the 2000s this difference in favour of tax havens became even higher (tax havens' assets reached the average of US$3,896,500 million; while developing countries' figures remained at US$1,691,901 million). In relation to stocks of liabilities, even though developing countries still hold higher averages, in the last decade the tax havens' stocks became closer to developing countries' figures (US$2,569,646 million compared to US$2,469,930 million).

The graphs illustrate the meaning of the figures discussed above. In the first graph, the lines that represent the evolution of stocks of assets and liabilities of high income OECD countries are very symmetric, demonstrating that although stocks of liabilities are higher than assets; the net values represented by the distance between the lines is less significant when compared to the other groups. Therefore, the discrepancy is much more relevant for the other groups than for high income OECD countries, when compared to the total amount of assets and liabilities held by them. The lines of developing countries and tax havens intercepted each other, demonstrating that they changed position as the tax havens' assets and liabilities stocks surpassed stocks held by developing countries. The graph illustrates very clearly the slowdown in the developing countries' position through the disposition of the red (liability) and yellow (asset) lines.

Net values (table 3.3.2.4 (c) of this section) of the entire period analysed are positive, presenting liabilities higher than assets. On examination of the behaviour of each group of countries, different trends are identified. High income OECD countries maintained during the period analysed an increasing net positive position, which signifies that they kept importing more debt than exporting it. Even though the developing countries' net figures are also positive (liabilities>assets) during the entire period analysed, there is a different movement in the last period, since net values of stocks were reduced demonstrating that they inverted the trend of importing more than exporting debt. In fact, this movement is observed in both groups of developing countries: BCIMRS and 'other developing' countries. Tax havens, on the other hand, present a completely different behaviour from the other groups. Their net figures for the entire period analysed are negative (liabilities<assets), which shows that they kept exporting debt. In terms of growth, the table below shows how much net values increased in each decade compared to 1970s data:

Table 3.3.2.4. (d) Growth of Net Debt

Growth of Net Debt				
Groups of Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	1	4	15	33
Tax Haven	1	6	18	63
Total developing countries	1	4	8	8
Grand Total	1	4	11	17

Tax havens' negative net figures presented an overwhelming increase, putting in evidence the fact that their position as net exporters of debt is not an occasional situation but a trend that was intensified in the 2000s. Having in mind that in terms of equity (both FDI and Portfolio) tax havens were identified as capital importers, their position as capital exporters of debt allows us to infer that they are transforming equity into debt. From a tax perspective, there is an explanation for that since income derived from equity investment usually is taxed only after distribution of dividends. Therefore, taxation of equity income can be deferred, excepted when the home country of investors has enacted Controlled Foreign Company (CFC) legislation. Furthermore, usually, Portfolio Equity investment does not trigger the application of CFC rules. So, in practice, from a tax perspective, it makes sense for investors[215] resident in high tax jurisdictions to make equity investment in tax havens and through different vehicles of investment (companies or other mechanisms) headquartered there, funds are lent as debt.

The analysis of Portfolio Debt and Other Investments' stocks highlighted the importance of these investments to explain the discrepancy between assets and liabilities reported by countries. But why do developing countries and high income OECD countries appear to better report portfolio debt liabilities, whereas tax havens adopt the opposite behaviour, better reporting portfolio assets? Is there a tax explanation that encourages the situation reflected in the figures analysed? Furthermore, assuming that tax havens are mere conduits of investment, to which countries do those assets reported by tax havens belong? These questions need to be addressed to understand the position of developing countries in the international tax system.

[215] Investors can also convert individual investment into corporate investment.

Another relevant aspect is that comparing the net values of Total Assets and Total Liabilities (provided in section 3.3.2.1.) with the net values provided in this section, we will see that the former are lower than the latter. Moreover, values of section 3.3.2.1 are also lower than the net values of Portfolio Debt and Other Investments plus Portfolio Equity and FDI. The table below illustrates this situation.

Table 3.3.2.4. (e) Sum of net values of stocks of FDI, PI Equity and PI Debt and Other investments

Net of PI (Equity and Debt) and Other Investments + Net of FDI				
Countries	**70s**	**80s**	**90s**	**2000s**
High Income OECD	63,994	382,351	1,316,704	2,798,824
Tax Haven	(21,147)	(88,358)	(277,878)	(613,857)
BCIMRS	80,952	258,559	647,280	1,135,889
Other Developing Countries	89,305	264,863	840,049	1,095,652
Total Developing Countries	170,257	523,422	1,487,329	2,231,539
Total of all groups	213,104	817,416	2,526,155	4,416,507

The net lower values presented in section 3.3.2.1. can be explained by the fact that Total Assets and Total Liabilities include not only FDI and Portfolio Investment, but also Reserves minus gold[216] and Financial Derivatives[217]. Besides high income OECD countries, other countries have not reported well the stocks of Financial Derivatives, which signifies that this category of investment cannot justify the reduction in the net discrepancy described in section 3.3.2.1. Reserves minus gold, on the other hand, represent significant figures, especially for developing countries that in the recent past have considerably increased their stocks. The table below illustrates the evolution of Reserve assets held by countries since 1970 to 2004. All figures are presented in millions of US dollars and they represent the average of each period:

[216] Reserves minus gold include: foreign exchange, SDR holdings and the reserve position in the IMF. Gold holdings were not accounted since they do not represent a liability of another country. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 229.

[217] Among derivative instruments are options on currencies, interest rates, commodities, indices, etc.; traded financial futures; warrants; and arrangements such as currency and interest rate swaps. IMF, 'BOPS Manual' (n 152) 92.

Table 3.3.2.4. (f) Evolution of official reserves held by countries

Total Reserve Assets minus gold (average)				
Groups of countries	**70s**	**80s**	**90s**	**2000s**
High income OECD	105,802	291,843	669,491	1,137,028
Tax Haven	16,889	50,233	169,932	274,402
BCIMRS	10,723	31,214	160,285	573,769
Other developing countries	56,494	134,389	357,342	730,833
Total developing countries	67,216	165,603	517,627	1,304,602
Total of all groups	189,908	507,678	1,357,050	2,716,032

Since the Asian financial crisis in the 90s, developing countries have accumulated significant amounts of Reserves.[218] These reserves represent assets held by monetary authorities of countries to self-insure their economies against financial instability. To this extent, the figures above prove that whereas high income OECD's Reserves increased 11 times since the 70s, developing countries' reserves improved 19 times.[219] In addition, in the 70s Reserves held by developing countries represented only 64% of Reserves held by high income OECD countries. In the 2000s, the difference between their holdings was reverted, the reserves of developing countries becoming 115% of the amount held by high income OECD countries.

Even though from a tax perspective, income derived from these assets is exempt, which signifies that this income does not increase developing countries' tax base, it represents an important outflow of capital. In other words, the amount of foreign assets held as reserves by monetary authorities of developing countries also challenges the profile of developing countries as capital importers.

[218] R. U. Mendonza, 'International Reserve-Holding in the Developing World: Self-insurance in a Crisis-prone Era?' (2004) 5 Emerging Markets Review, 61-82.
[219] It is important to note that while in the 'other developing countries' group reserves increased 13 times in the period analysed, in the BCIMRS reserves increased 54 times.

3.3.3. Outcomes of data analysis

In sum, bearing in mind all the arguments raised by the analysis of flows and stocks, the main characteristics of the IIP of high income OECD countries, tax havens and developing countries from 1970 to 2004 are:

(i) High income OECD countries concentrate most stocks of foreign assets and liabilities. Their gross stocks are significantly higher than gross stocks of developing countries and tax havens; whereas their net values are lower in percentage terms when compared to the total stocks held by them. Their IIP is positive (Liabilities>Assets) due to their massive position in Portfolio Debt and Other Investments, which surpasses the net values of other stocks, attributing to them the characteristic of debtors. In terms of flows, they are exporting equity (FDI and Portfolio Equity) and importing debt (Portfolio Debt and Other Investments);

(ii) Tax havens significantly increased their stocks in the recent past, achieving a relevant position in the international trade of foreign assets and liabilities. Different from the other groups, tax havens have negative IIP since stocks of assets are higher than stocks of liabilities. Therefore, they assumed creditor position and their IIP reduced the discrepancy. In other words, whereas in developing countries and high income OECD countries liabilities are better reported than assets, in tax havens the opposite situation is verified. In terms of flows, tax havens have been importing equity[220] and exporting debt;

(iii) Developing countries have the lowest gross stocks of assets and liabilities. Even though their net stocks have decreased over time, demonstrating the increased importance of bilateral flows to their economies, the remaining values are still significant. All net values of stocks (FDI, Portfolio Equity, Portfolio Debt and other

[220] Except by last decade in which net values of FDI stocks were reduced. This evidence added to the information extracted from flows signifies that tax havens might export FDI from 2000 to 2004. However, it is important to bear in mind that there might be other facts affecting those figures such as valuation, exchange currency rate, etc.

Debt) present a positive value, which means that liabilities are higher than assets. In terms of flows, there are interesting movements since even though their net values indicate a debtor position, recently they have been not only importing capital but also exporting it, as occurred to Portfolio Debt and Other Investments for all developing countries. In this particular case, their stocks were significantly reduced in the last decade, which was confirmed by the movement of flows.

The next tables synthesise the movement of flows and the net position of stocks for each group:

Table 3.3.3 (a) Summary table of movements of flows

Movement of flows				
Groups	**FDI**	**Portfolio Equity**	**Portfolio Debt plus Other Debts**	**Net flow position**
High Income OECD countries	Exporting	Importing (until 2000); Exporting from 2000 onwards	Importing	Importer
Tax havens	Importing (until 2000); Exporting from 2000 onwards	Importing	Exporting	Exporter
Developing countries	Importing	BCIMRS importing; other developing countries exporting.	Importing (until 2000); Exporting from 2000 onwards	Importer

Table 3.3.3. (b) Summary table of net stock position

Net position in each category of stocks				
Groups	**FDI**	**Portfolio Equity**	**Portfolio Debt plus Other Debts**	**IIP**
High Income OECD countries	Assets>Liabilities	Liabilities>Assets	Liabilities>Assets	Debtor
Tax havens	Liabilities>Assets	Liabilities>Assets	Assets>Liabilities	Creditor
Developing countries	Liabilities>Assets	Liabilities>Assets	Liabilities>Assets	Debtor

The tables above provide an overview of the analysis performed in terms of movements of flows and net position of stocks for each type of investment. It is important to emphasise that stocks' data was adopted because it is more complete and covers a longer period. Thus, it is necessary to bear in mind that changes in stocks are affected not only by movement of flows but also by revaluations arising from price changes and/or exchange rate changes and other changes in the volume of assets (e.g. write-off claims, reclassification of assets). Notwithstanding these limitations of analysing movement of flows through changes in stocks, the analysis of pure flows discussed in section 3.3.1. presented figures that are in line with outcomes raised in the stocks' analysis. Therefore, besides all the limitations on the analysis performed, the data allowed a better understanding of what is going on in terms of the flows of capital to reconsider the legal debate.

The overall picture of the international flow of capital put in evidence how complex the national interest of each group in the international taxation is since it is very hard to justify their preference between source and residence taxation based on their characteristics as capital importers and capital exporters. In a sense, the data proved that the flow of capital has become much more bilateral which reduces the importance of identifying a country as capital importer or capital exporter for tax purposes. Another interesting outcome that has to be considered when analysing countries' national interest in international taxation is the relevance of particular asset group since if a country receives very low flows of a certain investment, its interests in that particular category to raise tax revenue will be unimportant. However, even in this situation countries would need to consider how certain tax policies encourage (or discourage) future investments as well as interact with the problem of capital flight, as discussed in the next chapter.

Finally, it is interesting to compare the recent trends identified in the current process of globalisation in which countries tend to report better liabilities than assets with the profile of the financial flow in the first period of globalisation. This comparative analysis will show some differences between these two periods.

3.4. Comparison with the First Period of Globalisation (1870-1914)

The previous sections created a detailed view of the flows of capital from 1994 to 2007 and the stocks of foreign assets and liabilities from 1970 to 2004. The objective was to examine the profile of the flows and stocks of three different groups of countries: high income OECD countries, tax havens and developing countries. The analysis pointed out three major aspects: (i) difficulty in characterising countries as capital importers and capital exporters; (ii) the discrepancy between stocks of assets and liabilities reported; and (iii) the increased participation of tax havens in the international flow of capital.

In order to expand the understanding of the outcomes of the previous analysis, this section will complement those results with the analysis developed by Obstfeld and Taylor in which they analysed the stocks of foreign assets and liabilities from 1825 to 1995.[221] The long period analysed by them encompasses the first period of globalisation, which occurred from 1870 to 1914.[222]

The main idea discussed by Obstfeld and Taylor's study refers to the evolution of international capital mobility which can be comprehended by examining the differences between the net values and the gross values of stocks of assets and liabilities in the pre-war period (i.e. 1870-1914) and in the period of 1980-1995. Briefly explained, they argued that data on gross international asset positions seemed broadly consistent with the idea of a U shape in the evolution of international capital mobility since the late nineteenth century. Their data demonstrated an impressive drop in capital mobility in the interwar period, and a very slow improvement of capital mobility thereafter.[223]

Focusing on countries' profile as capital importers and capital exporters, the figures of Obstfeld and Taylor showed that until 1914 some developed countries held significant positions as 'creditors of the world'. At that time, the United Kingdom, France, Germany, the Netherlands, the United States, Canada and Japan held not less than 100% of total stock of assets. On the other hand, most developing countries were colonies of those creditor countries, receiving investments from them, which characterised them as

[221] The database developed by Obstfeld and Taylor is much simpler than the one developed by Lane and Milesi-Ferretti. Obstfeld and Taylor did not distinguish in their classification different types of stocks; they opted for a broad classification between assets and liabilities. This basic classification can be justified by the long period analysed by them which includes data with very different characteristics that could not be classified in the current categories of assets and liabilities, since some of them did not even exist in the nineteenth century (e.g. Financial Derivatives). The advantage of Obstfeld and Taylor's study is the extension of their database which covers the period of 1825 to 1995, using intervals of five years. The challenge of finding information about the first period of globalisation is fulfilled by their research. Obstfeld and Taylor (n 39) 121-83.
[222] Explanations about the concept of globalisation and its periods can be found in Chapter I.
[223] Obstfeld and Taylor (n 39) 145.

debtor countries. It was, therefore, much easier to analyse the IIP of countries, since they had a large position in one direction of the flow, it not even being necessary to segment the flow by type of investment because the simplicity of the financial market did not request that. Consequently, by that time it made sense to think of international taxation in terms of countries' profile as capital importers and capital exporters.

Another aspect reported by Obstfeld and Taylor's analysis is that assets were better reported than liabilities until 1914. This trend is related to the fact that stocks of assets were extremely concentrated in a few developed countries, being better accounted and reported by them; while liabilities were wide-spread in a large number of countries characterised as the 'developing world'. Comparing this tendency with the findings of Lane and Milesi-Ferretti what is identified is the opposite trend in the current reports, i.e. stocks of liabilities are much better reported than stocks of assets, which justified the world net foreign assets discrepancy.[224]

Regarding distribution of stocks, there are also interesting outcomes, comparing data from the pre-war period with data from the current process of globalisation. From 1825 to 1914, stocks of assets were concentrated in a few developed countries, whereas liabilities wide-spread around the developing world. In the current process of globalisation, stocks remained concentrated in a few countries, i.e. in the high income OECD group, which contains the old club of creditor countries. However, nowadays, these countries hold not only a massive position in assets but also in liabilities. This situation affects not only high income OECD countries but also the other groups. Consequently, countries worry about both directions of the flows, since the flow is much more bilateral, requesting countries to consider inflows and outflows when defining their tax policies.

Furthermore, in terms of distribution, it is not possible anymore to polarise the discussion around developed and developing countries. It is necessary to consider the influence of tax havens, which assumed an important position in the international flow

[224] Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 231.

of capital. Thus, the difficulty nowadays in classifying countries as capital importers or capital exporters is justified not only by countries' bilateral position on flows but also by the interference of tax havens in the direction of these flows. To this extent, a major difference between the analysis performed with Lane and Milesi-Ferretti's data and the analysis proposed by Obstfeld and Taylor refers to the absence of tax havens in their considerations.

In sum, there are significant differences between the first period of globalisation and the current one. From 1870 to 1914, it was possible to analyse the flows of investments around the world only considering two groups of countries: developed and developing ones. Their level of economic development also was associated with their profile as net creditor or debtor. In the current process of globalisation these premises cannot be assumed anymore. To understand the international flow of capital it is necessary to comprehend the position of tax havens as well as to examine the flows considering different types of assets. Developed countries cannot be considered anymore simply as net creditors; whereas developing countries are not only net debtors. The traditional assumptions proved to be out of date.

3.5. Conclusion

The data and arguments introduced in each section of this chapter aimed to put in evidence current aspects of the international flow of capital and stocks of foreign assets and liabilities held by countries as well as their evolving characteristics in order to provide a new framework to reconsider the position of developing countries in the international tax system.

The main contribution of this chapter relies on the adoption of economic data to contextualise the debate on international taxation. The analysis proved that it is very hard to characterise countries as capital importers and capital exporters. In fact, this argument can only succeed when the flows are largely in one direction, as in the first period of globalisation. To this extent, considering the bilateral nature of flows, it is also important to note that when net values represent a small fraction of the flows, it does not matter for tax purposes if a country is capital importer or capital exporter. Equally, the magnitude of an asset group may be important to define countries' tax interests in certain investments. The low level of Portfolio Equity in developing countries could make the tax arrangements for these assets relatively unimportant, though this situation would also depend on expected future levels, who is investing and also on how these tax policies encourage or discourage capital flight, as discussed next.

The analysis showed, therefore, that the current economic profile of countries is much more complex than the basic assumptions that guided the discussion of international taxation in terms of capital import and capital export. It is not only hard to classify countries according to this simplified criterion but also to think in terms of two groups of countries only: developed and developing countries. It is necessary to evaluate the position of tax havens and how developing and developed countries' tax systems interact with them.

Moreover, there is a tendency for countries to report better financial liabilities than assets followed by the increased participation of tax havens in the international flow of capital. This situation indicates that there might be other explanations for the discrepancy rather than badly reported data. What is going on in the current process of globalisation that created this distortion on how countries report their asset position? Why this distortion affects Portfolio Investment rather than FDI?

Even though data of only a small group of tax havens were available, the outcomes proved that their behaviour might be connected to the unreported outflows from high tax jurisdictions (high income OECD countries and developing ones). In a sense, this situation makes the picture even more complicated. It is not only the wrong argument to think of international taxation in terms of capital import and capital export terms, but it is necessary to understand the importance of tax havens and their relationship with unrecorded outflows. In the next chapter, the importance of tax havens and their relationship with unrecorded outflows are examined.

Chapter IV. Tax havens and the problem of capital flight

The previous chapter introduced evidence about the economic profile of three groups of contries (high income OECD countries; tax havens; and developing countries) in the context of financial globalisation, demonstrating that the international trade of foreign assets and liabilities is much more complex than the traditional assumption in which developing countries are capital importers and developed countries are capital exporters. It was demonstrated that: (i) the North/South assumption cannot explain the behaviour of the international flows of capital; (ii) tax havens are important players; and (iii) the discrepancy between reported stocks of assets and liabilities has significantly increased in the recent past.

In theory, the sum of all countries' IIP should be zero since what represents a liability for one country, must be an asset for another. However, recent data of stocks of foreign assets and liabilities held by countries have demonstrated a net asset discrepancy, i.e. countries tend to better report liabilities than assets, there remaining a significant amount of assets unreported.[225] In terms of flows, these unreported assets represent unrecorded outflows of capital. When focusing on each group of countries' IIP what was verified is that although high income OECD countries and developing countries have reported better liabilities than assets, tax havens adopted the opposite behaviour, since their stocks of assets were higher than their stocks of liabilities. According to the traditional assumption, the tax havens' position should be balanced since they work as intermediaries, i.e. they act as mere conduits of the flows. Therefore, the way tax havens' behaviour explains the discrepancy indicates that there might be other reasons for the discrepancy rather than only badly reported data.[226]

[225] It is important to note that even though not all countries of the world were included in the analysis performed by Lane and Milesi-Ferretti, due to the global coverage of the data, they assumed that the outcome i.e. the net foreign asset discrepancy represented a world trend. This signifies that even if all countries were accounted, a net asset discrepancy would be identified. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 231-33.

[226] Lane and Milesi-Ferretti were aware that measurement error in their dataset was substantial, due to: (i) missing data, i.e. incomplete reporting of balance of payments and IIP data; (ii) complex financial

Assuming that the discrepancy does not signify only badly reported data, the behaviour of tax havens represents an important aspect to understand how proper data of the international flow of capital might work. In a sense, the analysis of tax havens' behaviour will help to create some alternatives to understand the international flow of capital and, consequently, the effective interest of developing countries. To this extent, in the previous chapter it was possible to identify tax havens as creditors since they better reported assets than liabilities. The outcome reflected the analysis of only 14 tax havens.[227] Therefore, it will be necessary to examine the behaviour of the missing tax havens in order to improve the conclusions of the previous chapter.

But why do countries have difficulty in better reporting outflows of capital? What is the relationship between tax havens' behaviour and the net asset discrepancy? Capital flight might be one explanation. Thus, the phenomenon of capital flight will be examined in order to evaluate a possible explanation for the current profile of the international flow of capital.

How does this analysis relate to the tax debate? Firstly, the impact of capital flight on countries' flows challenges even more the discussion of international taxation in terms of countries' classification as capital importers and capital exporters, and, consequently, its association with source and residence taxation. It is not only difficult to classify countries as capital importers and capital exporters, but the problem of capital flight demonstrates that official figures cannot capture entirely the outflows of capital from countries. This signifies that official figures tend to overestimate countries' positions as debtors since the problem of capital flight is not captured.

Secondly, the difficulty in classifying countries as capital importers and capital exporters demonstrated that source and residence taxation cannot address properly the

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transactions; (iii) discrepancy between current account transactions and financial flows, captured by net errors and omissions (NEO).

[227] Bahrain, Costa Rica, Cyprus, Hong Kong, Ireland, Jordan, Latvia, Luxembourg, Malta, Mauritius, Panama, Singapore and Switzerland and Lebanon.

effective interest of developing countries in international taxation. In a sense, source and residence taxation cannot properly discuss allocation of taxing rights between developed and developing countries, and, consequently, allocation of tax base. However, can source and residence taxation explain the behaviour of capital flight? The traditional assumption regarding allocation of taxing rights reflects the provisions in tax treaties. In a simplified manner, source taxation has been applied to active business income (profits), whereas residence taxation has been applied to passive income (e.g. dividends; interest). From a practical perspective, this division is supported by the fact that it is easier to determine residence of individuals than residence of enterprises, since the latter relies on artificial criteria that can be easily manipulated. There has been less agreement, in fact, in terms of taxation of passive income, since even though tax treaties aimed to eliminate source taxation, in practice some have remained.[228] The discussion about source versus residence taxation of passive income was centred on countries' profiles as capital importers and capital exporters of portfolio investment. Consequently, developing countries have defended source taxation since they were characterised as capital importers, whereas developed countries have fought for residence taxation since they were presumed to be capital exporters of this type of investment. Does the enforcement of source taxation by developing countries followed by the enforcement of residence taxation by developed countries encourage capital flight? In other words, is the phenomenon of capital flight encouraged by tax policies?

It is not possible to quantify how much of capital flight can be explained by tax policies. However, this fact does not reduce the importance of tax policies in understanding the phenomenon of capital flight. Thus, tax policies adopted by developing countries, developed countries and tax havens will be examined in order to identify how they encourage capital flight, and consequently, if the discrepancy is justified by tax policies.

In sum, this chapter aims to analyse the relationship between tax havens' behaviour and capital flight to complement the study of the international flow of capital performed in

[228] R. S. Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification' (1995-96) 74 Texas Law Review 1301, 1305.

the previous chapter. The objective is to understand what might be distorting the flows of capital, causing the trend of developed and developing countries to report their liabilities (inflows) better than their assets (outflows). The use of economic concepts here is necessary only to set up the meaning and the relevance of capital flight. The limitations of the analysis performed consists in availability of data from tax havens and capital flight. It was not the scope of this study to improve data of tax havens and capital flight. The purpose is restricted to demonstrating the relationship between tax havens' behaviour and capital flight, putting into perspective figures that reveal the importance of these arguments to evaluate the interest of developing countries in international taxation.

4.1. The net asset discrepancy

The IIP of an economy is obtained by subtracting the external financial assets from the external liabilities. It represents the developments and trends in the performance of an economy vis-à-vis the rest of the world since it reflects what a country owns in relation to what it owes to other nations.[229]

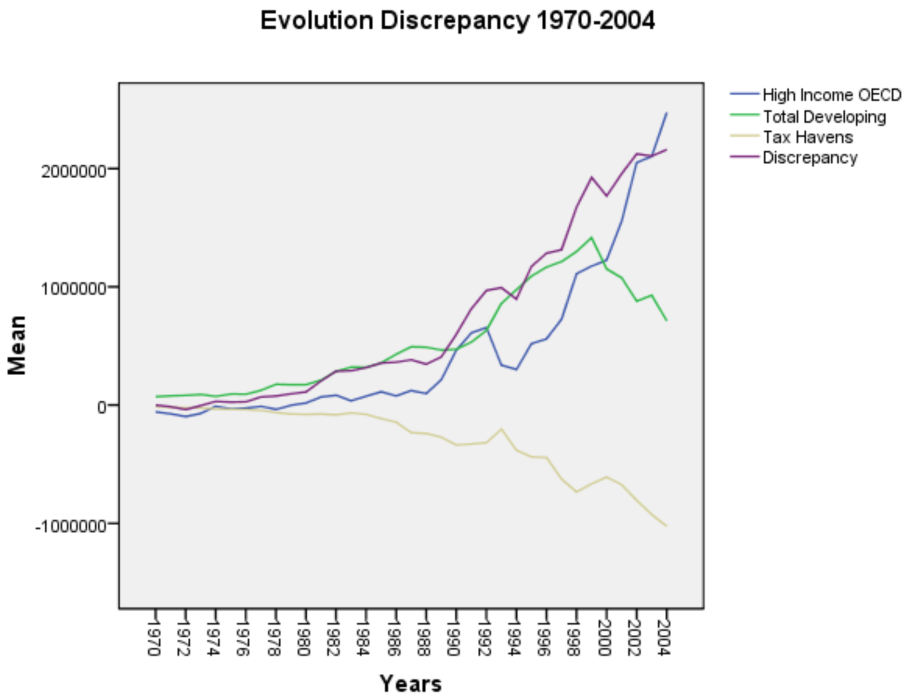
Adding up the IIP position of the groups analysed (high income OECD countries, tax havens and developing countries), a gap becomes evident since stocks of liabilities are higher than stocks of assets. Consequently, there is a tendency on evaluating the figures to find countries in a debtor position rather than a creditor position. Even though the total values of assets and liabilities reported should be equal in theory, since what is a liability to one country must be an asset to another one; in practice, the net values of assets and liabilities differ from zero.[230] This problem reflects the difficulty faced by

[229] IMF, 'BOPS Manual' (n 152) 6.

[230] As already mentioned, even though not all countries of the world were included in the analysis performed by Lane and Miles-Ferretti, due to the global coverage of the data, it can be assumed that the discrepancy represents a global trend, i.e. even if all countries were accounted, a net asset discrepancy would be identified.

countries in accurately reporting their international investment positions. The graphic below demonstrates the evolution of the discrepancy since 1970[231]:

Chart 4.1. Evolution of the discrepancy and the IIP of each group of countries from 1970 to 2004



The graphic above reveals how the discrepancy (purple line) has increased since 1970. The positive net position (Liabilities>Assets) of high income OECD countries (blue line) and developing countries (green line)[232] shows that they are responsible for the positive net figures of the discrepancy; whereas the negative net position (Assets>Liabilities) reached by tax havens' IIP (grey line) reduces the discrepancy. It becomes clear, therefore, that tax havens have an opposite IIP to developing countries and high income OECD countries since for the former stocks of assets surpass stocks of liabilities.

[231] Source of data: P.R. Lane and G. M. Milesi-Ferretti, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 -2004', (2007) 73 Journal of International Economics, pp. 231-233.

[232] The drop on the line registered from 2000s onwards reflects the substantial reduction of developing countries' debt position.

But why do developing countries and high income OECD countries have difficulties in reporting their asset positions? One hypothesis is that a considerable part of the missing asset values of developing countries and high income OECD countries that constitute the gap, also called net foreign asset discrepancy[233] relates to capital flight. Capital flight can distort the marginal interest of countries in the international flow of capital since a significant part of outflows is probably undermined by this phenomenon.

In the next sections, the relationship between tax havens and capital flight will be examined. The meaning and measure of capital flight will be evaluated in order to provide a dimension of the importance of this phenomenon when discussing international taxation. Studies have used different methods to predict it, depending on the kind of question that is being asked. Therefore, there is not only one figure that defines the magnitude of capital flight. Besides that, there is no attempt in this study to criticise methods and previous estimates of capital flight. The analysis of capital flight here serves only to justify a new legal approach of international taxation. The economic aspects of capital flight represent only a necessary step of the present analysis. The aim is to investigate the phenomenon of capital flight in order to understand the current profile of the international flow of capital, and, consequently, the position of developing countries.

4.2. The meaning of capital flight adopted in this study

On examining the literature of capital flight it becomes clear that there is no consensus about its concept and consequently its definition is directly related to the question being investigated. In fact, the discussion is focused on whether capital flight should measure only unrecorded flows or measure more broadly including recorded capital which would represent all outflow of capital.

Collier and Schneider defended the broad measure, i.e. to include outflows officially recorded, based on the argument that all outflow of capital represents a loss of national

[233] Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 231.

utility or welfare, without regard to whether it was a recorded or unrecorded capital. However, these authors also explained that when capital flight is measured narrowly, the social cost of the outflow of capital is represented by the reduction of the domestic tax base since unrecorded flows are not taxed.[234] From the narrow perspective, it becomes clear that the problem with unrecorded outflows is not the investment being made abroad but the fact that the tax authority cannot tax such capital since it does not exist officially.

Following the narrow perspective, Epstein measured capital flight based on the estimations of unrecorded capital. He defined capital flight as the transfer of assets abroad in order to reduce loss of principal, loss of return or loss of control over one's financial wealth due to government sanctioned activities.[235]

Another way to differentiate capital flight from other outflows is focusing on its motivation. While the latter leave a country seeking the best rate of return to invest, the former leave a country in order to escape some sort of regulation. In other words, whereas reported outflows look for diversification; capital flight tries to avoid some attitude of local government, which can be tax regulation. Reported outflows that seek diversification are not the problem that we are examining here. Furthermore, there might be some part of capital flight that is criminal money, i.e. money derived from illegal activities. However, the problem of capital flight examined here is not focused on its portion of criminal money, but the fact that they represent unreported outflows from countries with low level of development, i.e. countries with shortage of capital.

Since the objective of this chapter is to analyse the phenomenon of capital flight in order to better understand the interest of developing countries on residents' undeclared foreign investments, this chapter will adopt the definition of capital flight as the unrecorded

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[234] P. Collier, A. Hoeffler and C. Pattillo, 'Flight Capital as Portfolio Choice' (1999) IMF Working Paper WP/99/171, 27. B. Schneider, 'Measuring Capital Flight: Estimates and Interpretations' (2003) 104 Overseas Development Institute Working Paper 4.

[235] G. A. Epstein, 'Capital Flight and Capital Controls in Developing Countries: an Introduction' in Gerald A. Epstein (eds), *Capital Flight and Capital Controls in Developing Countries* (Edward Elgar Publishing Limited, 2005), 4.

outflows of capital from countries. In other words, this study will adopt the narrow perspective of capital flight since it is interested in measuring the reduction of countries' tax base and tax revenue caused by unrecorded capital outflows. Therefore, the focus will be on the relationship between capital flight and the net asset discrepancy.[236]

As already mentioned, capital flight aims to escape some sort of regulation. Tax havens provide the perfect environment for capital flight to be allocated since the threshold that underpins their concept is also laxity of regulation (e.g. tax regulation, bank regulation, etc.). Thus, the problem of capital flight needs also to consider the activity of tax havens, since it is very hard to dissociate one phenomenon from the other.

4.3. The behaviour of tax havens

The behaviour of tax havens represents an important instrument in understanding how proper data of the international flow of capital might work. In the previous chapter, data of 14[237] tax havens showed that these countries have higher stocks of assets than liabilities, which classified them as creditors. This situation suggests that if more tax havens were accounted in the analysis, the discrepancy would be reduced. In other words, their behaviour as creditors helps to reduce the net asset discrepancy identified

[236] Lane and Milesi-Ferretti were aware of the problem of capital flight. In their previous study about external wealth of nations (Lane and Milesi-Ferretti, 'The External Wealth of Nations' (n 171) 266-67, they used NEO as a measure of capital flight and added it to the total stocks to estimate countries' IIP. In the database adopted (Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 229-33), however, they did not make systematic use of NEO when calculating countries' IIP, but reported them separately. They understood that NEO values would have been partially captured by some data sources used to calculate their database such as BIS and CPIS because in these sources liability positions are derived from assets held by other countries. However, in fact these methods cannot capture the problem of capital flight since countries have badly reported their assets due to capital flight and, therefore, to reconstruct the liability position based on asset position does not exclude the impact of capital flight on data. In fact, this method can only capture part of the problem of capital flight if assets held by tax havens could be allocated to high tax jurisdictions. Even in this circumstance, there are limitations since in most cases tax havens cannot identify the beneficial owner of assets, rendering useless the identification of intermediary persons obtained from them. (IMF, 'The Coordinated Portfolio Investment Survey Guide: Second edition', <http://www.imf.org/external/pubs/ft/cpis/2002/pdf/cpis_index.pdf> accessed 27 June 2011, 12.) Thus, even though Lane and Milesi-Ferretti tried to improve data with these other sources, the problem of capital flight still needs to be addressed.

[237] Bahrain, Costa Rica, Cyprus, Hong Kong, Ireland, Jordan, Latvia, Luxembourg, Malta, Mauritius, Panama, Singapore and Switzerland and Lebanon.

through the sum of countries' IIP. But why can the behaviour of tax havens explain part of the discrepancy?

The phenomenon of capital flight might be a possible explanation. As already mentioned, capital flight aims to avoid some sort of regulation and tax havens provide the perfect environment for its allocation. In the previous chapter, through the analysis of Lane and Milesi-Ferretti's database, 14 tax havens were identified and their IIP calculated. The table below synthesises those figures in millions of US dollars:[238]

Table 4.3. (a) Evolution of tax havens' IIP

Tax havens' net position					
Years	**1970**	**1980**	**1990**	**2000**	**2004**
IIP	-13.725	-78.561	-337.746	-608.765	-1.024.532

(Note: Evolution of tax havens' IIP, demonstrating their increased position as asset holders)

Regarding the list of 50 tax havens presented in chapter III, it becomes clear that the group of 14 tax havens represents only a small sample. The main limitation of researching in this area refers to availability of data since most tax havens does not report their international investment position. Having in mind the importance of this group of countries for the international flow of capital, Lane and Milesi-Ferretti elaborated a complementary study to estimate the stocks of assets and liabilities held by 'small international financial centres'.[239] The study elaborated by them provides complementary data for jurisdictions not included in their previous database.[240]

Lane and Milesi-Ferretti estimated the total amount of assets and liabilities held by 32 small international financial centres for 2007.[241] Comparing this list with the one

[238] It is important to note that figures provided in the table below differ from figures used in the previous chapter since here the values of stocks is presented in the years indicated, whereas there the figures represented the average of stocks of the periods indicated.
[239] Lane and Milesi-Ferretti, 'Cross-Border Investment in Small International Financial Centers' (n 209) 1-22.
[240] The adoption of Lane and Milesi-Ferretti's database is justified by the limited amount of information available from these jurisdictions. However, even though data from Lane and Milesi-Ferretti represents a more complete source of information, they emphasised that data source used were not only incomplete but also often indirect. So, the authors made clear that the values estimated provide only a range of magnitude for those figures rather than a precise assessment. ibid 3.
[241] Lane and Milesi-Ferretti's sample of 32 'small international financial centres' was composed of: Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Bahrain, Barbados, Belize, Bermuda, Cayman

provided in chapter III (tax havens' list), both lists have in common 31 jurisdictions.[242] Thus, the new figures can complement data analysed in the previous chapter. Moreover, comparing the sample of 32 small international financial centres with the group of 14 tax havens, which data were available from their previous study, there is an overlapping of 4 jurisdictions, i.e. countries included in the previous study that were also accounted in the new one.[243] Excluding these jurisdictions, there is information available for a sample of 26 tax havens.[244] This signifies that in putting together the previous outcomes with these ones, there is information available for 40 tax havens, out of a list of 50. This increases the reliability of the results identified in the previous chapter.

The figures of total assets and liabilities of those small financial centres calculated in 2007 were US$4,204,640 million and US$3,729,210 million, respectively. Adding up those figures, the outcome is US$475,430 million, which represents a net asset position for those small financial centres in 2007. This outcome is in line with the outcome identified for the 14 tax havens in the previous chapter. Carrying back the net asset position (US$475,330 million) to 2004 at an annual rate of 9%[245], it can be concluded that if these jurisdictions were also included in the database adopted, they would reduce the discrepancy by more than US$367,119 million. Thus, the behaviour of tax havens can explain, in a sense, part of the discrepancy.

From a different angle, it is also possible to infer that the missing assets of high tax jurisdictions, which include high income OECD countries and developing ones, are related to tax havens' behaviour, and, consequently, to the problem of capital flight. For

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Islands, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Lebanon, Liechtenstein, Macao, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Palau, Panama, Samoa, St. Kitts, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos, Vanuatu and British Virgin Islands.

[242] The only jurisdiction accounted by Lane and Milesi-Ferretti as a small international financial centre but not included in the tax havens' list provided in chapter III is Palau.

[243] Jurisdictions included in both studies are: Bahrain, Lebanon, Mauritius and Panama.

[244] Cayman was not accounted since the magnitude of its data would distort the analysis performed. Furthermore, considering that there are still other tax havens missing, the figures of total assets and liabilities in tax havens might be still under-estimated.

[245] Hollingshead analysed the world growth in offshore deposits from 1996 to 2009 and identified a compound rate of 9 %. A. Hollingshead, 'Privately Held, Non-Resident Deposits in Secrecy Jurisdictions' (2010) Global Financial Integrity < http://www.gfip.org/storage/gfip/documents/reports/gfi_privatelyheld_web.pdf> accessed 07, March 2011.

instance, comparing data from the Coordinated Portfolio Investment Survey (CPIS) performed by the IMF, which provides information on countries' liabilities of portfolio investment securities-equity based on information from assets held by investor countries with data from the International Financial Statistics (IFS) compiled also by the IMF, but in which the liability position is informed by the country receiving the investment, i.e. debtor country, the differences on the measures are significant, as indicated in the table below: [246]

Table 4.3. (b) Portfolio equity liability

Portfolio Equity Liabilities - 2007		
Tax havens	**Liabilities by creditor countries (A)**	**Liabilities by debtor country (B)**
Cayman Islands	753.621	2.200.000[247]
Hong Kong	315.691	433.623
Ireland	407.287	1.155.090
Luxembourg	1.717.100	2.821.020
Singapore	127.683	165.137
Switzerland	604.944	725.644
Total	**3.926.325**	**7.500.514**

(Note: Portfolio equity liability: difference between values reported by creditor countries and by debtor countries).

Column A shows figures reported by investor countries, whereas column B reflects figures reported by countries receiving the investment. In theory, both figures should match since what represents an asset for one country is a liability for another one. However, in practice what is verified is a significant gap between those forms of reporting assets/liabilities. The missing assets in high tax jurisdictions' reports show up as liabilities in tax havens. In terms of flows, the higher value of column B indicates that there might be unreported flows coming out from high tax jurisdictions to tax havens.[248] This situation is in line with the dynamics of capital flight.

[246] Lane and Milesi-Ferretti pointed out this situation, using data from Ireland, Luxembourg and the United States. Lane and Milesi-Ferretti, 'The External Wealth of Nations Mark II' (n 174) 233.

[247] Due to the fact that the Cayman Islands do not report their IIP to the IMF, US$2,2 trillion at the end of 2007 is based on information provided by hedge funds. Lane and Milesi-Ferretti, 'Cross-Border Investment in Small International Financial Centers' (n 209) 7.

[248] Based on the difference between portfolio equity liabilities reported by destination country and investor countries, Lane and Milesi-Ferretti concluded that while some progress could be made in determining where some of underreported assets were held, it was still hard to identify which countries resident hold such assets. Lane and Milesi Ferretti, 'The External Wealth of Nations Mark II' (n 174) 233.

Considering the net asset position of tax havens and the gap identified when cross-matching figures of assets reported by investor countries with figures of liabilities reported by tax havens, it becomes clear that the behaviour of tax havens can explain part of the discrepancy and this situation might be associated to the phenomenon of capital flight. Of course, there is a substantial error in the database, however the arguments developed here create an alternative to explain at least part of the discrepancy.

In the next section, the situation identified above will be examined from the perspective of tax policies. The objective is to investigate if there is a tax policy justification for the behaviour of tax havens and, consequently, for the problem of capital flight. Of course, it is impossible either to predict the amount of capital flight that can be justified by this argument or to ignore the importance of other factors such as the economic and political stability offered by developed countries on the determination of the magnitude of capital flight. However, the analysis of the impact of tax policies on capital's flows will help to understand if there are legal arguments that justify the discrepancy.

4.4. Capital flight and the interplay of tax policies

The phenomenon of capital flight might be explained by the incentive induced by the interplay of tax policies enacted by countries. There are two principles that underpin these tax policies: (i) source taxation and (ii) residence taxation. Source taxation allows a given jurisdiction to tax all income generated in its territory, but elsewhere income is not taxed at all. Residence taxation, on the other hand, focuses on the person that receives the income rather than its origin, which means that all income of a resident is taxed wherever earned.[249]

Countries can freely apply these principles of international taxation. However, in practice, standard tax policy behaviour can be identified on how source and residence

[249] C.E. McLure Jr., 'U.S. Laws and Capital Flight from Latin America' (1988) 2687 NBER Working Paper 1, 6.

taxation are applied. In a simplified manner, provisions of tax treaties establish that active income is taxed at source, whereas passive income is preferably taxed at residence. These provisions might have induced countries' tax policy behaviour.[250] The word 'preferably' just mentioned denotes the controversy involving residence taxation of passive income. The tax loophole, therefore, that encourages capital flight, arises from the interplay of residence and source taxation on certain categories of passive income in which there is no worldwide tax policy consensus. In other words, the impact of tax policies on capital flight is basically related to passive income (i.e. income from portfolio investment), since active income (i.e. profits from FDI) is taxed worldwide at source, not offering huge controversies besides the definition of tax base and tax rate.[251] In terms of motivation, capital flight is not leaving the country only to seek the best rate of return to invest. Capital flight is leaving the country to avoid some attitude of domestic government.

In the past, most developing countries taxed their residents and non-residents only at source, leaving foreign income untaxed.[252] Nowadays, most developing countries tax their residents' income on a worldwide basis, while non-residents are only taxed at source, following the standard tax behaviour adopted by developed countries. In practice, the implementation of residence taxation is restrained by administrative constraints, since they are unable to control and to levy taxes on foreign income.[253] Consequently, many developing countries still levy taxes on non-residents' passive income earned in their territories in order to compensate for their ineffective taxation of residents' foreign income. Thus, the levy of withholding taxes on non-residents' passive income can be interpreted as a sign of the inefficiencies of developing countries' tax regimes.[254]

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[250] Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification' (n 228) 1305.

[251] Furthermore, data analysed in the previous chapter support this argument, since the net stock of FDI seems a real residual figure.

[252] As discussed in the next chapter, few developing countries still adopt source taxation to tax their residents and non-residents.

[253] The implication of administrative constraints will be discussed in detail later on.

[254] A. Giovannini and J. R. Hines Jr, 'Capital Flight and Tax Competition: Are There Viable Solutions to Both Problems?' (1990) 3333 NBER Working Paper, 18.

In this context, source taxation is justified by the inability of developing countries' governments to enforce their domestic tax laws against capital flight. Developing countries understand that they limit their exposure to tax avoidance by taxing capital income when it leaves the country.[255] Thus, there are two weaknesses in the developing countries' international tax policies: (i) ineffective taxation of residents' foreign income; and (ii) levy of withholding taxes on non-residents' passive income since in terms of tax competition they become less attractive.[256] These two drawbacks combined with tax policy enacted by developed countries to tax non-residents' passive income as well as the tax policy of tax havens create the perfect scenario for capital flight. Capital flight's motivation is to avoid some sort of regulation and the way tax policies enacted by developing countries, developed countries and tax havens interact create the ideal situation for it.

Developed countries have been applying worldwide taxation for a long time. In practical terms it means that their residents' incomes are taxed worldwide, independently of where the source of income is, while non-residents' interest is usually exempted. Developed countries usually apply 'pure' residence taxation, which is not justified by the raising of tax revenue but by the inflow of capital that rebalances their Balance of Payments.

The United States' (US) portfolio investment taxation illustrates this argument. The United States implemented gradually the exemption of income from portfolio investment by first enacting the Foreign Investors Tax Act (FITA) in 1966 and then by implementing the Tax Reform of 1984. The FITA established that investment income received by foreigners engaged in business in the US would be included in the taxable

[255] ibid.
[256] Thus, withholding taxes is not a problem per se, but it becomes a drawback in terms of tax competition, when tax policies enacted by developed countries are taken into consideration. In this sense, Harris and Oliver argued: 'The source country's right to tax is not without limitation. First, it may be limited by practical constraints. Capital importing countries find it difficult to tax highly mobile income, i.e. income where the geographical source is easily moved. Any attempt to tax such income may result in capital flight, i.e. the capital may move to another country that does not tax this type of income. The residence country may be in a superior position to tax highly mobile income, as historically persons have not been as mobile as income'. P. Harris and D. Oliver, *International Commercial Tax*. Cambridge Tax Law Series (Cambridge University Press 2010) 103.

income from the business only if effectively connected with such business; however, holding securities for investment purposes did not constitute a trade or business, being taxed with a reduced tax rate. The Tax Reform of 1984 expanded the benefits offered to security investments by exempting interest paid to foreigners for portfolio debt obligations.[257] These tax policies were enacted in order to rebalance problems in the US Balance of Payments since the exemption offered to portfolio investment made the inflow of this category of investment soar.

Other developed countries have enacted tax policies that benefit foreign investment in securities. For instance, in 1985 Japan repealed a 20% withholding tax levied on interest paid to non-resident bondholders; while a tax policy enacted in January 1989 by the West German Government which levied 10% withholding tax on interest paid to non-residents was repealed after only six months (July, 1989) due to its negative impact on the German market.[258]

There is a case study of the impact of the US withholding tax and the use of the Netherlands Antilles-US tax treaty that demonstrated the sensitivity of capital flows to withholding taxes. This study analysed the impact of the US 30% withholding tax on interest income paid to foreign persons, demonstrating that in order to avoid the tax costs of borrowing domestically, US parent companies frequently used a tax scheme involving the Netherlands Antilles to benefit from its tax treaty.[259]

The scheme consisted of the US parent company establishing a subsidiary in the Netherlands Antilles that acted as a conduit for the parent company to borrow overseas. Then, the Antilles company floated a bond issue in a European financial market. The borrowed funds passed through the Antilles subsidiary in order to achieve its final destination, i.e. the US parent company. Later, interest payments on the bonds made by the parent corporation flowed out of the US tax-free through the Antilles to foreign

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[257] McLure (n 249) 14-24.

[258] E. Parke, 'One-Way Treaty with the World: The US Withholding Tax and the Netherlands Antilles' (2000) 7 International Tax and Public Finance, 308

[259] ibid 295-313.

investors. The US-Netherlands Antilles tax treaty granted this tax-free flow of interest from US to the Antilles. After the US repealed the 30% withholding tax on interest income paid to foreign investors, corporate issues through the Netherlands Antilles practically disappeared and US corporate bonds sales to foreigners remarkably increased. This case-study proved how sensitive investors are to withholding taxes on interest income.[260]

Another important point highlighted by the same case-study is the responsiveness of the flow of capital when the lending country allows a foreign tax credit to offset the withholding tax charged by the source country. Foreign tax credits can eliminate the impact of withholding taxes on the flow of capital only when the foreign investor can claim 100% of tax credits against their domestic income tax. In this situation, the foreign tax credit only reallocates income between tax authorities of developed and developing countries. However, in other situations withholding taxes still obstruct foreign investment. For instance, tax-exempted institutions have no interest in investing in a country where withholding taxes are levied since they do not have any domestic tax liability against which foreign withholding tax can be credited. Another consequence when tax credits do not fully offset the withholding tax levied at the source is the increased cost of borrowing since investors will require a higher pre-tax interest rate.[261] In practice, therefore, even though tax credits can offset the increased tax liability imposed by withholding taxes on non-residents' passive income, their effectiveness depends on resident countries' tax policy, which cannot be controlled by source countries, limiting this strategy.

Capital flight from developing countries represents unrecorded outflow of capital encouraged not only by developed countries' tax policies that do not tax non-residents' income at source but also by the economic and political stability inherent in developed countries' markets. However, with the adoption of residence taxation by developing countries, taxpayers can only keep their zero marginal tax rates on foreign investments if

[260] ibid.298-300.
[261] ibid 297-302.

they do not report their foreign income to the developing countries' tax authorities. In practice, it is hard for developing countries' tax authorities to track this illegal flow since investors usually make triangular operations, using a 'tax haven' that inputs asymmetric information in the flow, curbing the identification of the beneficial owner of the investments. Therefore, the adoption of residence taxation by developing countries is inefficient without complementary administrative measures (e.g. exchange of information and transparency of tax havens). As a consequence, in order to offset this flaw of their tax systems, developing countries levy withholding taxes on non-residents' interest and other types of passive income, reducing even more the attractiveness of their domestic markets to foreign investors.

The taxation imposed by developing countries, therefore, is asymmetric, discouraging both domestic and foreign investments. Domestic investments are prevented due to unbalanced taxation: while domestic passive income is fully taxed; foreign passive income is exempted by developed countries' tax policies. For example, if an investor lends capital domestically, the interest received will be taxed; whereas when lent abroad, it will be exempted. From the perspective of foreign investors, on the other hand, the levy of withholding taxes signifies an increase on their total tax burden (assuming that tax credits cannot completely off-set withholding taxes), added to the extra risk inherent of developing countries' financial markets.

Capital flight is also a problem to developed countries, however its dynamics is different which might facilitate its curb, as explained. Developed countries usually adopt residence taxation to tax their residents' income which signifies that not only income generated in the country, but also abroad, needs to be reported by residents to be taxed by them. In order to avoid tax, unreported outflows from them as well as income sourced abroad that would have to be reported are maintained in tax havens. Tax havens work as offshore parking of income. This unreported capital located in tax havens could be invested in developed and developing countries. If invested in developing countries this capital would be taxed at source, reducing the rate of return of the investment. On the other hand, if invested in their own jurisdictions (round tripping), this 'non-residents' income' is not taxed at all since developed countries do not tax non-residents' income at source and as this investment is located in tax havens, it will not be taxed at the residence either. There is, therefore, an incentive for capital flight from developed countries to be invested in their own economies. This facilitates the procedure of its identification since in this case developed countries represent the source country, being able to require further information of the capital invested in their economies.[262]

The situation described in the previous paragraph made clear that capital flight from developed countries starts as a situation of tax evasion, i.e. illicit outflows and then it turns up as a case of tax avoidance, i.e. 'foreign' capital not taxed at source due to the enforcement of the residence principle by developed countries.

At this point, the current analysis made clear that there is a tax policy basis that can explain the phenomenon of capital flight. The enactment of source or residence taxation of passive income (i.e. income derived from portfolio investment) by countries does not generate per se the problem of capital flight, however the interplay of these policies creates a breach for capital to avoid taxation. In this sense, the incentives usually offered by developing countries to attract FDI compared with their source taxation of non-residents' passive income encourages the round tripping of capital flight via tax havens, i.e. unrecorded outflows returning as non-residents' FDI.

It is not possible to predict exactly how much of the discrepancy can be explained by capital flight nor the amount of capital flight that can be justified by tax policies enacted by countries. This is a limitation of the analysis performed. Notwithstanding these limitations, the argument developed showed that there is a tax policy justification for capital to leave developing countries and to be invested in developed ones, through tax havens.

In the next section, estimates of capital flight will be examined in order to provide further evidence of its relevance. There are only few methods available to measure the

[262] This idea will be discussed further in Chapter VIII.

narrow approach of capital flight, in which capital flight represents only unrecorded outflows of countries, as discussed next.

The arguments developed in the next section will bring once again to the discussion the question of whether it still makes sense to debate international taxation in terms of allocation of taxing rights between source and residence countries, regarding developing countries as capital importers and developed countries as capital exporters. The relevance of capital flight will challenge this approach, emphasising the importance of unrecorded outflows. The limitation of source taxation might not be the main issue hampering developing countries' tax base.

4.5. The importance of capital flight

4.5.1. Method adopted to calculate capital flight

Before analysing some figures of capital fight, the method selected (the Hot Money method) will be briefly explained as well as the reasons that other methods could not be adopted.

According to the Hot Money method, the Net Errors and Omissions (NEO) account of the BOP is used as the only estimation of unrecorded capital outflows. The NEO is an account designed to balance the other accounts in the BOP since even though, in principle, every recorded transaction in the BOP is represented by two entries with equal values and opposite signs (one of these entries is designated a credit and the other is designated a debit), in practice, the sum of all credit entries usually differs from the sum of all debit entries due to different sources of data.[263] Consequently, there may be a summary net credit or net debit. The NEO is then used to balance the accounts, i.e. its value is equal to the unbalanced amount with the sign reversed. For instance, if a current account surplus is not offset by a financial account deficit and/or reserve deficit, there will be a negative NEO, representing capital flight. There are shortcomings in assuming

[263] IMF, 'BOPS Manual' (n 152) 6.

that a negative NEO represents capital flight since its negative sign can be justified by other problems in the accounts, not only from unrecorded outflow of capital. This is the usual critique of this method of measuring capital flight.

The NEO is therefore an indicator of capital flight of relative accuracy. Despite that, a large, persistent negative NEO that is not reversed should cause concern.[264] Such NEO might jeopardise the interpretation of BOP figures. In fact, a large negative NEO may also have implications for interpretation of the IIP. Thus, although there are some shortcomings in interpreting the NEO values as a measure of capital flight, a long period evaluation of its sign and value might be a critical indicator of the reliability of the IIP of countries reflected in official statistics. Furthermore, there are data available to calculate capital flight based on NEO for a significant number of developing countries, developed countries and tax havens. Therefore, even though there are other methods that can estimate capital flight more accurately, the NEO represents the method with more data available for the three groups of countries analysed.

There are two different measures of NEO available: NEO from BOPS and NEO from Lane and Milesi-Ferretti's database. Considering that the objective of analysing capital flight is to compare it with the discrepancy between the stocks of assets and liabilities held by countries, NEO from BOPS will be accumulated from 1994 to 2004, since before 1994 there is a lot of data missing from developing countries and the year 2004 represents the most recent year of the discrepancy calculated by Lane and Milesi-Ferretti. The NEO from Lane and Milesi-Ferretti's database represents accumulated figures, which means that 2004 NEO figures represent accumulated values from 1970 to 2004. However, it will be necessary to identify the evolution of the NEO based on its annual evolution since only negative figures can be accounted as capital flight through this method. The 2004 negative NEO signifies that when putting together NEO from 1970 to 2004 negative figures were higher than positive ones.

[264] ibid.

Regarding the size of each group, the group of developing countries is composed of 86 countries.[265] The group of developed countries is composed of 22 countries,[266] classified as high income OECD countries, following the same parameters explained in the previous chapter. The group of tax havens is represented by 14 countries.[267] The IIP of those countries reflect figures from Lane and Milesi-Ferretti's database.

Due to the fact that this study adopted the narrow approach of capital flight, the other indicated method would be the Dooley's method[268] since it attempts to identify only unrecorded private outflows of capital. However, nowadays its use is limited due to the fact that the standard components of the fifth edition of the Balance of Payments Manual (BPM5) do not require capital flows to be compiled by date of maturity which means that information required to adopt this method is no longer available.[269] Thus, even though this method was the most appropriate one to identify unrecorded outflows of capital, and, consequently, to adjust countries' IIP, in practice this method could not be adopted.

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[265] Brazil, China, India, Mexico, Russia and South Africa are classified as BCIMRS; whereas other developing countries are presented by Albania, Angola, Argentina, Armenia, Azerbaijan, Bangladesh, Belarus, Benin, Bolivia, Bosnia and Herzegovina, Botswana, Bulgaria, Burkina Faso, Cambodia, Cameroon, Chile, Colombia, Congo, Côte d'Ivoire, Croatia, Dominican Republic, Ecuador, Egypt, El Salvador, Ethiopia, Fiji, Gabon, Georgia, Ghana, Guatemala, Guinea, Haiti, Honduras, Indonesia, Iran, Jamaica, Kazakhstan, Kenya, Kyrgyz Republic, Lao People's Dem.Rep, Macedonia, Madagascar, Malawi, Malaysia, Mali, Moldova, Morocco, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Romania, Rwanda, Senegal, Sri Lanka, Sudan, Swaziland, Tajikistan, Tanzania, Thailand, Togo, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, Uruguay, Venezuela, Rep. Bol., Vietnam, Yemen, Zambia and Zimbabwe. Total developing countries label refers to BCIMRS added to other developing countries.

[266] Australia, Austria, Belgium, Canada, Czech Rep., Denmark, Finland, France, Germany, Greece, Iceland, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, the United Kingdom and the United States.

[267] Bahrain, Costa Rica, Cyprus, Hong Kong, Ireland, Jordan, Latvia, Lebanon, Luxembourg, Malta, Mauritius, Panama, Singapore and Switzerland.

[268] According to the Dooley's method, capital flight can be calculated by adopting the following steps: (i) computing the cumulative BOP assets (excluding FDI); (ii) adding NEO; (iii) adding the difference between the stocks of debt liabilities reported by the World Bank and the cumulative debt liabilities recorded in the BOP; and at last (iv) subtracting the stock of external assets measured by the capitalisation of income of foreign assets reported in the BOP using an interest rate, which can be the US Treasury Bill rate. The underpinning idea is that income earned on recorded capital outflows are reported in the BOP, while income from capital flight goes unreported.

[269] D. Kar and D. Cartwright-Smith, 'Illicit Financial Flows from Developing Countries: 2002-2006 – Executive report' (Global Financial Integrity) <http://www.gfip.org/storage/gfip/economist%20-%20final%20version%201-2-09.pdf> accessed 21 March 2009, 6-7.

The method mostly used in the literature to calculate capital flight is the World Bank Residual method. The main idea of this method is that sources of funds exceeding use of funds represent private outflow of capital, i.e. capital flight. Sources of funds are represented by (i) increases in net external indebtedness and (ii) net flow of foreign investment; whereas use of funds is represented by (i) current account deficit and (ii) net value of Reserves.[270] In a sense, capital flight captured by the World Bank Residual method represents the sum of identified private flows plus the net errors and omissions from BOPS.[271] Thus, the World Bank Residual method adopts the broader approach of the definition of capital flight, including not only unrecorded flows but also recorded private flows officially reported in the Balance of Payments. That is the reason that this method will not be adopted.

Thus, considering the limitations of the data available and the fact that the Dooley's method could not be applied in practice, in the next section, the only method used to estimate capital flight, understood as unrecorded private flows, is the Hot Money method.

Finally, it is important to emphasise that there was no effort made to improve the original data used, if there was any problem such as missing information or even inaccurate estimates. There were, therefore, neither adjustments nor attempts to complete the unrecorded values in the official figures provided by the IMF. The analysis of capital flight figures restricts itself to providing a measure of relevance of these outflows in order to understand its importance for the international tax debate, involving developed countries, developing ones and tax havens.

[270] ibid.
[271] S. Claessens and D. Naude, 'Recent Estimates of Capital Flight' (1993) 1186 IMF Working Papers WPS, 4-5.

4.5.2. Analysing the data

4.5.2.1. The Hot Money method

The magnitude of capital flight using the Hot Money method is estimated in the table below (all values are in millions of US dollars):

Table 4.5.2.1. Hot Money and Capital Flight

Estimating Capital Flight (KF)	I. Hot Money Method			II. Countries' IIP	III. IIP (+) NEO	
Groups 1994-2004	N. of countries	(A) NEO from BOPS (1994-2004)	(B) NEO Lane and Milesi (1970-2004)	(C) Stocks of Liab. – Assets (1970-2004)	Net = (A) + (C)	Net = (B) + (C)
High Income OECD	22	-381,153	-1,300,476	2,473,641	2,092,488	1,173,165
Tax Havens	14	-59,751	-91,295	-1,024,532	-1,084,283	-1,115,827
BCIMRS	6	-244,954	-398,669	536,716	291,762	138,047
Other Developing Countries	80	-185,792	-283,663	1,095,400	909,608	811,737
Total Developing Countries	86	-430,746	-682,332	1,632,117	1,201,371	949,785
Total of all groups	122	-871,650	-2,074,103	3,081,226	2,209,576	1,007,123

(Note: Analysis of the impact of accumulated flight capital calculated through the Hot Money method on countries' IIP).

The table provides a general picture of the evolution of accumulated flight capital[272] calculated through the Hot Money method from 1970 to 2004 based on NEO from BOPS and from Lane and Milesi-Ferretti's database. To calculate 'accumulated' NEO from BOPS, annual values were simply added up. No further adjustments were accounted such as inflation and interest earnings, which produced a very conservative measure of flight capital. There is, however, one fact that justifies the differences

[272] It is necessary to make clear that capital flight suggests illegal outflow of capital from a country. As this section deals with accumulated values of capital flight, which will be compared with countries' IIP, the expressions 'accumulated flight capital' and 'stocks of flight capital' will be adopted.

between NEO from BOPS and NEO from Lane and Milesi-Ferretti's database: the difference in the periods analysed since whereas Lane and Milesi-Ferretti compiled all data available since 1970, BOPS' data reflect only figures from 1994 onwards. Besides this shortcoming, the availability of data to apply the Hot Money method allowed the comparison of estimates among three different groups of countries: high income OECD countries, tax havens and developing countries. Developing countries are divided in two groups: (i) BCIMRS[273] and (ii) other developing countries.

The structure of the table is underpinned by the idea of comparing estimates of accumulated flight capital with the net values of stocks of foreign assets and liabilities. The first part (I.) provides estimates of accumulated flight capital calculated through the Hot Money Method; the second part (II.) provides figures of net values of stocks (i.e. countries' IIP); and the third part (III.) demonstrates the impact of accumulated flight capital over countries' IIP by adding part (I.) to part (II.).

It is important to understand the sign of figures provided in the table before focusing on the analysis of the outcomes. Only negative NEO represents capital flight. That is the reason that part (I.) provides only negative figures.[274] The second part, on the other hand, provides positive and negative figures; the reason for that is the fact that stocks of assets are reduced from stocks of liabilities, which means that whether liabilities are higher than assets, the figure is positive; whereas if assets are higher than liabilities, the figure is negative. Consequently, in order to verify the impact of accumulated flight capital calculated through the Hot Money method (part III.), it was necessary only to add column (A) and column (B) to column (C). In other words, capital flight represents assets held abroad by non-residents, therefore, considering the convention adopted in this study that liabilities are represented with a positive sign (due to the fact that in terms of flows they represent inflows of capital) and assets are represented with a negative sign, in order to adjust countries' IIP with figures of accumulated flight capital, it was necessary only to add NEO (column A & B) to countries' IIP (column C).

[273] Brazil, China, India, Mexico, Russia and South Africa.

[274] Positive figures were not accounted since they did not represent capital flight. Therefore, NEO of each group is composed by only negative values identified when analysing each countries' figures.

On examining the estimates of accumulated flight capital through the Hot Money method, at first glance, considerable differences are identified between NEO from BOPS (A) and NEO from Lane and Milesi-Ferretti's database (B). In a sense, estimates of accumulated flight capital from developing countries through NEO from BOPS and from Lane and Milesi-Ferretti's database should be higher. One justification for that is the fact that there is a lot of data missing before 1994. Therefore, even though columns (A) and (B) refer to different periods, in practice most data from developing countries are available only from 1994 onwards even in Lane and Milesi-Ferretti's database. In contrast, NEO from BOPS and NEO from Lane and Milesi-Ferretti in relation to High Income OECD countries are substantially different since there is a significant amount of information available for this group since 1970, which means that the difference is justified by the length of period analysed for each variable. Despite these limitations, the analysis of constant negative NEO might be interpreted as a conservative measure of accumulated flight capital.

Focusing on the figures from column (B), the first outstanding evidence is the fact that even though high income OECD countries concentrate most stocks of foreign assets and liabilities, in terms of accumulated flight capital, calculated through the Hot Money method, their estimates (US$1,300,476 million) are only twice the value of accumulated flight capital from developing countries (US$682,332 million), even considering the limitation of data available for developing countries before 1994. In a sense, considering NEO from BOPS during the period that there is substantial amount of information for these both groups of countries, what is interesting to note is the fact that is the total value of NEO from developing countries (US$430,476 million) is slightly higher than high income OECD figure (US$381,153 million), suggesting that if information from developing countries were better reported since 1970, the value of accumulated NEO of these two groups would have the same magnitude.

The figures of accumulated flight capital from tax havens are significantly lower (US$91,295 million) when compared to the other two groups. The outcomes from tax havens are consistent with their tax policies that encourage non-residents to hold assets in their jurisdictions. Therefore, it is not useful to measure accumulated flight capital from tax havens. In fact, regarding the dynamics of the flows, capital flight should be allocated in their jurisdictions. This conclusion is based on the argument that even though tax havens work as intermediaries in the international flow of capital, when comparing assets reported by investor countries with their internal reports of liabilities held by them, the latter figures are higher indicating that the missing assets of high tax jurisdictions may be allocated there.

The outcomes presented in column (III.) of the table represent low net values of stocks of liabilities and assets held by developing countries and high income OECD countries since the sum of column (A) and (B) to column (C) aimed to add up a portion of assets that were missing from countries' official figures. However, the analysis cannot explain the entire value of the discrepancy.

Thus, considering the limitations of applying other methods to calculate the accumulated flight capital followed by the flaws in assuming that NEO represents only unrecorded outflows of private capital, it is very hard to prove that the discrepancy represents only capital flight since there might be also an error i.e. unexplained values. However considering that (i) the discrepancy significantly increased during the period analysed; (ii) the difference between assets reported by high tax jurisdictions and liabilities reported by tax havens based on CPIS data; and (iii) the increased participation of tax havens in the international financial flow, it can be assumed that there is a considerable amount of capital flight affecting countries' IIP. NEO can help to estimate capital flight, however capital flight cannot explain the total value of the discrepancy.

Having in mind the limitation explained in the previous paragraph, in 2004, developing countries' net stocks of portfolio investment, which include portfolio equity, debt and other investments, corresponded to US$1,116,183[275] million, i.e. stocks of liabilities surpassed stocks of assets in this amount. It should be remembered, however, that this figure reflects assets and liabilities held by the private and the public sectors. The definition of capital flight adopted in this study refers to private unrecorded outflows of capital, i.e. figures that official statistics cannot capture. Thus, in order to identify the effective impact of capital flight measured through the Hot Money method (US$682,332 million), it would be necessary to segregate the public from the private amount. In practice, however, the data do not allow this separation. Despite this constraint, it can be concluded that the impact of capital flight is relevant since if not reversing their position of debtor to creditor, in relation to the private amount, their position would become more balanced, affecting the assumption that developing countries are capital importers of portfolio investment. Thus, even a very conservative estimation of capital flight, based on NEO, contributes to the argument that it is very hard to validate the traditional assumptions in the current scenario. The understanding of the impact of tax evasion (capital flight) on the legal debate brings up the effective interest of developing countries in international taxation.

In sum, this section aimed to show that there is evidence in the data that demonstrates the relevance of capital flight to high tax jurisdictions. Capital flight needs to be considered when discussing international taxation. Consequently, notwithstanding the difficulty of classifying countries as capital importers and capital exporters in the context of financial globalisation, the problem of capital flight makes this aspect even more complicated since it distorts the position of countries, overestimating their debtor's position.

But what is the implication of capital flight for taxation? Capital flight represents loss of tax base, since income derived from assets held abroad is not reported, and, consequently, countries cannot tax it. However, to predict how much of capital flight would increase tax revenue is very speculative. It is very hard to foresee a confident

[275] The difference between this figure and the one presented in Chapter III refers to the fact that here it is presented as the value of net stocks of portfolio investment in 2004, whereas there the tables reflect the average of net stocks per period analysed (1970-79; 1980-89; 1990-99, 2000-04).

figure because it relies on taxpayers' behaviour. Therefore, even though the exact amount of tax revenue is difficult to predict, we can assume that additional income would be raised. Furthermore, another interesting aspect that also needs to be considered is the fact that not all income reported could be taxed by countries. There are also internal inefficiencies that constrain countries' tax bases. Thus, added to the difficulty of predicting the behaviour of capital flight, it is also necessary to remember the fact that other problems also restrict countries' tax bases (e.g. administrative limitations), and consequently, the amount of tax revenue raised by them. The ideal situation would occur if unreported assets could become part of countries' tax bases. To this extent, the values predicted in the next paragraph only aim to provide a dimension of the capital flight problem in terms of taxation. If countries would be able to effectively raise that amount of tax revenue is another issue.

According to estimates of Tax Justice Network, the value of assets held offshore by the world's high net-worth individuals in 2005 lay in the range of US$11 – US$12 trillion.[276] Hence, the amount of accumulated flight capital estimated in this section would represent only 19% (US$ 2 trillion - total column B) of total assets held offshore. It is a conservative estimate; however it already represents a significant amount of wealth. To this extent, if we follow the methodology adopted by Cobham to calculate the loss of tax revenue that these assets (US$682,332 billion –column B for developing countries) might represent, we find out that on applying an interest rate of return of 7.5% per year, these assets could generate an income of US$51.2 billion and, consequently, the annual tax loss would be approximately US$15.4 billion (income tax rate of 30%).[277] In 2004, developing countries received from OECD countries as Official Development Assistance (ODA) disbursements of US$79.8 billion.[278] The comparison of the loss of tax revenue with ODA disbursements (20%) in 2004 made us

[276] The range of US$11–US$12 trillion is based on data from Boston Consulting Group, McKinsey's, Merrill Lynch and the Bank for International Settlements. Tax Justice Network, 'The Price of Offshore', <http://www.taxjustice.net/cms/upload/pdf/Briefing_Paper_-_The_Price_of_Offshore_14_MAR_2005.pdf> accessed 24 July 2011.
[277] A. Cobham, 'Tax Evasion, Tax Avoidance and Development Finance', 129 Working Paper Number <http://www3.qeh.ox.ac.uk/pdf/qehwp/qehwps129.pdf> accessed 18 October 2010.
[278] OECD, 'Statistics: DAC2a ODA Disbursements', <http://stats.oecd.org/Index.aspx?DatasetCode=TABLE2A> accessed 18 October 2010.

realise that developing countries would need much less financial assistance if they could tax the income generated from capital flight, even based on very conservative figures.

Comparing the figures of accumulated flight capital estimated through the Hot Money method with the values of assets held offshore by the world's high net-worth individuals, it becomes clear that the former represents a very conservative figure. One possible explanation for this difference is the fact that capital flight estimated here reflects mainly illegal flows, i.e. unrecorded outflows of capital, whereas the amount of private non-resident deposits held in secrecy jurisdictions encompasses legal and illegal flows of capital. Due to the behaviour of tax havens, situations of tax evasion (illegal flows) are mixed up with tax avoidance (legal flows). Even though most tax havens are also developing countries, they are jeopardising other developing countries' tax base.

Following this line of reasoning, it is interesting to note, as debated in Chapters VII and VIII, that there is much more control to combat capital flight in the developed world rather than in developing countries. In these circumstances, tax evasion might be replaced by tax avoidance (i.e. more sophisticated mechanisms to escape taxation).

As discussed in the body of this chapter, there are many different ways to estimate capital flight. A lot has been written about the importance of tax havens and the amount of assets held offshore. However, the discussion was not clear about what is the effective problem. In a sense, studies have provided different estimates of the problem represented by the behaviour of tax havens without making clear what they are referring to. Therefore, the objective of this section was not to calculate better estimates of capital flight than the ones predicted by previous studies. The main idea here was only to explain the problem of capital flight and how it is affecting developing countries, from a tax perspective.

Finally, the analysis of capital flight proved that it is even harder to characterise a country as capital importer and capital exporter. Capital flight needs to be considered in order to avoid overestimates of countries' debtor position. The classification of countries as capital importers and capital exporters in terms of flows has left aside the problem of capital flight. Consequently, if the discussion about international taxation remains focused on allocation of taxing rights between source and residence countries based on the old assumptions, the effective interest of developing countries will not be addressed. In other words, to increase developing countries' tax base, the importance of capital flight needs to be regarded.

4.6. Conclusion

The relevance of capital flight to developing countries proved that the crisis of residence taxation faced by developed countries is also affecting them since it became evident that developing countries do need instruments to tax income derived from foreign assets held abroad by their residents. The enlargement of source taxation is not the correct measure to improve the tax base of developing countries. This means that it is not limited source taxation that jeopardises developing countries' tax base, but the amount of capital flight that remains untaxed.

Developing countries need to understand their effective interest in international taxation. To this extent, assuming that a significant amount of accumulated flight capital might be invested as portfolio investment, as suggested by the figures of Chapter III, the analysis of the principles that have underpinned taxation of income derived from portfolio investment as well as developing countries' experience in this area represents the next step of this study.

Chapter V. Taxation of Portfolio Investment

5.1. Introduction

Before the current process of globalisation, foreign direct investment (FDI) was significantly higher than portfolio investment. Consequently, portfolio investment was a secondary issue in the international tax debate. It was not necessary to distinguish the flow of cross border investment between FDI and portfolio investment.[279] The increased importance of portfolio investment in the global economy changed this scenario. Figures of the international flow of capital can easily demonstrate this new reality: in 2007, in a sample of 151 countries,[280] inflows of FDI corresponded to 2,298,280 millions of dollars; while inflows of portfolio investment reached the value of 3,577,740 millions of dollars.[281]

Despite economic evidence of the increased importance of portfolio investment, only a few legal studies in the current literature have addressed taxation of portfolio income in this new context.[282] Moreover, the studies available approached the subject only from the perspective of developed countries. One reason for that might be the fact that this type of investment is still concentrated in these countries.[283] However, the concentration

[279] As previously discussed, FDI is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another country, owns 10% or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). On the other hand, portfolio investment covers transactions in equity securities that corresponds to less than 10% of the ownership of the foreign entity made by individuals or corporation, plus debt securities, including bonds and notes, money market instruments and financial derivatives. IMF, 'BOPS Manual' (n 152) 6.

[280] The sample of 151 countries is composed of 22 High Income OECD countries, 29 tax havens and 100 developing countries. Further details of these data are available in Chapter III.

[281] IMF, International Financial Statistics (2009). ESDS International. University of Manchester.

[282] D. J. Frisch, 'The Economics of International Tax Policy: Some Old and New Approaches' (1990) 47 Tax Notes, 1-17; M. J. Graetz and I. Grinberg, 'Taxing International Portfolio Income' (2002-03) 56 Tax Law Review, 537-86; A. Schindel and A. Atchabahian, 'General Report' in International Fiscal Association (ed.), *Source and Residence: New Configuration of their Principles*, (vol. 90a, Cahiers de droit fiscal international, Sdu Fiscale & Financiële Uitgevers 2005) 21-99;

[283] Graetz, based on the US Treasury Report on Benchmarked Survey of US Ownership of Foreign Securities (1998), argued that: 'Although US portfolio investments are widespread throughout the world, two-thirds of such investment is in 10 countries, with 5 countries (UK, Canada, Japan, the Netherlands

of this type of investment in developed countries should not lead to the misguided conclusion that taxation of portfolio investment is of limited interest to developing countries. As the figures analysed in Chapter III suggest, a substantial amount of capital flight might be probably invested as portfolio investment. Therefore, the relevance of portfolio investment and, consequently its taxation, cannot be underestimated for developing countries. Even though the current debate has not yet addressed this issue, to understand where we are in relation to taxation of portfolio investment, three different approaches will be examined: (i) economic theory; (ii) legal debate; and (iii) practical aspect. Even though it seems that these three approaches do not fit together, their analysis will provide a broader perspective to understand where we are in terms of taxation of portfolio investment. In a sense, they are not complementary arguments, which means that each one of them does not need to be understood in relation to the other, but they input additional information on taxation of portfolio investment in an autonomous way.[284]

The objective of this chapter, therefore, is to analyse taxation of passive income, i.e. income derived from portfolio investment and classified as interest, dividends or capital gains, from three different angles. Despite the assumption that developing countries are mainly interested in FDI, until now it has also been presumed that developing countries are better off by enforcing source taxation of non-residents' portfolio investments through the levy of withholding taxes; whereas developed countries prefer to apply residence taxation on income derived from portfolio investment. These assumptions, which are also associated to countries' economic profile as capital importers and capital exporters, have been used in the economic and legal discourse, as demonstrated next.

The analysis performed through those three different approaches will show different problems affecting taxation of portfolio investment. In a sense, it will highlight the fact

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and Germany) attracting more than $100 billion each of such investment'. M. J. Graetz, 'The David R. Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies' (2001) 54 Tax Law Review 261, 315.

[284] I. Roxan, ('Understanding International Taxation in the Age of Globalisation'. Seminar delivered at the London School of Economics and Political Science on the 24th November, 2010). Quotation authorised by the author.

that income derived from portfolio investment is very hard to tax due to the mobility of this type of investment.

Regarding economic theory, taxation of portfolio investment will be examined through the criterion of economic efficiency. The criterion of economic efficiency is the cornerstone element of neutrality policies, which analyses international taxation in terms of the distortions it causes on the international flow of capital. Neutrality policies are based on the idea of identifying countries as capital importers and capital exporters since it examines taxation in terms of incentives created for inbounds and outbonds of investment. As demonstrated previously, nowadays we need to distinguish between FDI and portfolio investment, in addition to the fact that flows are much more bidirectional. Considering these new assumptions, neutrality policies will be tested in order to verify whether they can still justify tax policies applied to portfolio investment.

In relation to the legal debate, the standard tax policy behaviour adopted by countries to tax portfolio investment is verified on the allocation of taxing rights provided in tax treaties.[285] The analysis of the allocation of taxing rights in tax treaties will help to understand how the legal debate has evolved between developed and developing countries. As a consequence, problems affecting taxation of portfolio investment in tax treaties will be revealed; showing how hard it is to tax this type of income.

Finally, current tax policies enacted by developing and developed countries will be evaluated in order to demonstrate what is going on in practice (pragmatic approach). The objective here is to understand how countries have taxed income derived from portfolio investment. In a sense, the difference between tax policies enacted in practice and the arguments adopted by the economic theory and the legal debate will become clear.

In sum, this chapter will analyse how taxation of portfolio investment has been justified by economic, legal and pragmatic arguments. The comparison of these different

[285] Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification' (n 228) 1305.

approaches will put in evidence the difficulty on taxing portfolio income and, consequently, some limitations that might also affect taxation of capital flight invested as portfolio investment.

5.2. Economic aspect: neutrality policies

Most analysis of international income tax policy is underpinned on economic efficiency, particularly on neutrality policies. Neutrality policies were developed by Musgrave when: (i) the international flow of capital was basically represented by FDI; (ii) the flow of capital was unidirectional making the identification of capital import and capital export countries easy; (iii) there was a clear association between development and flow of capital, which means that developed countries were capital exporters, while developing countries were capital importers.[286]

Nowadays these premises that underpinned her economic theory have changed, making it more difficult to justify international taxation through neutrality policies. Thus, in the next paragraphs, the arguments of different authors will be examined in order to reconcile new premises brought by the current process of globalisation with the economic theory developed by Musgrave.

According to the neutrality policy, the connection between methods for preventing double taxation and the level of incentive to invest abroad creates different 'neutralities'. The term neutrality applied by Musgrave means whether tax systems are neutral when choosing between investing at home or abroad. In fact, neutrality is an economic concept based on the assumption that productivity will increase if producing factors are distributed by market forces without the interference of taxation. There are three types of neutrality: Capital Export Neutrality (CEN), National Neutrality (NN), and Capital Import Neutrality (CIN).

[286] P. B. Musgrave, *Taxation of Foreign Investment Income: An Economic Analysis* (John Hopkins Press, 1963).

The objective of CEN policy is to prevent taxation from distorting an investor's decision on the place of investment (i.e. home or abroad). CEN is achieved when residents of a country pay the same amount of tax, whether they have domestic or foreign income. CEN would work perfectly in a world where only residence taxation was applied. However, countries usually tax income at source and to promote CEN, the residence country should recognise tax credits for the amount of tax paid abroad. Theoretically, to maintain CEN, there should be no limit on foreign tax credit, since the total amount of tax paid by a taxpayer with foreign income should not exceed the total tax that would be payable according to the taxation imposed at the residence country. In this context, if the taxation of income was higher abroad, the residence country would have to reimburse the taxpayer to promote CEN. Based on these arguments, economists have concluded that CEN promotes worldwide economic efficiency. In practice, CEN has been adopted by developed countries, which tend to favour residence taxation.[287]

NN is based on the argument that governments are not indifferent to which government collects tax revenue, since only taxes collected at home maximise the national welfare. Therefore, investors should only invest abroad if both the investor and the government benefit from such investment. NN is achieved when the tax revenues of the country of residence and the after-tax returns of its residents are equal.[288] In this context, investors can only deduct foreign tax from their domestic taxable income.[289]

The aim of CIN policy is to ensure that the tax levied on domestic or foreign investment should be the same, i.e. CIN ensures that the total tax imposed on investments in a certain country is the same whether the taxpayer is a resident or a foreigner. CIN can be promoted when all countries levy identical tax rates on all income produced within their

[287] T. Dagan, 'National Interests in the International Tax Game' (1998-99) 18 Virginia Tax Review 363, 367-69.
[288] ibid 370.
[289] Even though NN represents an alternative tax policy that can be enacted by countries, in practice countries do not use it, opting for CEN or CIN policies. The reason for countries not applying NN is connected to an economic theory described as 'beggar thy neighbour' policy. Based on this theory, countries would not adopt NN due to the fact that a foreign government would be likely to react to it, enacting a similar policy. The aftermath of most governments using NN policy would represent a loss to the world welfare. Therefore, the following discussion will focus only on CEN and CIN policies. Frisch (n 282) 5.

territories. However, in practice countries also adopt residence taxation and the achievement of CIN depends on residence countries recognising tax exemptions on income produced abroad. Even though not promoting worldwide welfare, developing countries have opted for CIN policy due to the assumption that they are capital importers and this policy tends to benefit their economic situation, (i.e. to balance the distortion in the allocation of capital). [290]

These methods of efficient allocation of capital have been applied based on methods to relieve double taxation between source and residence countries, focusing on active income i.e. business profits. As already mentioned, globalisation has remarkably increased the flow of capital around the world, which includes FDI and portfolio investment. The flow of capital needs to be distinguished in two categories, which have different impact on countries' economies. The former is connected to entrepreneurial investment, while the latter is not being classified as non-entrepreneurial investment.[291] From this new perspective, the debate involving methods of efficient allocation of capital, i.e. the use of neutrality policies needs to be reviewed considering both types of income: active business income and passive income. This new context provides a different interpretation for the adoption of CEN by developed countries and CIN by developing countries. Some authors have already updated the discussion about neutralities with the new characteristics of the flow of investments from the perspective of developed countries. The outcome of the debate involving developed countries will help to understand the situation in developing countries.

Expanding the understanding of tax neutralities to this new scenario in which there are two different types of investments with economic value, a question arises: Can a country promote more than one type of neutrality, i.e. is it possible for a country to adopt CIN policy for one type of investment and CEN policy for another one?

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[290] Dagan, 'National Interests in the International Tax Game' (n 287) 370.
[291] K. Vogel, 'World-Wide Versus Source Taxation of Income – A Review and Revaluation of Arguments' in *Influence of Tax Differentials on International Competitiveness: Proceedings of the VIIIth Munich Symposium on International Taxation* (Kluwer Law and Taxation Publishers 1990), 144.

From a theoretical perspective, the core issue to answer this question is to understand whether neutrality is an absolute and indivisible concept or whether neutrality is a relative concept that allows division. The doctrine has assumed different positions: there are authors who accepted a relative concept of neutrality whereas others did not. Professor. Vogel argued in favour of an absolute concept of neutrality by defending that neutrality applied only to certain economic processes would always represent less than full neutrality; in fact, for him, partial neutrality represents a non-neutral situation.[292]

Jeffery, on the other hand, analysed neutrality from a different perspective, looking at the nature of the problem that needs to be solved. He emphasised the fact that one kind of neutrality cannot solve all types of complexities brought by international tax arrangements. Thus, Jeffery defended the argument that the international economy requires a flexible concept of neutrality and the best approach is not to see neutrality as an absolute ideal. On this basis, there can be different types of neutrality considerations depending on what neutrality goals are being compared.[293] The argument developed by Jeffery justifies the adoption of CIN and CEN for different types of income by the same country, even though CEN and CIN cannot be applied simultaneously for the same type of income. This line of reasoning has guided the current debate about economic efficiency.

Assuming that a country can apply CIN and CEN to different types of income, there is a current discussion on whether CIN should be applied to active business income and CEN to passive income.

Frisch argued in favour of the application of these different neutralities based on economic and political arguments. For this author, the advantage of applying CIN to active business income is that the competitiveness of an enterprise operating in a country with low or non-taxation is not affected by the level of taxation enforced in the multinational's home country (political argument). The diminished competition of

[292] Vogel (n 291) 140.
[293] Jeffery (n 28) 8-9.

multinationals affects the world economy and not only a multinational's home country. On the other hand, he defended that CEN may work better with passive income, since it makes sense to tax investors equally whether they invest at home or abroad.[294]

Avi-Yonah initially defended the argument that CEN is still the best alternative for taxing cross-border investment and it should be applied equally to portfolio and foreign direct investment. He pointed out the following arguments in favour of CEN: (i) even though portfolio investment is higher than FDI, it does not mean that the latter is not important in the allocation of investment; (ii) the application of CEN to portfolio investment does not preclude its application to FDI; (iii) taxation impacts multinational's decisions and the adoption of CIN will provide incentive for companies to move to lower tax jurisdictions; (iv) taxation of dividends might justify the lighter taxation of corporate profits, however this situation is better solved by integration between corporate and shareholders' taxation rather than by relief at corporate level; and (v) political argument based on competitiveness of multinationals ignores the possibility of solving this conflict by enacting cooperative policies, such as CEN by all OECD members. In sum, Avi-Yonah's arguments were based on the main concept that cross-border income should not be taxed less than domestic income, independent of the type of income that is produced abroad.[295]

However, recently, Avi-Yonah published an article recognising the fact that the US and the rest of the developed world have moved toward territorial taxation of corporate income, decreasing their emphasis on Controlled Foreign Company (CFC) rules. He justified this trend by economic and political reasons. From an economic perspective, tax competition has led multinationals to move their headquarters to countries that do not tax their foreign business income. From a political perspective, multinationals' representatives have pressured local governments to change their corporate tax rules in order to protect the domestic industry, enhancing their capacities to compete in the international market. It seems, therefore, that even though, in terms of economic

[294] Frisch (n 282) 9-11.
[295] Avi-Yonah, 'Globalisation, Tax Competition, and the Fiscal Crisis of the Welfare State', (n 122) 110.

efficiency, CEN is supported by economists, in practice, CIN might be the best alternative for active business income due to economic and political interests.[296]

Graetz went a step further in the discussion by pointing out the inadequacy of thinking of international taxation only in terms of economic efficiency. He first published an article arguing that: (i) the best way to structure taxes on international investment income is to focus on maximising the US national welfare rather than global welfare which signifies that CEN might not correspond to the interest of a country in international taxation; (ii) the tax systems of countries adopt different tax bases and tax rates which lead the US to adopt tax policies that represent a compromise between CEN and CIN; (iii) economic efficiency is only one aspect of international tax policy, other aspects (e.g. fairness, revenue needs, compliance costs, administrative burdens) also need to be regarded when discussing international taxation; (iv) the neutrality policy developed by Musgrave did not consider the benefits of inbound investments, which represents a serious flaw in her theory when applying it to the current profile of the international flow of investment between developed and developing countries; and (v) it is necessary to draw a sharp distinction between tax policy applied to FDI and to portfolio investment. In sum, Graetz demonstrated that the traditional debate involving CEN and CIN is surpassed based on the analysis of the US economy.[297]

Later, Graetz and Grinberg introduced new arguments on the debate of neutrality policies, by examining if CEN or CIN could justify the US policy for taxing income from portfolio investment. First, they defined the premises of their analysis by demonstrating: (i) the increased importance of portfolio investment in the international flow of capital; (ii) the fact that tax policy debate has focused only on FDI, leaving portfolio investment aside; and (iii) while FDI is made by corporations, portfolio investment is earned by both individuals and corporations. Then, Graetz and Grinberg examined if CEN or CIN could justify the taxation of portfolio income. They concluded

[296] R.S. Avi-Yonah, 'Back to the Future? The Potential Revival of Territoriality' (2008) University of Michigan Law & Economics, Olin Working Paper No. 08-012 <http://ssrn.com/abstract=1185423> accessed 5 January 2010.

[297] Graetz, 'The David R. Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies' (n 283) 272-91.

that both CEN and CIN are inapt for portfolio income given the wide variation in both corporate and individual tax rates, as well as the variety of portfolio income which would require impractical case by case distinctions by residence countries for investment in specific foreign countries. Moreover, the bilateral adjustments required to achieve CEN for portfolio investment would conflict with the principle of non-discrimination, which requires that foreigners and domestic residents have to be treated similarly. Considering the problems for the enforcement of CEN and CIN, Graetz and Grinberg suggested a deduction rather than a credit for taxes levied abroad on portfolio income since this strategy would serve the national interest of the US. This measure would imply the adoption of NN for portfolio income. After demonstrating the complexities of enforcing CEN, CIN and NN for portfolio income, Graetz and Grinberg argued that the US goal on international taxation should be the elimination of source-based taxes on portfolio income and the enforcement of residence taxation of this type of investment. Thus, at the end, Graetz and Grinberg concluded that neutrality policies could not fully justify the allocation of taxing rights regarding portfolio income. The simple alternative that would solve the problem that neutrality policies could not solve would be the elimination of source taxation of portfolio income.[298]

The arguments presented in the previous paragraphs demonstrated the evolving debate about international taxation and neutrality policies. It became clear that the new profile of the flows of capital brought by globalisation were included in the discussion involving international taxation. Consequently, it became harder to justify tax policy adopted by developed countries through neutrality policies. Despite these difficulties, there is a tendency in tax policies adopted by developed countries: the adoption of source taxation for FDI and residence taxation for portfolio investment.[299] The

[298] Graetz and Grinberg, 'Taxing International Portfolio Income (n 282) 558-86.
[299] The preference for residence taxation of portfolio investment in developed countries is confirmed by the enactment of the following tax policies: the US exemption of portfolio interest income in 1984 (Inland Revenue Code §§871 (h), §881); the 2001 US-UK tax treaty that: allocates the taxation of interest entirely to the state of residence of the beneficial owner and limits to 5% the withholding tax levied on dividends paid to a beneficial owner that owns shares representing directly or indirectly 10% of the voting power of the company paying the dividends; the EC Savings Directive (Council Directive 2003/48/EC) that disposes that withholding taxes on interest paid to an individual resident in a Member State will only be levied if there was not a mechanism for exchange of information to grant the taxation exclusively at the state of residence; and the EC Interest and Royalties Directive (Directive 2003/49/EC) which abolishes

movement toward territorial taxation of corporate income can be justified by the preservation of domestic firms' competitiveness in foreign markets; while residence taxation of portfolio income can be justified by fairness on taxing individuals resident in the same country as well as its incentive for the inflow of capital.[300] The situation is not so clear in relation to developing countries.

In the traditional debate, developing countries were associated with CIN policy, even though economists defended that CEN would better preserve the worldwide economic welfare. CIN policy has been used to justify the taxation of FDI based on the assumption that these countries are capital importers and the inflow of capital was much more important than the outflow. However, with the increase of portfolio investment, the adoption of CIN policy by developing countries needs to be evaluated separately for this type of investment.

The first consideration about portfolio investment, as already argued, refers to the concentration of this type of investment in developed countries. However, this situation cannot underestimate the importance of this type of investment to developing countries. As already mentioned, there might be a significant amount of portfolio investment from developing countries represented as capital flight invested in developed countries. The allocation of capital flight as portfolio investment is encouraged by the mobile characteristic of this type of investment as well as the difficulties in taxing it. In this context, the endorsement of CIN policy by developing countries leaves aside the importance of capital flight, since benefits derived from outflows are not captured by CIN policy. The fact that developing countries are interested not only in inflows but also in outflows makes CIN policy inadequate for their purposes.

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taxation of interest and royalty payments made between associated companies of different Member States in the Member State at source. The last section of this chapter will contribute with further examples that support the assumption that developed countries are eliminating the levy of withholding taxes on portfolio income.

[300] There are also other arguments that justify the preference for residence taxation of portfolio income in developed countries: (i) the necessity to attract investment to finance fiscal deficits; and (ii) the absence of capital control which makes the levy of withholding taxes on portfolio investment difficult.

The adoption of CIN policy needs also to be evaluated in terms of the incentive created on the location of this flow of investment. In other words, another problem affecting the endorsement of CIN policy by developing countries refers to the interaction of this policy with CEN policy endorsed by a developed country.

The adoption of CIN by developing countries signifies that all investments made in their territory will be taxed, independent of whether the investor is resident or non-resident. In practical terms, it means that only source income is taxed, foreign income earned by residents, is exempt.[301] On the other hand, CEN policy works in the opposite way: its basic premise is the fact that residents will be taxed equally, independent of the source of their income. CEN policy is entirely focused on residents' income, which signifies that the exemption of non-residents investing in their territory does not compromise their objectives; in fact it is 100% consistent with its aims.

The problem arises when CIN and CEN policies interact: the adoption of CIN policy by developing countries creates the perfect incentive for residents investing abroad which is enforced by CEN policy adopted by developed countries that grants the full non-taxation of foreign income of residents in developing countries. The outcome of the adoption of CIN policy by developing countries contradicts with their interest in attracting foreign capital, creating the perfect scenario for outflows of capital, especially capital flight. On the other hand, CEN policy enforces the right of developed countries to tax the income of their residents without interfering with their competitiveness to attract foreign portfolio investments.

Besides that, the levy of withholding taxes not only disincentivises the inflow but also makes developing country reliant on developed countries' tax policy since the inflow of investment in developing countries is dependent on the recognition of foreign tax credits by developed countries. In the case of capital flight, tax credits do not even matter because these investments are never reported in the residence state. This signifies that the chance of capital flight being invested in countries that tax foreign portfolio

[301] This assumption will be revised when analysing the current tax policy enacted by developing countries.

investment at source is very low. Consequently, the interaction of CIN and CEN policies creates the perfect incentive for capital flight to be invested as portfolio investment in developed countries.

Different problems arise in order to justify neutrality policies in the current scenario. The distinction of FDI and Portfolio Investment added to the fact that the flows are much more bidirectional makes it difficult to classify countries as capital importers or capital exporters, and, consequently, to define their tax policies in terms of this dichotomy. Furthermore, addressing taxation of portfolio investment only from the perspective of inflows leaves aside the importance of capital flight to developing countries.

5.3. The taxation of portfolio investment in Double Tax Conventions

Double Tax Conventions[302] try to divide the allocation of taxing right between source and residence countries based on classification and assignment rules that classify income according to its economic character.[303] This signifies that taxable income is arranged in categories and taxing rights over them are distributed to one or both contracting states. To this extent, active business income is taxed at source country; whereas passive income (i.e. income derived from portfolio investment such as dividends, interest and capital gains) is taxed at residence state, but the source state can levy a reduced withholding tax. According to Avi-Yonah, low withholding tax rates on portfolio income represent a compromise between the desire of a source country to levy some tax on income derived from foreigners and the primary right of a residence country to tax such income.[304]

The preference for source or residence taxation is also justified by countries' classification as capital importers and capital exporters. To this extent, developing

[302] The expression Double Tax Convention ('DTC') is also referred as tax treaty in the body of this study, suggesting the same meaning.
[303] Rohatgi (n 56) 13-21 and 32-75.
[304] Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification' (n 228)1308.

countries have fought for source taxation; whereas developed countries have defended residence taxation of passive income. This debate is shown by differences in the DTC Models: whereas the UN model tries to enlarge provisions on source taxation, the OECD and US models try to eliminate it or even to reduce it to the minimum.

The analyses of Articles 10, 11 and 13 from the OECD Model Tax Convention, UN Model Tax Convention and the US Model Tax Convention that provide rules for taxation of dividends, interest and capital gains illustrates the debate about allocation of taxing rights between source and residence countries:[305]

Table 5.3. Distribution of Taxing Rights in DTC Model Convention[306]

DTC Model Convention	Dividends (Article 10)	Interest (Article 11)	Capital Gains on immovable property (Article 13)	Capital Gains on movable property (e.g. shares) (Article 13)
2008 OECD Model Convention	Tax sharing (withholding tax of 5% to 15%)	Tax sharing (withholding tax of 10%)	Tax sharing	Taxation at alienator's residence
2001 UN Model Convention	Tax sharing (no cap on withholding rates)	Tax sharing (no cap on withholding rates)	Tax sharing	(i) Source Taxation if (…) % of participation is sold; or (ii) Taxation at alienator's residence if participation sold is less than the percentage disposed in (i).
2006 US Model Convention	Tax sharing (withholding tax of 5% to15%)	Residence State Taxation	Tax sharing	Taxation at alienator's residence

The table above made the battle for distribution of taxing rights between source and residence states in relation to passive income clear. At first glance, the outcomes are: (i) the difference between the allocations of taxing rights in these three categories of income; and (ii) the tendency to restrict source taxation and benefit residence taxation.[307]

[305] Tax sharing is represented by the expression 'may be taxed'; whereas taxation exclusively at source state or at residence state is defined by the expression 'shall be taxable only'.
[306] K. Van Raad, *Materials on International & EC Tax Law* (n 58), 502-17.
[307] Even though the UN Model tries in a very modest way to allocate more rights to source state.

The dividend Article in all three models adopts tax-sharing provisions, which allow the levy of a withholding tax by the source state. In the US and the OECD Model there is a tendency of applying a reduced withholding tax (5%) when the beneficial owner of the dividend is a company that owns directly at least 10% and 25%, respectively, of the voting stock of the company paying the dividends. This rule is in line with domestic policies enacted by developed countries that exempt intra-company distribution of dividends (e.g. EC Parent-Subsidiary Directive). The OECD Commentary on the Model Convention has also explained that there is no reason to tax at source payments of dividends between companies.[308]

The interest Article of the OECD and the UN models allows source taxation, while the US Model Convention permits only the taxation of interest at the residence state of the creditor. The OECD Model limits the withholding tax at 10%. The UN Model leaves the tax rate to be determined by bilateral negotiation. The US allocates the right to tax interest entirely to the state of residence. This rule is in line with the US domestic tax laws that exempt non-residents' interest originated from portfolio investment. As presented in the next section, the taxation of interest in practice is very limited since most countries already exempt this kind of income to attract foreign investors and not to increase the cost of investment.

The capital gain Article of the three Model Conventions in relation to immovable properties allows both source and residence states to tax; while in relation to movable properties the right to tax is allocated to the residence of the seller with the exception of a minor case provided in the UN Model that allows only the source state to tax when a certain percentage (determined in bilateral negotiations) of participation is sold. Different from the taxation of dividends and interest that a limited withholding tax is established, the capital gains Article in the three Model Conventions does not provide for the tax rate that can be levied by the state of source when both countries share the right to tax. The taxation is determined by domestic tax policies without a cap. The

[308] OECD Commentary on the Model Convention, Article 10, item 10.

reason for that might be the fact that the taxation of capital gains varies considerably from country to country.

Even though the effective allocation is subject to individual negotiation between contracting states, the Model Conventions have many differences not only between them but also among taxation of dividends, interest and capital gains. The differences between the Model Conventions reflect the economic interest that guided their development, whereas the differences between the taxation of dividends and capital gains can only be justified by political reasons rather than by economic motives since from an economic perspective it does not make sense to treat them differently as provided in the Model Conventions.

From an economic perspective, both dividends and capital gains represent earnings from a company. Dividends correspond to retained and current earnings, while capital gains reflect the present value of future earnings. Thus, it does not make sense to tax them differently. Nevertheless, tax treaties apply different tax rules to them creating an opportunity for taxpayers to choose the way they will be taxed. For instance, if a non-resident receives dividend from a country, dividends will be taxed at source, according to the standard rule provided in the OECD Model Convention. If the same non-resident opts for selling the shares that pay the dividends before its payment, the capital gain will be taxed in his country of residence.[309]

Another way to avoid source taxation of dividends is by using total equity swaps. This financial instrument allows the investor to receive the same return as investing in shares by entering into a swap with a bank that pays as a return the same value of the shares but with the legal nature of interest. What an equity swap does is simply to change the category of income received as a return, aiming to exploit tax benefits disposed in the domestic legislation or tax treaty.[310]

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[309] Y. Keinan, 'The Case for Residency-Based Taxation of Financial Transactions in Developing Countries' (2008) 9 Florida Law Review 1, 20-7.
[310] ibid.

These examples demonstrate how much inconsistency there is in the allocation of taxing rights between dividends and capital gains, making the taxpayer interested in manipulating the category in which his income might be classified. The economic substance of the income needs to be considered when defining the allocation of taxing rights. Otherwise loopholes will bar the proper taxation of income at source, the levy of withholding tax becoming a meaningless provision.

The problems explained in the previous paragraphs derive from the fact that the rules provided in the Model Conventions are formal rather than economic rules. According to Keinan, formal rules do not rely on the economic source of income, being easy to administrate because they are based on bright lines that simply require one single determination such as residence of payer to determine the source of income. Economic rules, on the other hand, try to define the economic source of income, requiring further examination such as to determine where a copyright is actually used. Thus, economic rules are harder to avoid but formal rules are easy to administer.[311]

Considering this scenario, policymakers have two alternatives: (i) to maintain the current formal rules but harmonising the taxation of Articles 10 and 13; or, (ii) to replace the formal rules of Articles 10 and 13 with economic rules that define the economic substance of the income classified in each Article. Both measures can reduce the chances of manipulation of income by taxpayers. Nevertheless, the first alternative is easier to administer and to implement.

Besides all the alternatives inherent in tax treaties that allow taxpayers to control in a certain way the tax burden of a transaction, there is another fact that threatens even more the source taxation of portfolio income: investments made by pension funds, charitable institutions and collective investment funds. Usually pension funds and charitable institutions are exempt from tax, while collective investment funds are often not subject

[311] ibid.

to tax.[312] This signifies that a considerable amount of dividends is already not taxed at source, the levy of withholding taxes remaining applicable only for dividends earned by individuals and corporations. In the case of corporations, there is also the tendency to exempt the payments of dividends between associated companies. In practice, therefore, withholding tax is levied on dividends paid to individuals only.

In sum, this section aimed to demonstrate that the traditional debate about allocation of taxing rights in DTC between source and residence countries and its association with developing and developed countries is still based on their classification as capital importers and capital exporters. Negotiating treaties, therefore, does not get an effective result in taxing portfolio investment. Besides the loopholes that allow taxpayers to manipulate the classification of income that they receive, and consequently, the amount of tax paid, the discussion does not address the actual problem affecting portfolio investment, which refers to finding an effective way to tax it. Whether developed and developing countries keep discussing taxation of portfolio investment in terms of allocation of taxing rights between source and residence countries, a significant amount of income will remain untaxed.

5.4. Tax Policies adopted by Developed and Developing Countries

After examining economic and legal arguments about taxation of portfolio investment, this section will focus on tax policies adopted by developed and developing countries. The aim of this section is to identify tendencies that escape from the theoretical debate. In other words, while economists have been trying to find a way to validate neutrality policies and lawyers have been struggling to justify the allocation of taxing right between source and residence states in tax treaties, this section will look straight forward to what is going on in practice by analysing tax policies enacted by countries to tax portfolio income, i.e. dividends, interest and capital gains.

[312] S. van Weeghel, 'Dividends (Article 10 OECD Model Convention)' in M. Lang et al, *Source versus Residence: Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (Wolters Kluwer 2008), 66.

The next tables summarise the information provided in the annex where tax policies adopted by 116 countries were analysed. Countries were classified in two groups: developing countries; and OECD countries. For each group the following information was provided: (i) tax policies (i.e. worldwide or territorial taxation) adopted by countries to tax their individual residents; (ii) exemptions applied to dividends, interest and capital gains when paid to individuals and companies non-resident; and (iii) number of tax treaties signed and actually in force by each country.[313] The purpose of putting these data together is to build up a framework to answer from a pragmatic approach the questions on: whether countries are interested in taxing their residents' foreign portfolio income; whether countries enforce source taxation of portfolio income; and whether countries rely on tax treaties to allocate taxing rights between source and residence countries. Whereas data described in (i) and (iii) do not require further explanation and could be easily compiled in the next tables, data on tax rates applied to dividends, interest and capital gains (ii) need further details, before presenting the synthesised results of the analysis performed.

The present analysis is interested in identifying tax incentives offered by countries that exempt dividends, interest and capital gains. However, countries can adopt a general exemption, applying to all categories of dividends and interest (very unusual in practice), or a restrict exemption that applies only to certain circumstances, for example, non-taxation of interest from government bonds, corporate bonds, bank deposits, etc. To this extent, there is a myriad of situations in which exemptions can be offered in these three categories of income. Even though the original data used to feed the tables in the annex provided a reasonable amount of information to perform the aimed study, there were not enough details to classify the data in more specific categories, i.e. per type of assets as the OECD did in the past for interest paid on bank deposits, government bonds and corporate bonds, illustrated below.[314]

[313] The sources of information provided in Annex I are: (i) Worldwide Tax Summaries provided by Pricewaterhouse&Cooper <http://www.taxsummaries.pwc.com/uk/wwts/wwts.nsf?Open> accessed 20 February 2010; and (ii) Tax Surveys published by the International Bureau Fiscal Documentation <http://www.ibfd.org> accessed 20 February 2010.

[314] OECD, *Taxation and Household Savings* (OECD 1994) 177.

Table 5.4. (a) Withholding taxes applied by OECD countries on interest

Withholding taxes on interest on selected assets paid to non-residents.			
Country	**Bank deposits**	**Government Bonds**	**Corporate Bonds**
Australia	10	10	10
Austria	-	-	-
Belgium	10	10	10
Canada	25	-	-
Denmark	-	-	-
Finland	-	-	-
France	-	-	-
Germany	-	-	-
Greece	10	10	10
Iceland	-	-	-
Ireland	-	-	27
Italy	30	12.5	12.5-30
Japan	15	20	20
Luxembourg	-	-	-
Netherlands	-	-	-
New Zealand	15	15	15
Norway	-	-	-
Portugal	20	20	25
Spain	25	-	25
Sweden	-	-	-
Switzerland	35	35	35
Turkey	10	15	10
United Kingdom	-	25	25
United States	-	-	-

The OECD's table provides detailed information that allows us to conclude about specific aspects of the tax policies adopted by OECD countries in relation to each asset. Then, it is possible to argue that a considerable number of OECD countries do not tax interest on bank deposits, government bonds and corporate bonds. However, the data available are restricted to OECD countries. The present study aimed to develop a broader analysis involving not only OECD countries but also a significant number of developing countries in order to compare the similarities and differences between their tax policies. This fact increases the difficulty on finding data as detailed as the one used by the OECD. Thus, in order to have a significant sample of countries, it was necessary to sacrifice accuracy in the information displayed. In practice, this signifies that a limitation was imposed on the data analysed, i.e. in the table provided in the annex 7, the withholding taxes are not classified by type of assets, but only as tax rates applied to dividends, interest and capital gains paid to non-resident individuals and companies. Nevertheless, in the annex, when besides the general rate applied to dividends, interest and capital gains there were specific data available about tax rates applied to certain assets, this information was incorporated in the table and displayed in the format of a range. For instance, the range 0%-30% is displayed in the field of interest withholding taxes paid to individual non-resident in the US. This signifies that there is an exemption being offered to certain interest besides the general rate of 30%.

The compilation of all withholding taxes on dividends, interest and capital gains in the same table below limited the accuracy of information extracted but allowed the design of the profile of countries offering tax incentives to portfolio income. Thus, if a country offered any kind of exemption to a certain category of assets that paid portfolio income, the incentive was accounted in order to identify the number of countries that renounce source taxation in a certain way. Consequently, the way withholding taxes is analysed allowed the identification of the number of exemptions being offered on portfolio income by the group of countries selected. However, further information is necessary to understand the magnitude of the exemptions being offered since the intrinsic characteristics of each exemption do not matter, all of them are accounted in the same way as one even if offered with a broader scope. To deal with this limitation of table 5.4.(c), in the body of the text, the major characteristics of the exemptions applied by each group of countries and accounted in the tables will be explained in detail. Having in mind these aspects, the tables summarising the results are presented:

Table 5.4. (b) Worldwide taxation and territorial taxation adopted by countries

Summary		(I)		
		Tax policy on resident individuals		
Groups of countries	**Total number of countries**	**% adopting Worldwide taxation**	**% adopting Territorial taxation**	**% with no income tax system**
Developing countries[315]	86	71%	22%	7%
OECD countries[316]	30	100%	-	-
TOTAL	**116**	**78%**	**16%**	**5%**

(Note: Analysis of the adoption of worldwide taxation and territorial taxation by countries. Percentages reflect the number of countries in each group adopting worldwide taxation and territorial taxation)

Table 5.4. (c) Exemptions offered on the levy of withholding tax by the source country

Summary		(II)				
		PAID TO NON-RESIDENT INDIVIDUALS		PAID TO NON-RESIDENT COMPANIES		
Groups of countries	**Total number of countries**	**% offering some kind of exemption on dividends**	**% offering some kind of exemption on interest**	**% offering some kind of exemption on dividends**	**% offering some kind of exemption on interest**	**% offering exemptions on K gains on sale of shares**
Developing countries	86	37%	33%	47%	41%	43%
OECD countries	30	20%	73%	77%	70%	57%
TOTAL	116	33%	43%	54%	48%	47%

(Note: Analysis of exemptions offered on the levy of withholding tax by the source country. Percentages are based on the number of countries offering exemptions in each group. The total reflects the total sum of exemptions offered by both groups divided by the total number of countries)

315 Albania, Algeria, Angola, Argentina, Armenia, Azerbaijan, Bangladesh, Belarus, Benin, Bolivia, Botswana, Brazil, Brunei Darussalam, Bulgaria, Burkina Faso, Cambodia, Cape Verde, Central African Republic, China, Colombia,Congo, Dem. Rep. Of, Croatia, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Fiji, French Guyana, Gabon, Georgia, Ghana, Guatemala, Honduras, India, Indonesia, Iran, Kazakhstan, Kenya, North Korea, Kuwait, Kyrgyz Republic, Lao, Lesotho, Libya, Lithuania, Macedonia, Madagascar, Malaysia, Mali, Moldova, Morocco, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Oman, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Qatar, Romania, Russia, Rwanda, Saudi Arabia, South Africa, Sri Lanka, Swaziland, Taiwan, Tajikistan, Thailand, Tonga, Trinidad and Tobago, Tunisia, Uganda, Ukraine, United Arab Emirates, Uruguay, Uzbekistan, Venezuela, Vietnam and Zambia.

316 Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Israel, Italy, Japan, Korea, Rep., Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Turkey, the United Kingdom and the United States.

Table 5.4. (d) Number of tax treaties signed by countries

Summary	(III) Tax Treaties[317]		
Group of countries	**Minimum number of tax treaty signed by a country of the group**	**Maximum number of tax treaty signed by a country of the group**	**Average of tax treaties in the group per country**
Developing countries	0	89	24
OECD countries	20	120	68

(Note: Analysis of the number of tax treaties signed by countries. The last column reflects the average of tax treaties per country, which is based on the division of total tax treaties signed by the number of countries in each group)

To facilitate the comprehension of the data provided in the tables above, they are segregated in three categories (taxation of resident individuals; taxation of portfolio income paid to non-resident individuals and companies; and tax treaties signed by countries), indicated by numbers (I, II, III) and colours (grey, green and pink). In the first category (I) (table 5.4.(b)), the percentage of countries that adopt worldwide, territorial taxation and no-income tax system to tax resident individuals is indicated. The second category (II) (table 5.4.(c)) displays the percentage of countries offering some kind of exemption on dividends, interest and capital gains. The third category (III) (table 5.4.(d)) presents the number of tax treaties signed by countries, i.e. the minimum number of tax treaties signed by a country classified in the group, the maximum number of tax treaties signed by another country classified in the group and the average of tax treaties signed by the group (total number of tax treaties divided by the total number of countries). The structure of the tables will help to identify the results discussed in the next paragraphs.

Starting with ‘Tax policy on resident individuals’ (aspect (I), in grey, table 5.4.(b)), the first evidence is the fact that nowadays most countries adopt worldwide taxation of their resident individuals’ income. In the sample analysed, 91 countries out of 116 apply worldwide taxation, which represent 78% of the sample. Only 16% of countries still

[317] Besides information from Pricewaterhouse&Coopers and IBFD (n 313), to verify which tax treaties were in force, data from the research performed by Drevet and Thuronyi were also analysed. S. A. Drevet and V. Thuronyi, ‘The Tax Treaty Network of the U.N. Member States’ (2009) June Tax Notes International, 783-87.

adopt territorial taxation of residents' income. Focusing on the two groups, the data also demonstrate that all OECD countries adopt worldwide taxation to tax their residents' income; whereas there are still a few developing countries adopting territorial taxation (22% of developing countries) to tax their individual residents. This evidence supports the argument that the interest of developing countries in international taxation has evolved from a restricted concern on the levy of withholding taxes on foreign investments that come into the country to the taxation of foreign investments made by their own residents abroad. Whether the enforcement of residence taxation by developing countries is feasible is another question; however the data showed that the provision to tax residents' foreign portfolio income was already enacted by most of them.

The second aspect described in the tables refers to taxation of dividends, interest and capital gains paid to non-resident individuals and companies (aspect (II) in green, table 5.4.(c)). The segregation between individuals and companies was necessary to payments of dividends and interest due to the fact that most countries apply different tax policies depending on the receiver of the income. Each cell of the table presents the percentage of countries offering some kind of exemptions in each situation. In relation to capital gains originated from the sale of shares, there was no separation between gains earned by individuals and by companies since most countries apply the same tax policy, independently of the characteristics of the receiver of the gain. Thus, the capital gains column presents only the percentage of countries levying 0% withholding taxes on capital gains stemmed from sale of shares plus the percentage of countries that do have capital gains tax rules to apply to this situation.

Examining the figures, at first glance, what was verified is the fact that the two groups offer some exemptions on portfolio income. Nevertheless, any inference from the sample needs to be considered very carefully since the number of countries in each group differs as well as the magnitude of the exemption offered. Therefore, the best alternative is not to focus on the simplified data provided in the table above for examining the exemptions, but to examine the detailed data provided in the annex 7. The first piece of evidence that comes out is the fact that while in OECD countries, which includes the European Union countries, most exemptions derived from harmonised tax policies applied to interest paid to individuals (Savings Directive) and to dividends and interest paid to companies (Parent Directive and Interest and Royalty Directive, respectively); in developing countries exemptions on dividends and interest are based on individual measures with particularities that complicate their comparison. Furthermore, the exemptions offered by developing countries are not sophisticated enough to differentiate between the individual characteristics of beneficial owners. They are still focused, in most cases, on the characteristics of the asset from which portfolio income is derived. This might be explained by the fact that it is easier to verify the asset from which income is derived than to identify the effective beneficial owner of each transaction.

Analysing the exemptions offered by developing countries on dividends what we see is the fact that many countries offer general exemptions on dividends; whereas interest is usually taxed, i.e. there is a general tax rate on interest but some exemptions are offered, the most common exemptions being on interest derived from government bonds, corporate bonds, bank deposit and foreign currency deposits. There are also specific exemptions offered on dividends and interest related to investments and loans in strategic economic sectors, as for example the exemption offered by the Democratic Republic of Congo on mining projects.

On the other hand, OECD countries offer more exemptions on portfolio income than developing countries since besides the exemptions offered on government bonds, corporate bonds, bank deposit and foreign currency deposits which most countries already offer, there are harmonised tax policies that exempt interest and dividends paid by agents located in the European Union and received by beneficial owners resident (companies and individuals) in this area. These tax policies relieve portfolio income from withholding taxes based on the assumption that there is information being exchanged that ensures that the income paid by one country will be taxed in the other one.

Another interesting aspect that came out when comparing the tax policies enacted by OECD countries and developing countries is the fact that the former avoid general exemptions, while the latter offer them more frequently, specifically in the case of dividends. According to Avery Jones, the remaining withholding taxes enforced in domestic tax policies might represent an instrument of power when a country is negotiating a tax treaty.[318] In his words: 'The more outrageous the provisions of internal law, the better the starting position for negotiating treaties'.[319] Thus, the difference between their tax policies might also be connected to the fact that OECD countries have a higher number of DTCs signed. So, the levy of withholding taxes provided in the domestic legislation is probably limited by DTC provisions.

The difficulties found in analysing exemptions levied by countries on dividends and interest also apply to capital gains. In fact, the analysis of capital gain policies is even more complicated due to peculiarities of the domestic rules involved. The problem pointed out by different authors is that there is neither a definition of capital gain nor a standard rule for its taxation.[320] Simontacchi demonstrated that there is no general rule for taxation of capital gains by examining the tax law of OECD countries. Through this analysis he identified different reasons for the variation of the taxation of capital gains among OECD countries: (i) capital gains are not deemed to be taxable income in some countries; (ii) capital gains accrued to companies are taxed, whereas capital gains earned by individuals are not if made outside the scope of their trade or business; and (iii) capital gains earned by individuals are taxed only in certain cases, leaving many cases not taxed.[321] Due to these circumstances, the situation analysed is restricted to capital gains earned on sale of shares. Furthermore, the total number of countries offering

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[318] Avery Jones, 'The David R. Tillinghast Lecture: Are Tax Treaties Necessary? (n 32) 3.
[319] ibid.
[320] Y.Neeman, 'General Report' in International Fiscal Association (ed.), *The Definition of Capital Gains in Various Countries* (vol. LXIb, Cahiers de droit fiscal international, Sdu Fiscale & Financiële Uitgevers 1976), 18 et seq.
[321] S. Simontacchi, 'Capital Gains (Article 13 OECD Model Convention)' in M. Lang et al, *Source versus Residence: Problems Arising from the Allocation of Taxing Rights in Tax Treaty Law and Possible Alternatives* (Wolters Kluwer 2008) 130.

exemptions per group also includes countries that do not tax capital gains due to the absence of a capital gain tax policy.

Another aspect that also needs to be evaluated when analysing the outcomes provided in the annex 7 is the fact that there are some countries with incomplete information about capital gains tax. These countries were simply not accounted. Focusing on the percentages displayed in the table 5.4. (c), the two groups of countries presented a significant number of exemptions on capital gains earned on sale of shares, however there is no coordination between the taxation of dividends and capital gains in the domestic tax policies, even though both are earnings with similar economic substance. It is very peculiar, therefore, how countries worry more about how to tax dividends, and sometimes, how to exempt such income, while leaving aside the taxation of capital gains.

Finally, the third category (III, in pink, table 5.4.(d)) presents the number of tax treaties signed by countries. The first column displays the minimum number of tax treaties signed by a country classified in the group; the second column presents the maximum number of tax treaties signed by another country classified in the group; and the third column displays the average of tax treaties signed by the group (i.e. the total number of tax treaties divided by the total number of countries classified in the group).

Focusing on the minimum number of tax treaties signed by each group of countries, while there are a significant number[322] of developing countries that have no DTC; all OECD countries have DTCs in force and the OECD country with the lowest number of DTCs (Chile with 20 DTC) corresponds almost to the average of DTCs signed by the group of developing countries.

In relation to the maximum number of treaties signed by countries, the OECD's group presents the highest score with 120 tax treaties signed by France. In the developing

[322] Countries that have no DTC in force: Angola, Cambodia, Congo Dem Rep., El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Tonga.

countries' group the country with the highest number of DTCs is China with 89. It is interesting to note that China is among a few developing countries that have received significant amounts of portfolio investment since 2000.

The last piece of information in relation to tax treaties provided in the table is the average of tax treaties signed by countries in each group. OECD countries scored the highest average, represented by 68 tax treaties per country. Developing countries' average is just 24 DTC per country.

In sum, the figures of table 5.4.(d) demonstrate that tax treaties are much more important to OECD countries than to developing countries. The absence of a significant number of tax treaties makes these countries rely entirely on the provisions of their domestic laws to enforce taxation of residents' foreign portfolio income. If developing countries are interested in implementing more exemptions of withholding taxes on portfolio income, they will have to recognise the necessity of other legal instruments to ensure taxation of their residents' foreign income.

Finally, remembering the questions presented at the beginning of this section, the analysis performed contributed to the following answers: (i) both OECD and developing countries adopt worldwide taxation of residents' income, having taxing rights over residents' foreign income; this means that the assumption that developing countries are only interested in taxing investments that come into the country is out of date; (ii) there are different types of incentive being offered on portfolio income and they do not represent a trend restricted to OECD countries even though these countries have already implemented harmonised tax policies that allow further exemptions not only based on the characteristic of the asset from which portfolio income is derived but also in relation to the characteristics of the beneficial owner; and (iii) OECD countries rely much more on DTCs to tax foreign income than developing countries.

Therefore, what the analysis of tax policies demonstrated is that developing countries have no clear understanding of the entire picture of what is going on in terms of taxation of portfolio investment. They have already adopted worldwide taxation of residents' income, even though they do not have the instruments to enforce it in practice. On the other hand, they have already given some exemptions on portfolio income earned by non-residents. In sum, the mix of positions adopted by developing countries reveals that these countries have a blurred perspective on how to implement taxation of portfolio income, ignoring the importance of capital flight as well as the fact that taxation of portfolio investment is very hard to implement.

5.5. Conclusion

This chapter analysed taxation of passive income, i.e. income derived from portfolio investment, such as dividends, interest and capital gains. Three different approaches were developed in order to demonstrate how the debate has evolved from the perspective of developing countries, considering not only the economic (neutrality policies) and legal (allocation of taxing rights in DTCs) aspects, but also a pragmatic approach (the analysis of tax policies enacted by countries in practice).

The economic and legal approach contributed to reveal several difficulties in discussing taxation of portfolio investment based on the classification of countries as capital importers and capital exporters. Moreover, arguments developed by both approaches could not capture the problem of capital flight. The pragmatic approach, on the other hand, puts in evidence the mix of tax policies adopted by developing countries, demonstrating that they do not have a clear understanding of the importance of portfolio investment and how to enforce its taxation.

As demonstrated, developing countries offer different types of exemptions to dividends, interest and capital gains at the same time that they adopt worldwide taxation of their residents' income. They expect, therefore, to tax foreign income of their residents. From this perspective derives the question on whether developing countries are able to tax in practice the foreign income of their residents and how mechanisms in force and used by developed countries would work for them. In other words, considering the economic interest of developing countries on taxing residents' foreign income and the fact that developed countries have relied on DTCs and other instruments to exchange information in order to ensure taxation of portfolio income at residence, how can these mechanisms of exchange of information help developing countries to tax foreign income of their residents? This question is addressed in the next chapters.

Chapter VI. Updating the legal debate

Since the beginning of the discussions about international taxation, double taxation and tax avoidance and evasion have been treated together. The association between them and the increased importance attributed to double taxation over tax avoidance and evasion are the key issues to understand the position of developing countries in the international tax system. It is essential to keep in mind, therefore, the tension between eliminating double taxation and combating tax avoidance and evasion, since whereas the elimination of double taxation has a positive effect on the international flow of capital, the combat of tax avoidance and evasion can lead to the implementation of mechanisms to control the international flow of capital, restricting it.

Globalisation has changed the balance between the importance of double taxation and tax avoidance and evasion. The international flow of capital has substantially increased and, consequently, opportunities for international tax avoidance and evasion. The structure of financial markets nowadays relies on tax havens. Consequently, the flows of capital through them became a regular route. In light of these facts, it is necessary to reconsider the importance of tax avoidance and evasion. To this extent, a historical approach will shed some light on how double taxation and tax avoidance and evasion have been dealt since the development of tax treaties.[323]

Initially, the perception of the League of Nations, when this organisation started to deal with the aspects of international taxation, was that international double taxation was the cause of tax avoidance.[324]

[323] It is worth noting that some documents refer to the problem of tax evasion whereas others make reference to tax avoidance. It is very difficult to draw the line between tax evasion and avoidance. Considering that it is not the objective of this study to define these terms, both situations will be addressed together. Furthermore, as explained next, the dynamic of capital flight requires attention to both situations.
[324] M. A. Grau Ruiz, *Mutual Assistance for the Recovery of Tax Claims* (Kluwer Law International 2003) 104.

As already mentioned in Chapter I, the global initial effort that dealt with the problem of double taxation and tax evasion was started in the 1920s by the League of Nations. One of the initial steps taken by the Financial Committee of the League of Nations was the request for a theoretical study of Double Taxation to four economists, G. W. J. Bruins, L. Einaudi, E. R. A. Seligman and Sir Josiah Stamp, whose report was published in 1923.[325] This report focused on the technical aspects of double taxation and the principles that could guide the allocation of taxing rights among nations.

In April 1922, the International Economic Conference held at Genoa recommended that the League of Nations should also examine the problem of the flight of capital, which in other words involves the problem of tax evasion. In the Genoa Conference it was recommended:

> We have considered what action, if any, could be taken to prevent the flight of capital in order to avoid taxation, and we are of the opinion that any proposals to interfere with the freedom of the market for exchange, or to violate the secrecy of bankers' relations with their customers are to be condemned. Subject to this proviso, we are of the opinion that the question of measures of international co-operation to prevent tax evasion might be usefully studied in connection with the problem of double taxation which is now being studied by a Committee of experts on behalf of the League of Nations. We therefore suggest that the League of Nations should be invited to consider it.[326]

From the quotation above it becomes clear that since the beginning of the development of double tax convention studies, the measures to counteract tax evasion were limited by the interest in the international flow of capital, which, on the other hand, was supported by the elimination of double taxation. Elimination of double taxation is one prerequisite to encourage the free flow of capital. The final paragraph of the quotation confirmed the association between tax evasion and double taxation by proposing that both issues

[325] League of Nations, 'Report on Double Taxation submitted by the Financial Committee' (1923) 1923.2.4 Economic and Financial Series 1.
[326] League of Nations, 'Report on Double Taxation and Tax Evasion presented by the Committee of Technical Experts on Double Taxation and Tax Evasion' (1927) doc. C. 216.M.85.1927.II, 40 Economic and Financial Series 1, Introduction, footnote 2, and 4-31.

would be dealt by the same Committee of experts. From the way the argument was developed, it can be inferred that treating the two measures together was a strategy to limit measures of tax evasion to the removal of double taxation.

In June 1922, the Financial Committee of the League of Nations entrusted a study about administrative and practical aspects of double taxation and tax evasion to a group of high officials of the fiscal administration of various countries (also referred as the Committee of Technical Experts on Double Taxation and Tax Evasion).[327] This group of high officials submitted a general report to the Financial Committee of the League of Nations in 1925. It is worth noting what the report says about the relationship between capital flight and tax evasion:

> Capital is exported abroad for many reasons. Some investors think that the rate of interest abroad is more attractive or suppose that their capital will be better managed abroad; some seek to protect themselves against risks of ultimate expropriation and yields to fears of political nature; others desire in general to minimise their risks by dividing up their wealth in a number of different countries. Finally – and there have been many and striking instances of this fact in recent years – nationals of a country whose budget shows a deficit, and whose issues of paper money become more and more numerous, fear above all the definitive depreciation of their currency, which in that case is the cause of the export of capital abroad and its failure to return to the owner's own country. In this flight of capital due to these various reasons, consideration of taxation play only a secondary part. <u>The matter on which we have been working has been taxation evasion, that is to say evasion which, particularly by means of the fight of capital, enables the interested persons to escape taxation which is legally due</u>. (…)
> We recognise that the extent to which evasion of taxation occurs differs greatly in different countries and that the nature of this evasion also differs widely. In some countries evasion is due mainly to fraud, but there are others in which evasion due to fraud

[327] From Belgium: C. Clavier, Director-General of Direct Taxation and Land Survey in the Ministry of Finance; from Czechoslovakia: Dr. V. Valnicek, Chief of Section in the Ministry of Finance; from France: M. Baudoin-Buget, Director-General of Direct Taxation; from Great Britain: P. Thompson, Deputy Chairman, Board of Inland Revenue; from Italy: Prof. Pasquale d'Aroma, Vice Governor of Bank of Italy; from the Netherlands: S. S Damaste, Director-General of Taxation; and from Switzerland: H. Blau, Director of the Federal Taxation Department.

> is almost negligible and the evasion which exists is mainly due to the other reasons that we mentioned.[328]

The quotation above demonstrates that since the initial work of the League of Nations, the phenomenon of capital flight has been associated to the problem of tax evasion. From a tax perspective, capital flight involves not only capital derived from illegal activities, but also any kind of outflow that allows individuals to escape taxation that is legally due. Furthermore, the quotation also makes clear that the expression tax evasion does not exclude the idea of tax avoidance since it refers to all situations that enable individuals to escape taxation, not restricting itself to cases of fraud.

Although the Financial Committee in its later report in 1925 expressed its agreement with the main lines of the Experts' Resolutions, the Financial Committee in 1927 emphasised the importance of taking into consideration 'the disadvantage of placing any obstacles in the way of the international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction'.[329] The experts also suggested the enlargement of the Committee for the progress of the work regarding double taxation and tax evasion. So, the Financial Committee adopted the position that the interest in the flow of capital must prevail over possible restrictions to control tax evasion. Tax evasion was regarded as a secondary issue. The main consideration was to ensure that no obstacle would hamper the international flow of capital.

In 1927, the enlarged Committee of Technical Experts on Double Taxation and Tax Evasion presented draft conventions based on the resolutions developed by the technical experts in 1925.[330] Double taxation and tax avoidance were treated in four separate conventions: (i) Draft Convention for the Prevention of Double Taxation; (ii) Draft Convention for the Prevention of Double Taxation in the special matter of Succession

[328] League of Nations, 'Reports and Resolutions on Double Taxation and Tax Evasion submitted by the Technical Experts to the Financial Committee of the League of Nations' (1925) doc. F.212 1925 22, 12 Economic and Financial Series 1. Emphasis added here.
[329] League of Nations, 'Report on Double Taxation and Tax Evasion presented by the Committee of Technical Experts on Double Taxation and Tax Evasion' (n 326) Introduction.
[330] High officials of the fiscal administration of the following countries joined the Committee of Technical Experts: Argentina, Germany, Japan, Poland, United States of America and Venezuela.

Duties; (iii) Draft Convention on Administrative Assistance in Matters of Taxation; and (iv) Draft Convention on Judicial Assistance in the Collection of Taxes.[331] The Draft Convention on Administrative Assistance in Matters of Taxation established rules for exchange of tax information, which represents the way proposed to combat tax avoidance and evasion.

An issue heavily debated by the Committee of Technical Experts was whether the Conventions above mentioned should be multilateral or bilateral. The ideal solution would be multilateral conventions. Nevertheless, the Committee was not convinced in recommending this strategy. Regarding double taxation, the Committee was aware that the tax systems of countries had substantial differences that would curb the adoption of a multilateral convention, unless drafted in general terms. In this case, however, the drafted convention would not have practical value. In the matter of tax evasion also, the adoption of a multilateral convention was avoided due to the complexity involved in its negotiations. The Committee understood that a bilateral model would immediately satisfy the legitimate interests of taxpayers and contracting states.[332] Bilateral conventions were adopted for practical reasons rather than because they represented the best solution to the problem of double taxation and tax evasion.

The Commentary of the 1927 Draft Convention on Administrative Assistance in Matters of Taxation explained the terms and conditions established in the Draft and the reasons behind them. The first explanation referred to the fact that the Committee agreed that double taxation and tax evasion should be treated in a coordinated way. The reason for that was based on the assumption that eliminating double taxation would also solve the problem of tax evasion. However, we know nowadays that, even though the two issues are related, the elimination of double taxation does not solve the problem of tax evasion. Another interesting argument refers to the fact that when a relief was provided to avoid double taxation, countries should have been able to assess the amount of tax paid in the

[331] League of Nations, 'Report on Double Taxation and Tax Evasion presented by the Committee of Technical Experts on Double Taxation and Tax Evasion' (n 326) 4-8.
[332] ibid.

other country, which can only be done through the exchange of information.[333] Today this awareness has been forgotten, since most tax relief is granted without further consideration of what really happens in the other country of the taxpayer.

In 1928, the report presented by the Technical Experts in 1927 was examined by Government Experts of 68 States whether members or not of the League of Nations. The General Meeting of Government Experts added to the draft Convention for the Prevention of Double Taxation prepared by the technical experts two new texts of model bilateral Conventions which draw no distinction between impersonal and personal taxes, the first applying to countries in which domicile taxation dominated, and the second one to countries which different tax systems. The significant differences between the 1928 texts of model bilateral convention for the prevention of double taxation referred to the allocation of taxing rights between the state of residence and the state of source. This tension between source and residence taxation in the convention for the prevention of double taxation did not affect the Bilateral Convention on Administrative Assistance in Matters of Taxation. In fact, the Government Experts did not introduce any substantial modification in the Convention on Administrative Assistance presented by the Technical Experts.[334] The new models for the prevention of double taxation, which increased the allocation of taxing rights to the state of residence, did not raise the interest in exchange of information, even though its enforcement relied on this matter. The absence of interest in exchange of tax information might also be explained by the fact that at that time most countries had exchange controls, which means that countries had information on capital going in and out of their borders.

During the Second World War, two regional tax conferences were held under the auspices of the Fiscal Committee in Mexico City in June 1940 and July 1943. Later, in 1946, another meeting was held in London. The outcome of those meetings was the new Models of Tax Conventions. In the Mexico and London Model Conventions each one of the subjects below was treated in a different convention: Prevention of the double

[333] ibid 23.
[334] League of Nations, 'Report presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion' (1928) doc. C.562.M.178.1928.II., 49 Economic and Financial Series 1, 25-8.

taxation of income and property; Prevention of the double taxation of estates and successions; Reciprocal administrative assistance for the assessment and collection of taxes on income, property, estates and successions. Therefore, they differed from the reports presented by the Technical Experts in 1927 and by the Government Experts in 1928, which included four separate models of convention; the Mexico and London Drafts gathered the administrative assistance and the collection of taxes in the same instrument, reducing the number of conventions to three rather than four.[335] This measure might be seen as an initiative to simplify the number of models required to eliminate double taxation and combat tax evasion. Actually, this tendency was confirmed in the next models, which went further, gathering all subjects in a single instrument. Therefore, currently, clauses to eliminate double taxation and to curb tax avoidance and evasion (i.e. clauses for exchange of tax information) are included in the structure of the OECD Model Convention.

Based on the historical aspects examined above, we can conclude that since the initial effort to develop a tax treaty, the interest in eliminating double taxation has prevailed over the interest in combatting tax avoidance and evasion. Countries have worried much more about how to protect and to enhance the international flow of capital rather than on how to control it in order to eliminate tax avoidance and evasion. To this extent, the elimination of double taxation has been dealt through the allocation of taxing rights between source and residence countries; whereas the combatting of tax avoidance and evasion has been through clauses for exchange of tax information. Even though double taxation could be solved through unilateral measures, i.e. domestic tax policies that allow tax credits or exempt income tax abroad, countries have preferred to deal with this issue at the international level, which might be explained by the legal protection that tax treaties make certain.

Allocation of taxing rights has been the dominant argument discussed in the literature regarding the interest of developed and developing countries in international taxation.

[335] League of Nations, 'Fiscal Committee: London and Mexico Model Tax Conventions: Commentary and Text' (1946) doc. C. 88. M. 88. 1946. II.A., II. Economic and Financial Series 1.

As already argued, source taxation was associated to developing countries' interests, whereas residence taxation to developed countries. There are several studies addressing the problem of international taxation from this angle, i.e. from the perspective of allocation of taxing rights. There are studies that investigated this issue from its historical aspect, i.e. considering the division of taxing rights since the development of the initial idea of a tax treaty and, consequently, the dominant interest of developed countries in residence taxation.[336] Other studies preferred to examine the allocation of taxing rights, focusing on the economic allegiance doctrine[337] and neutrality policies[338] in order to try to validate the allocation though economic theories. Even game theory has been used to examine the interest of developed and developing countries regarding residence and source taxation. In this sense, Dagan performed a study focused on the effect of tax treaties and unilateral policies on the allocation of taxing rights between developing and developed countries, assuming that the former are capital importers, while the latter are capital exporters. She concluded that source countries (developing countries) better preserve their taxing rights by adopting unilateral policies, instead of by enacting tax treaties.[339] The differences between the OECD and UN Model Conventions are also based on allocation of taxing rights between source and residence countries and, consequently, their benefits to developed and developing countries.

But why have developing countries defended source taxation? What are their effective interests behind this argument? Examining the arguments adopted by developing

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[336] Avery Jones, 'The History of the United Kingdom's First Comprehensive Double Taxation Agreement' (n 48); M. J. Graetz and M. M. O'Hear, 'The "Original Intent" of U.S. International Taxation' (n 36).

[337] According to the economic allegiance doctrine, income should be taxed: (i) where the result is physically or economically produced; and (ii) where the income is consumed or disposed of. Referring to problems on the economic allegiance doctrine: R. S. J. Martha, *The Jurisdiction to Tax in International Law: Theory and Practice of Legislative Fiscal Jurisdiction* (Kluwer Law and Taxation Publishers 1989); A. A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (Kluwer Law and Taxation Publishers 1991); D. Pinto, 'Exclusive Source or Residence - Based Taxation: Is a New and Simpler World Tax Order Possible?' (2007) 61 Bulletin for International Taxation 277; Tadmore (n 40).

[338] Neutrality policies were explained in detail in Chapter V. To recap briefly, they adopt a different approach to justify source and residence taxation, based on methods to prevent double taxation and the level of incentive to invest abroad, i.e. the neutrality of the tax system depends on the choice of investing at home or abroad. For further reference: P. B. Musgrave, 'Sovereign, Entitlement, and Cooperation in International Taxation' (2000-01) 26 Brooklyn Journal of International Law 1337; Frisch (n 282); Graetz and Grinberg, 'Taxing International Portfolio Income' (n 282); Jeffery (n 28); Vogel (n 291).

[339] T. Dagan, 'The Tax Treaties Myth' (1999-00) 32 N.Y.U. Journal of International Law and Politics 941.

countries, the answer becomes evident: the debate is in fact about allocation of tax base. To this extent, the preference for source taxation can be justified by developing countries' administrative constraints to tax foreign income of their residents added to the absence of knowledge of the relevance of capital flight in terms of potential tax revenue. Developing countries have assumed a defensive position rather than an offensive one in terms of international taxation since they have preferred to collect a limited amount of source taxation by levying withholding taxes on non-residents' local income than to enforce taxation of residents' foreign income.

The economic premises that have validated the defensive position assumed by developing countries have been challenged by globalisation. The international flow of capital is much more complex, the North/South assumption that justified the adoption of source taxation by developing countries is not verified anymore. It is necessary to examine the flow, regarding the differences between FDI and Portfolio Investment. In this regard, it was demonstrated that even though developing countries sustain a net debtor position derived from their past as capital importers, the flows have become more bidirectional. Thus, developing countries have also exported FDI and Portfolio Investment. Developed countries, on the other hand, have assumed a net debtor position, importing capital from other groups of countries. In terms of FDI, they still have a creditor position, however, considering the amount of FDI that circulates among their economies, it became evident that only a reduced amount is exported to developing countries. Regarding Portfolio Investment, developed countries have assumed a debtor position. This situation has been confirmed by the direction of the flows received by them. Furthermore, even though it has no impact in terms of tax base, the increased accumulation of reserves by developing countries' monetary authorities since the Asian crisis in 1997 also highlights the fact that the flow of capital does not follow anymore the North/South assumption.

In sum, even though developing countries have a past of capital importers reflected in their net debtor position, this trend has been changed in the current process of globalisation due to the increased outflows of FDI and Portfolio Investment as well as their enlarged reserves of foreign assets held by their monetary authorities. On the other hand, developed countries have not only reversed their position as creditors of the world, but they have also sustained a substantial net inflow of capital, confirming their new trend as debtors.[340]

Moreover, it is not possible any longer to understand the flow of capital in terms of only two groups of countries: developed and developing ones. It is essential to consider the position of tax havens. These countries became part of the route of the international flow of capital in the current process of globalisation. Consequently, the problem of tax avoidance and evasion achieved a different dimension since capital can easily flow out of a country. The phenomenon of capital flight illustrates this situation since it represents unrecorded outflows from countries. As a consequence, countries' debtor positions have been overestimated. In this regard, the relevance of capital flight to developing countries also proved that the crisis of residence taxation faced by developed countries is also affecting them since it became evident that developing countries do need instruments to tax income derived from foreign assets held abroad by their residents. From this angle, it is revealed that international tax avoidance and evasion cannot be treated as a secondary issue by developing countries.

Allocation of taxing rights, therefore, should not be seen as the problem faced by developing countries regarding international taxation. Limitation of source taxation is not the key issue. The point is how to enlarge their tax base. From this angle, what became clear is that to enlarge their tax base they will have to deal with the problem of international tax avoidance and evasion. In this sense, the analysis of the current profile of the international flow of capital complemented by the study of capital flight put in evidence the effective interest of developing countries regarding international taxation: developing countries need to be able to tax residents' foreign income.

[340] Detailed information about the international flow of capital as well as stocks of assets and liabilities accumulated by countries is provided in Chapter III.

Even though initially the debate about international taxation has focused on the prevention of double taxation in terms of allocation of taxing rights rather than the elimination of tax avoidance and evasion in order to encourage the international financial flow, the initiative promoted by the OECD since 1998 regarding harmful tax competition has demonstrated the increasing consciousness of the developed countries with this ‘secondary’ aspect of international taxation.

Initially, the work developed by the OECD to combat harmful tax competition identified the problem of international tax evasion and avoidance with tax havens and preferential tax regimes. However, as demonstrated, tax havens and preferential tax regimes have no technical meaning and the factors used to identify them have changed over time. An overview of the evolving concept of tax havens showed how the OECD’s position has modified, i.e. starting from a more radical approach, suggesting changes in tax systems and ending with a discourse focused on transparency and exchange of information. The evolution of the criteria to identify tax havens also contributes to understanding the position of the OECD countries in relation to international tax avoidance and evasion: developed countries want to have mechanisms that can protect their tax base, however, they do not want to eliminate tax havens and offshore financial centres since they ensure how the global financial market works, i.e. they are part of the world finance structure.

Until now, the involvement of developing countries with initiatives to enhance transparency and exchange of tax information as mechanisms to combat tax avoidance and evasion has been very limited. Developing countries need to get involved with the work developed to combat international tax avoidance and evasion since this is the effective issue that will allow them to enlarge their tax base.

To this extent, it will be necessary to understand where we are in terms of mechanisms to combat tax avoidance and evasion. The international community, initially through the initiative of the OECD and later through the Global Forum, has chosen measures that enhance transparency and instruments for exchange of tax information as the answer to combat tax avoidance and evasion. Therefore, the advantages and flaws of these instruments will enlighten whether the measures taken until now have really contributed to combatting tax avoidance and evasion.

It is also important to make clear that both tax evasion and tax avoidance should be targeted by those instruments since even though the first outflow of capital flight from developing countries (or from developed ones) represents an illegal flow, and consequently the problem of tax evasion, later, when this capital is further invested in a different jurisdiction, this movement might represent only tax avoidance. Thus, considering the fact that these two aspects are so connected and it is very difficult to disentangle them, tax policies need to address both situations.

After verifying how the current instruments for exchange of tax information work (Chapter VII), different scenarios will be examined in order to understand how these instruments would help developing countries to deal with the problem of capital flight (Chapter VIII).

Chapter VII. Current mechanisms for exchange of tax information

7.1. Introduction

This chapter aims to assess how the current instruments of exchange of information help developing countries to tax residents' foreign income. Until now the debate involving developing countries and international taxation has been focused on the taxation of domestic investments of non-residents. The trade-off between the raising of tax revenue and attraction of foreign investment conflicts with this approach. To make things more complicated most developed countries largely exempt non-residents' portfolio income. These policies adopted by developed countries can be better reconciled with the necessity to raise tax revenue and attract foreign investment. In this context, developed countries do need to have mechanisms to enforce residence taxation of their residents' foreign income. The essential mechanism to enforce residence taxation is exchange of information, which can be implemented by different legal bases; e.g. bilateral and multilateral arrangements, supranational laws or domestic laws. Developed countries, therefore, have structured different instruments to secure the effectiveness of the principle of residence taxation on their residents' foreign income.

The taxation of residents' foreign income has not received too much attention in developing countries. The focus on non-residents' local income has overridden the significance of residents' foreign income. The evolution of the international flow of capital as well as the adaptation of their tax systems to the international economy by moving from territorial taxation to worldwide taxation of their residents' foreign income demonstrate that developing countries aim also to tax residents' foreign income. The strategy of enforcing taxation of residents' foreign income could be better reconciled with the problem of tax competition since developing countries would raise tax revenue that they need to promote development without curbing foreign investment.

The discussion on how to tax residents' foreign income has been established on the choice between the levy of a withholding tax by the source country and the implementation of mechanisms for exchange of information by the residence country, which in fact relies on the provision of information by source countries. These two strategies on how to enforce residents' foreign income taxation have been considered substitutable in the literature even though there is no theoretical background to support such argument. Keen and Ligthart demonstrated that the substitutability between the levy of withholding tax and the implementation of mechanisms for exchange of information might derive from countries' practical experience.[341] These authors exemplified the importance of practical experience by quoting two studies. The first study quoted by them was developed by Gordon and Hines[342] in which the reduction of withholding taxes in double tax treaties was associated with the inclusion of information exchange provisions that could also prevent tax evasion and help to enforce residence taxation.[343] The second study was developed by Huizinga and Nicodeme and the question investigated was whether information exchange and withholding taxes were complementary or substitutable regarding bank interest in 1999. These authors examined 440 pair-relationships between developed countries and they found out that in the sample of 440 pair-relationships only 17 had both information exchange and non-zero withholding taxes on interest income. These 17 entries with joint information exchange and withholding taxation all pertained to Australia. Based on this evidence, Huizinga and Nicodeme concluded that apart from Australia, information exchange and withholding taxes were substitutable instruments to grant residence taxation rather than complementary strategies.[344] However, it is important to note that those studies were based on developed countries' data; developing countries' experience was not considered by both studies.

[341] M. Keen and J. E. Ligthart, 'Information Sharing and International Taxation' (2004) CentER Discussion Paper N. 2004-117 <http://ssrn.com/abstract=639021> accessed 2 September 2009, 10.
[342] R.H. Gordon and J.R. Hines, 'International Taxation' in A. J. Auerbach and M. Feldstein (eds), *Handbook of Public Economics*, (vol. IV, Elsevier Science 2002).
[343] Keen and Ligthart (n 341) 10.
[344] H. Huizinga and G. Nicodeme, 'Are International Deposits Tax Driven?' (2004) 88 Journal of Public Economics 1093.

Therefore, the conclusion brought by the studies used by Keen and Ligthart to justify the substitutability between levy of withholding tax and exchange of information is clearly applicable to developed countries. To developing countries other assumptions need also to be considered, as discussed in Chapter V. The chapter on taxation of portfolio income demonstrated that developing countries are offering tax incentives on this type of income by not levying withholding tax on a significant number of cases. On the other hand, the data analysed in that chapter also pointed out that developing countries have a very limited number of tax treaties when compared to developed countries. Thus, while withholding taxes and exchange of information are substitutable mechanisms according to developed countries' experience, there is less evidence in developing countries that confirms this hypothesis because their renunciation of source taxation is not rebalanced by mechanisms (e.g. tax treaties) that secure exchange of information. Another issue is if the mechanisms in force for exchange of information were adopted by developing countries would they work properly, providing the necessary information that these countries need. This argument is examined in this chapter.

Another fact that contributed to the argument about the substitutability between withholding taxes and exchange of information in developed countries was the EU Savings Directive in which EU Member States exchange information automatically about individuals' interest income from debt-claims.[345] During a transitional period, Austria, Belgium and Luxembourg opted for levying a withholding tax of which 75% of the tax revenue raised had to be remitted to the residence country of the taxpayer.[346] The EU Savings Directive provided not only additional evidence about the substitutability between the levy of withholding tax and exchange of information but also added information about the preference of developed countries for exchange of information policy. The preference of developed countries for exchange of information can also be verified in their double tax conventions. Most tax conventions made between developed countries opted for a zero-withholding on certain types of income, e.g. dividends,

[345] Keen and Ligthart (n 341) 10.
[346] EU Savings Directive will be discussed again in the following sections.

interest and royalties, relying on tax information provided by mechanisms for exchange of information provided in tax treaty.

One possible explanation for the preference for exchange of information in developed countries might be the fact that the levy of withholding tax also requires information exchange between tax administrations to verify taxpayers' liability in the residence country. Thus, the levy of withholding tax needs also to be complemented by the process of exchange of information. Furthermore, there is also the traditional assumption that developed countries are capital exporters and they would raise more tax revenue focusing on residents' worldwide income rather than non-residents' local income. However, as already demonstrated in the previous chapters, these assumptions are too simplistic regarding the current profile of the international flow of capital. Even though in the past their preference for exchange of information over the levy of withholding tax could be explained by the international flow of capital, nowadays the complexity of the flow and the phenomenon of tax competition to attract foreign investment need also to be considered to understand developed countries' preference for exchange of information.

Regarding developing countries, the substitutability between withholding tax and exchange of information is not so evident due to the different allocation of tax revenue that these strategies cause. While withholding tax allows the source country to collect part of the tax revenue on non-residents' income; exchange of information allocates the entire tax revenue to the residence country. Whether countries are net capital importers or not, they would benefit from the levy of withholding taxes on non-residents' income. However, this does not mean that they do not need to have mechanisms to enforce worldwide taxation of their residents' income. As already demonstrated in the previous chapters, due to the current profile of the international flow of capital as well as to the phenomenon of capital flight, developing countries also need to have mechanisms to enforce taxation of residents' foreign income. Moreover, the levy of withholding taxes by developing countries is not as simple as assumed by the literature. The levy of withholding taxes can create distortions on the classification of income, which also requires an effective tax administration to control it. Even though the levy of withholding taxes by developing countries is a sensitive issue, the approach adopted here will focus on taxation of residents' foreign income by developing countries, based on the enforcement of mechanisms for exchange of information. It is important to keep in mind, however, that in any case taxation of residents' foreign income depends on the cooperation of the source country, whether providing information or levying a withholding tax.

This chapter will evaluate how successfully developing countries can tax residents' foreign income based on the analysis of existing instruments for exchange of information (i.e. bilateral and multilateral agreements – Double Tax Conventions (DTC), Tax Information Exchange Agreements (TIEA), the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (CMAATM); and supranational laws (Council Directive 77/799/EEC; Council Directive 2003/48/EC; Council Regulation EC 1798/2003)), including mechanisms available exclusively for certain developed countries. The analysis of developed countries' experience with instruments for exchange of information available exclusively for them will enrich the analysis with additional information of their implementation and the difficulties that they faced. However, regarding the effectiveness of extraterritorial tax information, i.e. statistical data of information exchanged, there are few studies available which makes it difficult to understand how exchange of information works in practice. Consequently, the analysis will present more theoretical information about how the instruments available for exchange information work rather than outcomes of their effectiveness in practice. Of course whenever data are available; they will be examined, being aware of intrinsic limitations.

A critical analysis of each instrument for exchange of information will be performed, demonstrating the amendments that occurred in their evolving process, their advantages and limitations as well as the relationship among them (i.e. when there is more than one instrument available, which one should prevail).

It is important to make a disclaimer about the fact that the protection of taxpayers' rights is not deeply analysed in this chapter. The reference to the protection of taxpayers' rights is restricted to the general rules provided in the existing mechanisms for exchange of information that limit exchange of information. It should not be assumed that less importance is attributed to them. On the contrary, the reason for not extending the analysis to the protection of taxpayers' rights is based on the fact that it would require a detailed analysis which is outside the scope of this section. Another way to explain the limits of the current analysis is based on the argument that first we need to understand what type of information can be effectively exchanged and only after that, i.e. when we are able to identify what kind of information can be successfully exchanged, the issue of taxpayers' rights can be dealt with in a more pragmatic way.

7.2. Mechanisms for Exchange of Information

In this section, instruments for exchange of information (i.e. bilateral and multilateral agreements – Double Tax Conventions (DTC), Tax Information Exchange Agreements (TIEA), the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (CMAATM); and supranational laws (e.g. Council Directive 77/799/EEC [347]; Council Directive 2003/48/EC [348]; and Council Regulation EC 1798/2003[349])) will be critically examined, exploring the amendments that occurred in their evolving process, their advantages and limitations as well as the relationships among them (i.e. when there is more than one instrument available, which one should prevail).

The contribution of this analysis relies on the understanding of whether the evolution of instruments for exchange of information enlarged or not the rights of tax administrations to obtain extraterritorial tax information and whether developing countries can

[347] Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, OJL 336, 15.

[348] Council Directive n. 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJEC L157, 38.

[349] Council Regulation (EC) n. 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax, OJEC L264, 1.

implement them. This enlargement of tax administrations' powers is essential in the current process of globalisation since financial transactions are not restrained by countries' borders. It is undeniable that in an integrated global economy taxpayers have enhanced their abilities to invest in any part of the world; however the power of tax administrations to access such transactions relies on such instruments for exchange of information. A critical comprehension of whether the current instruments have enlarged tax administrations' power to verify taxpayers' liabilities is crucial for countries to enforce taxation of their residents' foreign investments.

7.2.1. Bilateral Agreements

A bilateral agreement is a contract made by two parties, specifying their reciprocal rights and obligations. Different from multilateral agreements in which parties adhere to a standard agreement without amending the pre-defined clauses, a bilateral agreement usually involves negotiation of its clauses and the two parties are only bound by the exact terms that they agree. This argumentation leads to the false impression that multilateral agreements are easier to make since parties just need to accept a standard agreement. However, it is very difficult to develop a model of multilateral instrument that satisfies the different interests of contracting parties regarding exchange of information. So, in practice, it was easier to establish a network of bilateral agreements for exchange of information than a multilateral one. This is the main reason that has justified the implementation of exchange of information through bilateral instruments rather than a multilateral one.

In the next sections, models of bilateral agreements that provide exchange of information are examined. These models have been elaborated by different organisations, however, as demonstrated next, they also have many aspects in common since there was a certain kind of interaction among them, resulting is some similar characteristics. An important distinction when analysing the models is to keep in mind that some of them have a broader scope, including other subjects besides exchange of information; while others were specifically developed to implement exchange of information. The idea is to examine the main characteristics of these models, pointing out their advantages and shortcomings in relation to developed and developing countries' perspectives.

7.2.1.1. The evolution of exchange of information's clause in the OECD Model Conventions[350]

During the initial work of the League of Nations, prevention of double taxation and administrative assistance in tax matters were treated in separate conventions. In fact, in 1927, the Financial Committee of the League of Nations presented four Draft Conventions, treating the following issues separately: prevention of double taxation, succession duties, administrative assistance in tax matters and judicial assistance in the collection of taxes.

The 1927 Draft Convention on Administrative Assistance in Matters of Taxation was structured in the following way: Article 1: how the scheme of assistance should work in practice; Article 2: persons and type of income which were subjected to the procedure of exchange of information; Article 3: limits to administrative assistance; and Article 5 to 8: measures of execution.[351] Even though it would require complementary understanding between two contracting states signing it, the Draft covered a broad range of issues, including automatic exchange of information, as discussed in the next chapter.

Later, in 1943 (during the Fiscal Committee in Mexico) and in 1946 (during the Fiscal Committee in London) new Model Conventions were published. The outstanding structural difference between the Mexico and London Drafts and the previous Model Conventions was the treatment of administrative assistance and collection of taxes in the same instrument. Even though the same structure was adopted by the Mexico and

[350] The expressions 'Double Tax Treaty', 'Double Tax Convention', 'Tax Treaty' and 'Model Convention' will be used in an interchangeable way in the body of this text. These terms will be used to refer to bilateral agreements signed between contracting states in order to prevent double taxation and combat tax evasion.
[351] League of Nations, 'Report on Double Taxation and Tax Evasion presented by the Committee of Technical Experts on Double Taxation and Tax Evasion' (n 326) 8.

London Draft, examining the rules we can identify substantial differences among them. An important variation refers to exchange of readily available information (Article III). While the London Draft included explicitly a provision that allowed automatic exchange of information between the competent authority of each contracting state in the ordinary course of each year; the Mexico Draft incorporated only a provision that allowed the transmission of tax information in concrete cases on special request.[352] The Fiscal Committee of the League of Nations compared those provisions in 1946 and argued that the divergence might be attributed to the fact that automatic exchange of information between tax authorities would work satisfactorily only when countries had a well-established and developed tax system and tax administration. This argument was used to justify the absence of an automatic exchange of information clause in the Mexico Model Convention. However, another possible explanation might be connected to the fact that the Mexico Model Convention allocated more taxing rights to the source country rather than to the residence country. From this angle, extraterritorial exchange of tax information is less crucial for the enforcement of source taxation than for the grant of residence taxation. Thus, the inclusion of a provision for automatic exchange of information in the London Draft might reflect a coordinated act between the adoption of the residence principle in the Model Convention to Prevention of the double taxation of income and property and the necessity of extraterritorial tax information established in the Model Convention on Reciprocal administrative assistance for the assessment and collection of taxes on income. This kind of coordination has been lost in the evolving process of double tax treaties with the increased allocation of taxing rights to the residence state not being followed by improved clauses of exchange of information.

Between 1958 and 1961 the Fiscal Committee of the League of Nations prepared four reports about double taxation and tax evasion. Only in 1963, a final report was presented, entitled ‘Draft Double Taxation Convention on Income and Capital. The 1963 Draft was later revised and resulted in the publication in 1977 of a new Model

[352] League of Nations, ‘London and Mexico Model Tax Conventions: Commentary and Text’ (n 335) 102-03.

Convention and Commentaries.[353] There were substantial structural changes comparing the Mexico and London Model Conventions to the 1963 Draft and 1977 Model Convention. The first change refers to the presentation of a single instrument to deal with the problems affecting double taxation and tax evasion. So, the three instruments included in the Mexico and London Model Conventions were synthesised in a single treaty. However, administrative assistance for the recovery of tax claims was left apart. This issue was left outside the scope of the 1963 Draft and 1977 Model Convention based on the argument that recovery of tax claims was usually dealt with in a separate bilateral agreement. Nevertheless, contracting states might introduce an Article dealing with it, if they preferred, as there was no objection to that.[354]

In fact, the inclusion of clauses dealing with the prevention of double taxation of income and exchange of information in the same instrument might create a problem. The objective of double tax treaties is to eliminate duplicated taxes on the commercial transactions between contracting states, which leads to the conclusion that tax treaties have a higher probability to be made between countries with a strong commercial relationship and a large flow of cross-border investment.[355] However, the necessity of extraterritorial tax information might not match with the commercial interest. In this circumstance, a country can solve the problem of double taxation using unilateral measures since the volume of commercial transactions might not justify the signature of tax treaties. The described situation is more complicated in relation to exchange of information since there is no unilateral measure that can substitute the absence of information provided by tax treaties. In fact, there is a gap left by the absence of a tax treaty. This gap inhibits the flow of exchange of information required to combat tax evasion. So, even though treating double taxation and exchange of information together can simplify the process of implementing tax treaties, it might create problems when

[353] OECD, *Model Tax Convention on Income and on Capital Model Tax Convention on Income and on Capital: Condensed Version July 2008* (OECD 2008), 8
[354] K. van Raad, *1963 and 1977 OECD Model Income Tax Treaties and Commentaries* (Kluwer Law and Taxation Publishers 1990).
[355] S. A. Dean, 'The Incomplete Global Market for Tax Information' (2008) 49 Brooklyn Law School Legal Studies Research Papers-Accepted Paper Series n. 107 1, 45.

there is a disparity between interest to avoid double taxation and interest to combat tax evasion through exchange of tax information.

The second considerable change introduced by the 1963 Draft and the 1977 Model Convention refers to the substance of Article 26 that incorporated exchange of information provisions in the treaty for the prevention of double taxation. Both Articles 26 of the 1963 and 1977 Model Convention are quite similar in terms of structure and substance, so they will be analysed together. The first interesting point refers to the change in the type of clause included in the last Models compared to the previous ones. While the 1927, 1928, 1943 and 1946 Models concerned practical measures to implement exchange of information, the 1963 Draft and 1977 Model Convention established only general principles.[356] This tendency has been followed in the next Model Conventions.

Another aspect refers to specific mention of forms of exchange of information. In the 1963 Draft and 1977 Model Convention, the ways to exchange information were expressly mentioned only in the Commentary. In the body of the Model Convention, there was no single explanation on whether exchange of information might be automatic or only by request, for instance. Nevertheless, both Commentaries made clear that the manner in which exchange of information would be performed relied on the understandings between the contracting states.[357] There was no pre-defined form of exchange of information suggested in the Models.

Since 1963, Article 26 of the OECD Model Convention has provided rules for exchange of information. The revisions that updated the Model Conventions periodically to reflect current country practices have adjusted the text of Article 26 as well as the interpretation of the rules established in the Commentary. In this sense, from 1963 to 2009, the structure of Article 26 has suffered very light modifications, excepted by the inclusion

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[356] ibid 39.

[357] League of Nations, 'London and Mexico Model Tax Conventions: Commentary and Text' (n 335) 314-15.

of paragraphs 4 and 5 in 2005. Paragraph 4[358] of Article 26 deals explicitly with the obligation to exchange information in situations where the requested information is not necessary to the requested state for domestic tax purposes,[359] that is, contracting states should exchange tax information independently of whether or not they need that information. This signifies that domestic tax interest should not bar exchange of information. Paragraph 5[360] of Article 26 granted that the limitations to exchange information established in paragraph 3[361] could not be used to prevent the exchange of information held by banks, other financial institutions, nominees, agents, fiduciaries as well as ownership information,[362] which means that a contracting state cannot excuse itself from providing information on grounds of bank secrecy or ownership information when this is treated as a secret by domestic laws.

Even though paragraphs 4 and 5 changed the structure of Article 26 of the OECD Model Convention, the Commentaries on this Article suggested that these modifications should not imply that the previous versions of the OECD Model Convention did not authorise the exchange of such information. In fact, the Commentary wants to make clear that the inclusion of these new paragraphs only reflects the current practice already adopted by the vast majority of OECD member countries. The argumentation developed by the OECD in the Commentary of the 2005 Model Convention tries to avoid the necessity of amendments on tax treaties already in force in order to grant the application of those

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[358] 'Article 26(4) If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.' OECD, 'Model Tax Convention on Income and on Capital Model Tax Convention on Income and on Capital: Condensed Version July 2008' (n 353) 40.
[359] ibid 358.
[360] 'Article 26(5) In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.' ibid 40.
[361] In general terms, paragraph 3 establishes certain limitations to the main rule in favour of the requested state which signifies that a requested state is not bound to provide information to the requesting state if in order to provide that information it need to: (i) go beyond its own internal laws and administrative practices; or (ii) disclose any trade, business, industrial, commercial or professional secret or trade process, or the disclose any information that would be contrary to public policy. ibid.
[362] ibid 359.

rules. The Commentary attempts to justify the provisions in paragraph 4 and 5 as merely new interpretations of current practice.[363] Nevertheless, reservations on Article 26 made clear that countries in which these provisions could have a major impact reserved the right not to include paragraphs 4 and 5. For instance, Austria, Switzerland, Belgium and Luxembourg reserved their rights not to include paragraph 5 in their conventions.[364]

The recent modifications introduced in Article 26 are focused on the issue of which information a government should obtain automatically from third parties such as banks and other financial institutions. However, to develop a system where information can be exchanged effectively it is also necessary to examine the mechanisms in force that promote the transmission of the tax information between countries. In other words, the Revision of Article 26 focused only on the first level of requirements to implement a system where tax information can be effectively exchanged. Spencer highlighted this point by examining the following conditions: (i) whether the source-country government is only obligated to exchange information on request; (ii) whether the source-country government does not receive information by a system of automatic reporting; and (iii) whether the residence-country government has enough information to request information from the source-country. Thus, despite the fact that the revision of Article 26 has improved some aspects of exchange of information in tax treaties, the source-country government might not be able to effectively exchange information. Spencer characterised such situation as 'de facto bank secrecy', which signifies in practical matters that the Revised Article 26 might have a limited impact on promoting effective exchange of information. Spencer concluded that, for exchange of information under Revised Article 26 to be effective, the source-country government generally must have a system for the automatic reporting of information.[365] This argument will be considered again when examining the structure on how mechanisms for exchange of information work in a situation where there is a tax haven interposed between two contracting states.

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[363] OECD, *Model Tax Convention on Income and on Capital Model Tax Convention on Income and on Capital: Condensed Version July 2005* (OECD2005) 313-325.
[364] OECD, 'Model Tax Convention on Income and on Capital Model Tax Convention on Income and on Capital: Condensed Version July 2008' (n 353) 361.
[365] D. E. Spencer, 'Tax Information Exchange and Bank Secrecy (Part 1)' (2005) 16 Journal of International Taxation 1, 1-2.

Furthermore, it is important to understand that Article 26 of the OECD Model Convention is not a ground-breaking innovation. As debated next, the US Model Income Tax Convention of November 2006 [Article 26(5)][366]; US Tax Information Exchange Agreement [Article 4(b)] and OECD Model TIEA had already established rules to override bank secrecy laws.[367]

Finally, it is interesting to note that an Article regarding mutual assistance for the recovery of tax claims was included in the OECD Model Convention only in 2003 when a structural change implemented Article 27. From the 1963 OECD Draft to the 2000 OECD Model Convention, there was only a brief mention in the Commentary of Article 26 about the possibility of extending administrative assistance to cover collection of taxes. During that period, assistance in the collection of taxes was treated in a separate treaty, i.e. in the Convention on Mutual Administrative Assistance in Tax Matters, a multilateral convention that entered into force in 1995.[368] The explanation for having (i) mutual assistance for exchange of information and (ii) assistance for the recovery of tax claims treated in different conventions is based on the assumption that the latter could be extended to cover all public debts, and States would be reluctant to agree with that.[369]

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366 Due to the similarities between Article 26 of the 2005 OECD Model Convention and Article 26 of the US Model Income Tax Convention of November 2006, there is no specific section in this chapter dedicated to the analysis of the US Model Income Tax Convention. However, Article 26 of the 2006 US Model Tax Convention requires a brief commentary. Even though the five initial paragraphs of both Model Conventions have the same structure and substance, Article 26 of the US Model Income Tax Convention has four extra paragraphs, establishing the following issues: paragraph (6): provision of information in the form of depositions of witnesses and authentic copies of unedited original documents; paragraph (7): collection on behalf of the other contracting state of amounts to ensure that relief granted by the Convention does not benefit persons not entitled; paragraph (8): permission to the representatives of the requesting State to enter the requested State to interview individuals and examine books and records; and, paragraph (9): development of an agreement by the competent authorities of the contracting states establishing the practical measures for the application of this Article. For further details see: United States Treasury, United States Model Income Tax Convention of November 15, 2006, <http://www.ustreas.gov/offices/tax-policy/library/model006.pdf> accessed 7 October 2009.

367 Spencer, 'Tax Information Exchange and Bank Secrecy (Part 1)' (n 365) 1.

368 van Raad (n 354) 312 (to check information about 1963 Convention and Commentary on Article 26), and OECD, *Model Tax Convention on Income and on Capital: Condensed Version April 2000* (OECD2000), 226.

369 Grau Ruiz (n 324) 124.

The current version of Article 26 has improved some aspects of exchange of information regarding domestic interest; bank secrecy as well as ownership identity. However, we are still far away from a model that can promote effective exchange of information. There are still some strategic issues that will have to be tackled by the OECD which include: (i) enforcement of mandatory automatic exchange of information from source countries; (ii) disclosure of certain tax information to third countries; and (iii) the identification of the beneficial owner of a chain of companies established in different countries. The necessity of dealing with these issues will become clear when analysing the problem of exchange of information from a dynamic perspective in the next chapter.

The analysis of the evolution of the OECD Model Convention aimed to demonstrate arguments that shaped the structure and substance of the current Article 26 on exchange of information. On focusing on structural adjustments in the OECD Model Convention, the main change was the inclusion of rules to avoid double taxation and to exchange information in one single treaty. The substance of the OECD Model Convention has also evolved, incorporating general understandings previously established in the Commentary as well as practices among most OECD Member States, even though there are still many issues to be solved in order to have an Article that really provides effective exchange of information. Nevertheless, the OECD Model Convention can provide tax information only when there is a commercial relationship between countries that required the signature of a treaty to relieve double taxation.[370] The disconnection between double taxation and tax evasion makes things more complicated, requiring other instruments to improve exchange of information when the signature of a DTC is not the appropriate solution.

7.2.1.2. United Nations Model Conventions

Before investigating the United Nations (UN) rules about exchange of information, it is important to understand the function of this institution regarding international taxation.

[370] Dean, ‘The Incomplete Global Market for Tax Information’ (n 355) 45.

The UN's work will shed some light on the problems and challenges affecting the UN Model Convention.

As explained previously in this chapter, the initial work on international taxation was coordinated by the League of Nations. In 1945, after the World War II, the UN took over the role of the League of Nations, including matters of taxation, though, in practice, the work of the League of Nations continued for a short time. In this sense, in 1946, even though the UN should have assumed the League's functions, the League's Fiscal Committee met in London to review the Mexico Draft. The outcome of their work was a new draft, also called the London Draft. Despite the development of the Mexico and London Drafts in the 1940s, the UN only established the Ad Hoc Group of Experts to tackle international tax matters in 1967. The Ad Hoc Group received far less institutional support and status than the League's Fiscal Committee. Consequently, the Ad Hoc Group played a limited role in establishing an international consensus on tax matters compared to the Fiscal Committee of the League of Nations. [371]

One possible explanation for the reduced institutional support received by the Ad Hoc Group of the UN might be the fact that parallel to its development, another organisation was also established whose interests overlapped with the Ad Hoc Group in relation to international taxation. The Organisation for European Economic Co-operation (OEEC) was formed in 1947 to manage American and Canadian aid under the Marshall Plan for the reconstruction of Europe after the Second World War.[372] International taxation was among the subjects dealt by the OEEC. In practice, the work of the League's Fiscal Committee was continued by the Fiscal Committee of the OEEC. Later, in 1961, the OECD took over from the OEEC and international taxation remained as an issue of great importance. In 1963, the OECD published its first Draft Convention and subsequently in 1977 it published the first OECD Model Convention. Thus, the fast

[371] United Nations, 'Institutional framework for international tax cooperation' (2003) Ad Hoc Group of Experts on International Cooperation in Tax Matters ST/SG/AC.8/2003/L.6, <http://daccessdds.un.org/doc/UNDOC/LTD/N03/481/35/PDF/N0348135.pdf?OpenElement> accessed 1 September 2009, 13.

[372] OECD, 'History' <http://www.oecd.org/pages/0,3417,en_36734052_36761863_1_1_1_1_1,00.html> accessed 06 October 2009.

development of a Tax Model Convention put the OECD in evidence and it took over the position of guide in the debate on international taxation.

The first UN Model Convention which was published in 1980 followed the same line established by the OECD Model Convention.[373] There were small variations regarding the allocation of taxing rights between source and residence countries, however the substance and the structure were similar to the OECD Model Convention. In practice, therefore, the work of the Ad Hoc Group consisted in adjusting the OECD Model Convention to the perspective of developing countries, based on the assumption that those countries were capital importers and would benefit from a better allocation of taxing rights to the source country. The matter of mutual assistance was particularly influenced by this assumption, since developing countries saw no urgent need for mutual assistance given that withholding taxes on non-residents' local income appeared to solve the problem.[374] At that time, the importance of residents' foreign income was ignored.

Since the beginning, the Ad Hoc Group of the UN adopted as a parameter the OECD Model Conventions to the development of its own Model Convention. Consequently, the periodical revision of the OECD Model Convention has also caused updates in the UN Model Convention, though with less frequency. The last condensed version of the UN Model Convention was published in 2001. Article 26 of the 2001 UN Model Convention followed the 2000 OECD Model Convention. There are, of course, some small variations in the text, but the core provisions remain the same. In fact, the main difference appeared in the Commentary in which a guideline regarding the implementation of appropriate exchange of information was included. The guideline provided possible arrangements from which the competent authorities of contracting states could select the particular ones that they would like to implement in the treaty. In fact, the guideline consisted of suggestions on how to implement exchange of

[373] United Nations, 'United Nations Model Double Taxation Convention between Developed and Developing Countries' (1980) ST/ESA/102 UN Publications.
[374] Grau Ruiz (n 324) 118, quoting: United Nations, 'Cooperation Internationale en matiere fiscale. Rapport du Groupe special d'experts de la cooperation international en matiere fiscale sur les travaux de sa deuxieme reunion' (1984) ST/ESA/143 UN Publication, 13 et seq.

information in practice. For instance, regarding automatic exchange of information, the guideline suggested sources of income to be covered and general operational aspects to be considered by the transmitting and by the receiving country. [375]

The necessity of clear rules on how to implement the general principles of exchange of information provided in Article 26 is undeniable. However, the rules established in the guideline are so broad that they cannot support an effective improvement in the implementation of exchange of information. There is no awareness of the fact that there has to be some consistency in the type of information exchanged by countries in order to achieve an effective exchange of information. More specific mandatory rules for the implementation of exchange of information would represent a better approach.

In 2005, the OECD published a new consolidated version of its Model Convention with substantial changes in Article 26. These changes were analysed by the UN and incorporated in a document. This new document presented a revised version of Article 26 and respective Commentary for inclusion in the next version of the UN Model Convention.[376] Even though the substantial modifications adopted followed the OECD's position, there are few issues that deserve a special mention.

The first aspect refers to the recognition in the general considerations of the Commentary of Article 26 that exchange of information represents an important and necessary instrument to curtail capital flight.[377] Thus, the initial position that exchange of information would be useful only for a limited number of cases and withholding taxes were enough for taxing foreign income was overcome. Developing countries do need to have instruments that enable them at least in theory to combat capital flight. The

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[375] United Nations, 'United Nations Model Convention between Developed and Developing Countries' (2001) ST/ESA/PAD/SER.E/21 UN Publication, <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002084.pdf> accessed 06 October 2009, 351-79.

[376] United Nations, 'Revised Article 26 (Exchange of Information) and Revised (2008) Commentary on Article 26: for inclusion in the Next Version of the United Nations Model Double Taxation Convention between Developed and Developing Countries (2008) <http://www.un.org/esa/ffd/tax/Article%2026_Exchange%20of%20Information%20_revised_.pdf> accessed 06 October 2009.

[377] ibid 4.

absence of exchange of information in developing countries represents not only a loophole in their tax policies but also an incentive for capital flight.

The second aspect refers to the importance of practical measures. This argument was already introduced in the previous version of the UN Model Convention as a guideline in the Commentary of Article 26. In the 2008 revised version of Article 26, however, this matter is also treated in the body of the Model Convention as paragraph 6.[378] The OECD Model Convention has no particular paragraph regarding practical measures of implementation. This initiative taken by the UN is clearly positive, but it has a limited effectiveness due to the broad scope of its text as well as to the arrangements provided in the guideline, which remained as part of the Commentary of Article 26.

The third aspect refers to the reciprocity principle derived from the text of paragraph 3 of Article 26. Paragraph 3 (a) determines that a contracting state is not obligated to carry out administrative measures at variance with the laws and administrative practice of the other contracting state. From the perspective of the UN, the problem of reciprocity arises when a tax treaty is made between a developed and a developing country. In this case, the UN made clear in its Commentary of Article 26 that reciprocal obligations on the contracting states do not allow a developed country to refuse to provide information to a developing country on the grounds that the developing country does not have administrative capacity comparable to the developed country. Following this line of argument, the UN added two reasons for defending the point that different levels of administrative capacity do not preclude exchange of information: first paragraph 3 does not require reciprocal benefits; and second the principle of reciprocity must be viewed from the perspective of the convention as a whole.[379]

Even though the argument of the UN led to the assumption that the OECD had argued in the opposite direction, on analysing the OECD Commentary of Article 26 what we see is also the awareness of the problem of countries with different levels of tax

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[378] ibid 3.
[379] ibid 3 and 14.

administration capacities. The OECD Commentary expressed that too rigorous application of the principle of reciprocity could frustrate effective exchange of information and the reciprocity should be interpreted in a broad and pragmatic matter. The OECD recognised that different countries will have necessarily different mechanisms for obtaining and providing information. Therefore, variations in practice and procedures should not be used as a basis for denying a request. The condition established by the OECD for the refusal referred to the situation where the effect of the variations would limit in a significant way the requesting State's overall ability to obtain and provide the information if the requesting State itself received a legitimate request from the requested State. However, the OECD made clear that the condition just described did not apply when the legal system or administrative practice of only one country provides for a specific procedure. In this situation, the exception would be the case where the requested information itself is not obtainable under the laws or the normal course of the administrative practice of the requesting State, a requested State may decline such a request.[380] In other words, when there is a significant difference between two legal systems, including their tax administration, the absence of a procedure does not justify a refusal by the requested country to provide the information. In this case, the refusal would only be valid if based on a different argument, i.e. if underpinned by the fact that information could not be obtained under the laws or in the normal course of administrative practice in the requesting state. Thus, the essential difference consists of the absence of a law/procedure versus the existence of a law/procedure that prohibits the provision of the information.

Comparing the UN with the OECD's approach on the application of the principle of reciprocity, the conclusion is that both organisations wanted to make clear that the absence of a law or an administrative procedure could not preclude the requesting state from obtaining information from the requested state.

[380] OECD, 'Model Tax Convention on Income and on Capital Model Tax Convention on Income and on Capital: Condensed Version July 2008' (n 353) 356-57.

In sum, the UN Model Convention did not go further from what was suggested by the OECD in terms of exchange of information. In fact, the OECD Model Convention has guided the development of Article 26 of the UN Model Convention. Thus, both Model Conventions adopted the same line of argument which led to the same shortcomings in Article 26. The importance of exchange of information for developing countries has become clearer recently, due to its connection to the problem of capital flight. However, the argument of capital flight needs to be taken further, i.e. it must be considered when examining which type of arrangement would effectively improve exchange of information between developed and developing country. The UN has not addressed mechanisms for exchange of information from this point of view. This point needs to be considered by the UN if this organisation wants to adopt a proactive behaviour in the promotion of mechanisms for exchange of information, not only following once again the ideas developed by the OECD.

7.2.1.3. Tax Information Exchange Agreements (TIEA)

The main reason for the signing of an income tax treaty is the prevention of double taxation that could arise if both contracting states do not agree on how to allocate taxing rights in relation to economic transactions that both states have enough connection that justifies the levy of their income tax. However, there are also situations where financial transactions are performed between two contracting states but only one has an income tax system. In this case, the signing of an income tax treaty does not make sense since double taxation will not occur. This example illustrates the situation in which double taxation is disconnected from tax evasion. In other words, the absence of double taxation does not signify that tax evasion will not happen. Consequently, another instrument is required to establish the legal basis for exchange of information. The appropriate instrument to set up exchange of information between countries with different income tax systems is the Tax Information Exchange Agreement (TIEA).

It is important to clarify that even though the current idea is the signing of a TIEA between an income taxing jurisdiction and a tax haven, this instrument can also be enacted in other situations, for instance, when countries cannot find an agreement on terms of an income tax treaty, or even when countries just want to enhance the cooperation of their tax administrations in order to combat tax evasion. The first situation can be illustrated by the TIEA signed between Brazil and the United States in 2001, neither country is a tax haven but they opted for signing a TIEA due to conflicting interests in the negotiation of an income tax treaty. The second situation refers to the signing of TIEAs by Latin American countries, following the CIAT Model.

There is not only one single model of TIEA. Due to globalisation that increased the international flow of capital among countries and the limitations inherent of an income tax treaty regarding exchange of information between countries with different income tax systems, the TIEA has increased its importance recently. In the next subsections, the main characteristics of models of TIEA elaborated by the OECD, the United States and the Inter-American Center of Tax Administration (CIAT) will be examined in order to identify their advantages and shortcomings. The idea is to include in the analysis the perspective of developing countries on TIEA.

The OECD TIEA

In 2002, the OECD published a model agreement for effective exchange of information (TIEA) as part of their work on the combatting of harmful tax practices. The OECD TIEA has been already discussed in Chapter II, however from the perspective of harmful tax competition. Here the analysis is tackled from a different angle, focusing on the intrinsic characteristics of this instrument for exchange of tax information. Thus, even though some arguments will overlap, the approach is different, which makes the analysis complementary rather than repetitive.

The OECD TIEA is part of the report elaborated by the OECD's Global Forum on Taxation, which includes both OECD and non-OECD members[381]. The report examined

[381] By that time the non-OECD delegation was composed of Bermuda, Cayman Islands, Cyprus, Malta, Mauritius and San Marino.

what was required to achieve a global level playing field in the areas of transparency and effective exchange of information in both civil and criminal tax matters.[382] The standards set in the report and incorporated in the OECD TIEA represent measures suggested to be adopted by financial centres around the world, not only tax havens.

The OECD TIEA can be signed in two different versions, i.e. as bilateral or multilateral instrument. The multilateral instrument is not a 'multilateral' convention in the traditional sense i.e. that allows later parties to adhere to its terms, binding all parties (initial and later participants) together without later consent of the first parties. Instead, it provides the basis for an integrated collection of bilateral treaties. A party to the multilateral TIEA would only be bound by the Agreement vis-à-vis the specific parties with which it agrees to be bound. Thus, a party wishing to be bound by the multilateral Agreement must specify in its instrument of ratification the party or parties vis-à-vis which it wishes to be so bound. The Agreement then enters into force, and creates rights and obligations, only between those parties (which can be more than two) that have mutually identified each other in their instruments of ratification.[383] In fact, the multilateral version of the OECD TIEA is quite similar in substance and structure to the bilateral version. The difference relies on the possibility of including more than two parties in the agreement. Moreover, in the bilateral version there are some more issues to be negotiated, such as the taxes which are the subject of the agreement, the meaning of competent authority and any other clause that they want to amend.

According to the understanding of the OECD's Global Forum of Taxation, there are three major aspects for ensuring transparency and effective exchange of information: (i) the existence of mechanisms for exchange of information; (ii) the appropriate level of access to the information; and (iii) the availability of information. These three aspects were incorporated in the OECD TIEA. The first aspect refers to the necessity of a legal basis for countries to exchange information for tax purposes. To this extent, the OECD TIEA complements the bulk of instruments already available for exchange of

[382] OECD, '2006 Report on Tax Co-operation' (n 70) 7.
[383] OECD, 'Agreement on Exchange of Information on Tax Matters' (2002) <http://www.oecd.org/dataoecd/15/43/2082215.pdf > accessed 08 October 2009, 2.

information (e.g. double tax conventions, Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters, domestic laws, etc.).[384]

The second aspect refers to devices incorporated in the OECD TIEA that not only enforce access to information on a standard basis but also include safeguards and limitations that work as a check and balance mechanism. The appropriate access to information is reflected in the fact that information exchange is not limited to criminal tax matters but also extended to information requested by civil tax matters. Moreover, under the dual criminality principle, domestic tax interest information held by financial institutions and ownership identity cannot cause restrictions for information exchange. On the other hand, the access of information needs to be balanced by the interests of both requested states and third parties. For this purpose, the OECD TIEA allows only the exchange of information upon request and when the information is foreseeably relevant for the requesting state, which disallows fishing expeditions. There are also limitations which give the right to the requested state to decline the required information.[385] At least, appropriate access to information also encompasses some confidentiality requirements which signifies that governments would not engage in information exchange without ensuring that the information provided would only be used for the purposes established in the Agreement. One limitation derived from the confidentiality requirement is the prohibition of disclosing information received to third countries. Third countries can only have access to information exchanged if the Agreement expressly permits it.[386]

[384] OECD, '2006 Report on Tax Co-operation' (n 70) 9-14.
[385] These limitations established that the requested state can decline to provide tax information when: (i) the requesting state would not be able to provide such information under its own laws for purpose of administration and enforcement of its own laws, including the case of self-incrimination; (ii) the request is not made in conformity with the agreement; (iii) the request would disclose any trade, business, industrial, commercial or professional secret or trade process; (iv) the requested information is protected by the attorney client privilege; (v) the disclosure of information would be contrary to public policy; and (vi) the requested information would be a discrimination against nationals of the requested party. For further details see Article 7 of the OECD TIEA. OECD, 'Agreement on Exchange of Information on Tax Matters' (n 383) 25-28.
[386] OECD, '2006 Report on Tax Co-operation' (n 70) 10-11.

In sum, there are two types of limitation imposed by the OECD TIEA model: (i) from the perspective of the requesting state: the proof that the tax information requested is foreseeably relevant; and (ii) from the point of view of the requested state: the possibility of declining a request whether one of the conditions for that refusal is presented. For exchange of information to work, therefore, both requesting and requested states need to demonstrate the fulfilment of certain requirements.

The limitations imposed here to protect the requested state and third parties can have a broader impact on the TIEA signed between developing countries and tax havens than on the TIEA entered into by developed countries and tax havens. The criteria that information can only be provided upon request and when foreseeably relevant makes a country able to request information only when it has access to enough previous details of the information being requested. Assuming that a considerable amount of capital flight is invested in developed countries, developed countries can fulfil the requirements to request information from tax havens. They have enough information to track it down. Developing countries, however, are in a difficult position. The difficulty derives from the fact that most capital flight is probably invested in developed countries through a tax haven and developing countries have no information at all on this capital. Thus, even if a developing country signed an OECD TIEA with a tax haven, the effectiveness of such instrument would be very limited. Probably, most developing countries will not be able to fulfil the requirement to request information established in the OECD TIEA.[387] The

[387] The OECD TIEA establishes in Article 5 the information that the requesting state needs to provide to the requested state in order to demonstrate that the information required is foreseeably relevant: '5. The competent authority of the applicant Party shall provide the following information to the competent authority of the requested Party when making a request for information under the Agreement to demonstrate the foreseeable relevance of the information to the request: (a) the identity of the person under examination or investigation; (b) a statement of the information sought including its nature and the form in which the applicant Party wishes to receive the information from the requested Party; (c) the tax purpose for which the information is sought; (d) grounds for believing that the information requested is held in the requested Party or is in the possession or control of a person within the jurisdiction of the requested Party; (e) to the extent known, the name and address of any person believed to be in possession of the requested information; (f) a statement that the request is in conformity with the law and administrative practices of the applicant Party, that if the requested information was within the jurisdiction of the applicant Party then the competent authority of the applicant Party would be able to obtain the information under the laws of the applicant Party or in the normal course of administrative practice and that it is in conformity with this Agreement; (g) a statement that the applicant Party has pursued all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties.

exception would be when capital flight is invested in their jurisdictions, i.e. capital illegally flows out of the developing country to a tax haven and then returns as foreign investment. Only in this case the TIEA signed between a developing country and a tax haven might work. An alternative would be that the developed country, where the capital is invested, requires that foreign investors identify themselves in order to invest their capital. The identification of investors would be sent automatically to the respective country of residence. In this situation the signing of the OECD TIEA between a developing country and a tax haven would make sense since the developing country would have enough data to demonstrate that the information requested was foreseeably relevant and not a mere fishing expedition, which is prohibited.[388]

In order to understand the reason why the OECD enacted exchange of information upon request rather than automatic exchange of information in the OECD TIEA model, Spencer analysed the framework of exchange of information between an OECD member and a tax haven. According to him, the objective of the OECD TIEA was for OECD members to be able to obtain tax-related information from tax havens despite bank secrecy and other confidentiality laws. However, due to the fact that most tax haven jurisdictions neither levy income taxes nor have an income tax administration, payers of income, including banks and other financial institutions do not need to report payment transactions to the tax authority. Consequently, the tax authorities do not have the necessary information to implement a mechanism for automatic exchange of information. This is the reason that justifies exchange of information upon request in the OECD TIEA model.[389] Thus, even though exchange of information upon request was not the ideal solution, according to Spencer, a realistic approach of the limitations inherent in the tax havens' tax systems led to the adoption of this mechanism for exchange of information.

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[388] Whether investments are made through legal entities, the source state would have to require information in order to identify the effective beneficial owners behind those structures. It would be even more complicated if a chain of legal entities headquartered in different tax havens are used.

[389] D. E. Spencer, 'Tax Information Exchange and Bank Secrecy (Part 2)' (2005) 16 Journal of International Taxation 1, 2-3.

Another contradictory aspect of the implementation of exchange of information upon request by the OECD TIEA model refers to its relationship to the OECD's previous work on exchange of information. Spencer explained this aspect by pointing out that since 1997 the OECD has recommended the use of tax identification numbers and the use of the revised standard OECD magnetic format for automatic exchange of information.[390] Thus, even though the OECD TIEA is assumed to have high standards of transparency and effective exchange of information, its comparison with OECD's previous work demonstrates that its structure has some flaws, especially regarding the preference for exchange of information upon request.

Notwithstanding the requirements to exchange information upon request, there are also some limitations that attribute to the requested state the possibility of declining a request. So, even though the requirements to request information might be fulfilled by the requesting country, the requested state still has the possibility of declining the request if one of the conditions established in Article 7 is presented. Paragraph one of Article 7 deserves a special commentary. This paragraph establishes that the requested state does not need to provide information that the requesting state would not be able to obtain under similar circumstances under its own laws for purposes of the administration or enforcement of its own tax laws.[391] This might work well when you have two contracting states with similar tax systems however in the case of the OECD TIEA usually we will have a taxing jurisdiction and a tax haven. In this case, the content of this paragraph becomes quite controversial since if a tax haven requires any information from a taxing jurisdiction, the latter will not need to provide it, excused by the fact that the requesting state, i.e. the tax haven, would not be able to obtain it under similar circumstances under its own laws for purposes of the administration or enforcement of its own tax laws. Thus, this clause in the OECD TIEA creates in practice a situation where information can only flow one way, i.e. from the tax haven to the taxing jurisdiction but not the other way around. The OECD and UN Income Convention Model related this limitation with the reciprocity principle, making clear exceptions for

[390] ibid.
[391] OECD, 'Agreement on Exchange of Information on Tax Matters' (n 383) 25.

cases where one of the contracting states does not have a specific mechanism since the absence of mechanism is different from the existence of one that restrains exchange of information in certain circumstances. The OECD TIEA limits its commentary to the situation of self-incrimination. Contextualising this limitation to the hypothesis of an OECD TIEA signed between a developing country and a tax haven, effective exchange of information becomes even more complicated since the developing country might not have the mechanism required to access such information domestically. The tax haven could refuse on this basis to provide the information requested. So, under these hypothetical circumstances the OECD TIEA signed between a developing country and a tax haven would not work properly.

In sum, the importance of exchange of tax information between countries has increased remarkably and the development of the OECD TIEA supports this argument. Even though the development of the OECD TIEA was important to extend exchange of information to situations where a DTC was not required, this instrument cannot implement effective exchange of information. From a critical view, the OECD TIEA had a greater impact on internal limitations of countries to provide information rather than on the mechanisms to really enforce exchange of information between countries. In other words, as the OECD and UN Model Income Tax Conventions, the OECD TIEA enforces appropriate access to information by granting that: (i) information exchange is not limited to criminal tax matters but also extended to information requested by civil tax matters; and (ii) under the dual criminality principle, domestic tax interest information held by financial institutions and ownership identity cannot cause restrictions for information exchange. However, exchange of information is based on exchange upon request which in practice cannot occur if the requesting state has insufficient knowledge of the information being requested. From the perspective of developing countries the flaws in the OECD TIEA became more relevant, since capital flight is usually invested in developed countries and they probably will not know any detail of the financial transactions carried outside their jurisdictions. Only when capital flight returns as foreign investment would developing countries benefit from the mechanism of exchange of information provided in the OECD TIEA.

This analysis put in evidence the fact that the OECD TIEA was developed from the perspective of OECD members. An answer to the current problem cannot be found easily, however the identification of the current shortcomings of the instruments available from the view point of not only developed countries but also developing ones might point out to the direction of a possible solution in which all countries need to be involved.

The US TIEA model

Even though only recently there was an international recognition of the importance of tax information exchange agreements due to the work of the OECD Global Forum on Taxation, which culminated to the elaboration of the OECD TIEA model in 2002, the United States of America (US) developed a TIEA model much earlier than the OECD. Since 1980, the US adopted a program to exchange information with developing countries, particularly in the Americas. The US TIEA model was part of the Caribbean Basis Economic Recovery Act (CBERA). The objective of the US TIEA was to supplement the efforts of the US Internal Revenue Service (IRS) to enforce the American income tax laws and to improve its compliance by obligating treaty partners to cooperate with the US on civil and criminal tax investigations.[392]

In order to encourage the signing of a TIEA, the US offered different types of benefits to the contracting states. The first benefit consisted of qualifying the contracting state for North American treatment for Americans attending conventions there under section 274 (h) of the Internal Revenue Code. This treatment allowed the deduction of certain expenses as long as the conditions established in the US domestic legislation were fulfilled.[393] The second benefit allowed the Caribbean beneficiary country to host a

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[392] B. Zagaris, 'The Procedural Aspects of US Tax Policy Towards Developing Countries: Too Many Sticks and No Carrots?' (2003) 35 George Washington International Law Review 331

[393] The United States Internal Revenue Code § 274 (h) (2001).

foreign sale corporation (FSC).[394] In practice, this signifies that this benefit is not available anymore to countries entering into a TIEA with the US. The third benefit that encouraged the signing of a TIEA by Caribbean countries consisted of the eligibility of treaty partners to receive loans under the Puerto Rico program. The Puerto Rico program was ended by the US Congress which means that this benefit is not available anymore to countries entering into a TIEA with the US. The only benefit still available is the first one which can be seen in the US-Bahamas TIEA[395] signed in January 2002.[396]

Later the US's approach to encouraging the signing of a TIEA had a reversal in strategic terms. Instead of offering benefits for countries that agreed to sign a TIEA, the new approach consisted in punishing countries that refused to sign a TIEA by not allowing the application of tax exemptions available in the US tax law. The exemption of non-residents' portfolio income illustrates this policy. The Tax Reform Act of 1984 that exempted interest paid to non-residents also allowed the American Revenue to deny the

[394] The FSC was a legal device created by the US tax legislation that allowed American companies to reduce their income tax burden on profits originated from exports performed by an offshore subsidiary. This benefit would encourage the establishment of American FSC companies in the Caribbean area, increasing investment in the region. However, in 1999 the European Union (EU) launched proceedings against the FSC provisions at the World Trade Organization (WTO), arguing that those benefits were an export subsidy. In March 2000, the Appellate Body of the WTO decided that the FSC provisions constituted a forbidden export subsidy. The US Congress then repealed the FSC provisions. The dispute did not end with the Appellate Body's decision in favour of the EU. In November 2000, the US enacted the Extraterritorial Income Exclusion Act which was also challenged by the EU, claiming the US did not properly implement the earlier WTO decision since this new US legislation reintroduced some benefits of the FSC legislation. The WTO decided once again that the US tax law was providing an export subsidy. The dispute is not completely solved but the FSC benefit is not available anymore. For further details: WTO, 'Dispute DS108 United State: Tax Treatment for Foreign Sales Corporations' <http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds108_e.htm> accessed 13 October 2009.

[395] The fourth paragraph of the preamble of the US-Bahamas TIEA signed in January 2002 establishes that: 'Whereas the Contracting Parties wish to enter into a form of agreement that allows United States taxpayers to deduct expenses allocable to a convention, seminar or similar meeting held in the Bahamas in the same manner and to the same degree that such a deduction would be permitted if such meeting were held in the United States,'. Article 5 also disposes about deduction of costs incurred with respect to attendance at a conference in the Bahamas. OECD, Agreement between the government of the Commonwealth of the Bahamas and the Government of the United States of America for the Provision of Information with respect to Taxes and for other matters, [hereinafter US-Bahamas TIEA], <http://www.oecd.org/dataoecd/20/14/35514646.pdf?contentId=35514647> accessed 14 October 2009.

[396] Zagaris, 'The Procedural Aspects of US Tax Policy Towards Developing Countries' (n 392) 335.

exemption benefit if the exchange of information between the US and the country of residence of the foreign taxpayer was insufficient to prevent tax evasion from the US.[397]

The US strategy to encourage countries to sign a TIEA consisted of the attribution of a special benefit or even the non-application of punishment to the contracting party. This mechanism, in fact, tried to balance the relationship established in the TIEA. Thus, the assumption behind the US TIEA is that there is an asymmetry of interests between the contracting states, which needs to be compensated by offset conditions. On the other hand, the OECD initial approach was based on a different premise, since it assumed that both contracting parties were interested in collaborating to achieve a global level playing field in the areas of transparency and effective exchange of information for tax purposes. Thus, in principle, no compensatory measure was offered to any party to make the relationship symmetric in terms of rights and obligations in the OECD TIEA. Recently, however, the OECD adopted a more coercive approach. The OECD elaborated a progress report on the jurisdictions implementing the international agreed tax standard. The internationally agreed tax standard requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes.[398] These requirements were incorporated in the OECD TIEA. So, countries that refused to accept the standard rules of transparency and exchange of information were included in a 'black list' published on the 2nd April 2009.[399] The current OECD approach follows the US's strategy since both of them 'punish' countries that refuse to exchange tax information. From a critical perspective, the objective of the TIEA is to establish exchange of information between countries with asymmetric income tax systems, the

[397] ibid.

[398] OECD, 'A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard: Original Progress Report 2nd April' <http://www.oecd.org/dataoecd/38/14/42497950.pdf> accessed 15 October 2009.

[399] First of all, the expression 'black list' refer to countries included in the table labelled: 'Jurisdictions that have not committed to the internationally agreed tax standard'. Costa Rica, Malaysia, Phillipines and Uruguay were included in the 'black list' published on 2nd April 2009 by the OECD. The list published on 14th October 2009 had no countries included in the 'black list'. OECD, 'A Progress Report on the Jurisdictions surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard: Progress made as at 14th October 2009' <http://www.oecd.org/dataoecd/50/0/43606256.pdf> accessed 15 October 2009.

US and OECD's approaches recognised this fact by adopting measures to enforce the relationship established in the TIEA. However, the current counterbalancing measures are retaliatory rather than compensatory, i.e. countries that do not collaborate are penalised whereas countries that collaborate do not receive any extra benefit. Compensatory measures could also be used to encourage exchange of tax information, e.g. sharing costs of exchange of information or even sharing of revenue recovered by both jurisdictions.

The first draft of the US TIEA was released in July 1984.[400] The technical explanation made clear that: (i) the US TIEA was influenced by Article 26 of the US Model Income Tax Convention; (ii) the agreement could cover all national level taxes (not only income tax); and (iii) the agreement did not need to include all the provisions of the Draft, i.e. the structure was flexible and could be adapted to countries' negotiations, excluding certain clauses or even including others not predicted in the Draft.[401]

The structure of the US TIEA model released in 1984 consisted of 9 articles of which main aspects are discussed here. Article (1) Object and Scope of the Agreement: this article set forth the objective of the agreement which was to provide methods for the exchange of information, without regard to the residence or nationality of that person or of the person who was in possession of the information. Article (2) Taxes Covered: this article identified the taxes about which the parties agreed to exchange information. As already mentioned, taxes covered could include not only income taxes but also taxes on wealth or capital, inheritances, real property and general consumption taxes such as the value added and sales taxes. However, sub-national level taxes should not be included. Article (3) Definitions: this article defined the terms used throughout the Agreement. Article (4) Exchange of Information: this article established the basic obligations of the contracting states, including the form and limitations to exchange information and to use it. This article allowed a discretionary choice among three forms of exchange of

[400] United States Department of Treasury, 'Draft and Technical Explanation of Caribbean Basis Initiative Exchange of Information Agreement', (1984) Treasury News R-2780, reprinted in R. A. Gordon and B. Zagaris, *International Exchange of Tax Information: Recent Developments* (n.225, Practicing Law Institute 1985), 169-206.
[401] Zagaris, 'The Procedural Aspects of US Tax Policy towards Developing Countries' (n 392) 336.

information: regular (automatic), upon request or spontaneous. It also made clear that the competent authority of each state needed to have power to satisfy the obligations accepted. Regarding bank secrecy and ownership identity, there is a specific provision to ensure access to such information, however there is also a disclaimer determining that the provision need not be included in a final agreement if the internal law of the contracting state does not have the effect of allowing bank secrecy or undisclosed ownership of securities. In addition, there is a provision making clear that the absence of domestic interest in the information requested cannot prevent exchange of information. The obligations of the requested party were limited, however, to the following aspects: (i) carrying out administrative measures at variance with the laws and administrative practices of either states; (ii) supplying information which is not obtainable under the laws or the normal course of the administration of either states; (iii) supplying information that could disclose a trade, business, industrial, commercial or professional secret or trade process; or (iv) supplying information which disclosure would be contrary to the public policy. Finally, Article (4) established that information exchanged should be treated as a secret in the same manner as tax information obtained under domestic laws. Information received cannot be disclosed to third countries, unless authorised by them previously. Article (5) Mutual Agreement Procedure: this article gave permission to the competent authorities to implement the program necessary to exchange information and to resolve any problem by mutual agreement procedure. Article (6) Costs: this article dealt with the allocation of costs, disposing that ordinary costs should be borne by the requested state whereas extraordinary costs should be borne by the requesting state. Article (7) Implementation, Article (8) Entry into Force and Article (9) Termination discussed bureaucratic procedures to implement the agreement.[402]

The interesting aspect of examining in detail the characteristics of the US TIEA model released in 1984 is to compare them with the current characteristics of the OECD TIEA

[402] United States Department of Treasury, 'Draft and Technical Explanation of Caribbean Basis Initiative Exchange of Information Agreement' (n 400), 189-90.

model. Subsequently, the outcome of this comparative analysis will be used to verify whether the recent US TIEA signed follow the original US draft or the OECD's model.

The main differences between the US TIEA model released in 1984 and the OECD TIEA model published in 2002 are: (i) the OECD TIEA includes in the taxes covered sub-national taxes, whereas the US TIEA restrains itself to taxes levied on the federal level; (ii) the OECD TIEA covers only exchange of information upon request, while the US TIEA allows three forms of exchange of information: automatic, spontaneous and upon request; (iii) the OECD TIEA makes clear that the dual criminality principle cannot obstruct the exchange of information; in the US TIEA this principle is not mentioned; (iv) both models established that bank secrecy and ownership identity cannot limit exchange of information, however in the OECD TIEA these situations are not excused by the internal law of the contracting states, whereas in the US TIEA internal constraints override bank secrecy and ownership identity rendering the provision innocuous; (v) in the OECD TIEA the requesting state needs to demonstrate that the information requested is foreseeably relevant, while in the US TIEA there is no such provision; and (vi) the OECD TIEA includes among the possibilities of declining exchange of information by the requested state the case of confidentiality between attorney and client, the US TIEA does not include such provision. Besides all these differences, the two models have many aspects in common which allows the assumption that the OECD was influenced by the previous work developed by the US.

The OECD TIEA improved some aspects of the US TIEA. The main improvements refer to: (i) permission to cover taxes imposed by or on behalf of political sub-divisions or local authorities; (ii) the dual criminality principle and domestic tax interest cannot restrain exchange of information; (iii) bank secrecy and ownership identity cannot limit the obligation to exchange information; and (iv) protection of attorney-client communication under certain conditions. Nevertheless, the OECD TIEA reduced the possibility of exchange of information by establishing that exchange of information upon request was the only mechanism of exchange covered by the agreement, added to the fact that when making a request, the requesting state needs to demonstrate that the information requested is foreseeably relevant by fulfilling the requirements listed. These two aspects allow exchange of information only when the requesting state has enough previous knowledge of the information requested.

Based on the differences between the US TIEA and the OECD TIEA, the examination of the most recent US TIEA signed with the Principality of Liechtenstein[403], Gibraltar[404] and the Principality of Monaco[405] demonstrate that the new US TIEAs have more characteristics in common to the OECD TIEA model than to the US TIEA, in terms of structure and substance since the new TIEA: (i) only cover exchange of information upon request; (ii) the requesting state needs to demonstrate that information requested is foreseeably relevant; (iii) bank secrecy and ownership identity cannot justify declining to exchange information; and (iv) the dual criminality principle and domestic tax interest cannot restrain exchange of information.

Zagaris performed an analysis in which the characteristics of the first TIEAs signed by the US in the 1980s and 1990s were examined. The TIEAs studied in detail by him were: (i) US-Barbados; (ii) US-Dominica; and (iii) US-Peru. The outcome of his analysis demonstrated the flexibility of the first TIEAs signed by the US. Each one of the treaties had a particular characteristic that differentiated them from the others, not limited to small details but to the aspects on how information was effectively exchanged. For instance, the US-Barbados TIEA allowed information to be exchanged on a regular basis and both the US-Dominica and the US-Peru provided explicitly that information could be exchanged on an automatic basis, upon request or spontaneously, i.e. the three most common forms of exchange of information were included in the TIEA.[406] In addition to the arguments raised by Zagaris's analysis, the US-Bahamas signed in January 2002 also presents very interesting aspects. The US-Bahamas TIEA is

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[403] Hereinafter referred as the US-Liechtenstein TIEA, signed on 8th December 2008, <http://www.oecd.org/dataoecd/8/1/41818936.pdf> accessed 16 October 2009.

[404] Hereinafter referred as the US-Gibraltar TIEA, signed on 31st March 2009, <http://www.oecd.org/dataoecd/53/18/42542003.pdf> accessed 16 October 2009.

[405] Hereinafter referred as the US-Monaco TIEA, signed on 8th September 2009, <http://www.oecd.org/dataoecd/1/24/43662746.pdf> accessed 16 October 2009.

[406] Zagaris, 'The Procedural Aspects of US Tax Policy Towards Developing Countries' (n 392) 337-52.

an outstanding example of how asymmetric interests can be reflected in a treaty. The clauses of this agreement made clear that the US is the party effectively interested in exchanging information. So, the clauses were agreed in a way that they grant the flow of information from the Bahamas to the US but not the other way around. Sharp *et al* described the US-Bahamas TIEA as an 'information provision agreement', since the Bahamian version does not require the United States to tender any requested information to the Bahamas.[407]

Analysing the evolution of the TIEAs signed by the US, the most recent TIEAs (e.g. US-Monaco, US-Gibraltar and US-Liechtenstein) have lost the initial flexibility that they presented before the OECD TIEA model was released. As already mentioned, there are positive aspects of the adoption of the OECD TIEA model, however we need to be aware that this type of agreement can establish other types of exchange of information. Exchange of information upon request is only feasible when the requesting country has previous knowledge of the information being requested. The US's experience with TIEAs demonstrated that other types of exchange of information can also be arranged through a TIEA. Moreover, the US went further on the assumption that this type of treaty is indicated only between a tax haven and a high tax jurisdiction. TIEA can be signed between taxing jurisdictions as well. For instance, the US signed TIEA with countries that had a well-developed income tax system, i.e. US-Peru TIEA, US-Mexico TIEA and US-Brazil TIEA.

Although the US has a longer experience with TIEAs than the OECD since its TIEA model was developed in the 1980s, we do not have enough information to understand whether the TIEA is really a helpful instrument to exchange information. Governments usually do not share data about how much information was exchanged through the use of TIEA for strategic reasons. The absence of information might increase taxpayers' compliance since they are not aware of the possibility of being caught by information exchange mechanisms. There are only a few public cases of exchange of tax information

[407] W. M. Sharp, W. T. Harrison III, R. A. Lunsford and S. A. Harty, 'U.S. Tax Information Exchange Agreements: A Comparative Analysis' (2002) Tax Notes International 193, 193-260.

between countries. For example, in 2000 the US made public that the IRS requested a federal judge in Miami to issue summonses of MasterCard and American Express card transactions in the US that were billed to banks in several tax havens.[408] Nevertheless, the data available is not enough to perform a quantitative and qualitative analysis of information exchanged through TIEAs. Thus, the US' experience can contribute only with arguments for a theoretical analysis of the characteristics of the TIEA. The American experience expanded the debate, demonstrating that: (i) the OECD TIEA model was not the first one developed; (ii) other types of exchange of information can also be enforced through a TIEA; and (iii) compensatory measures rather than retaliatory ones can be used to encourage the signing of a TIEA. Even though acclaimed by the international community as the standard instrument to enhance transparency and exchange of information on a global level, the OECD TIEA has some flaws that the comparative analysis performed with the US' TIEA helped to demonstrate.

The CIAT TIEA model

In order to critically analyse this model, first it is necessary to understand the background of this organisation. The CIAT (Inter-American Center of Tax Administrations) is an international public non-profit organisation, created in 1967 to promote the integration of tax administrations of its member countries. Initially, the CIAT had 20 member countries from the Americas (including the US). Currently, the number of members has increased and this organisation gathers 38 member countries and associate member countries, from four continents: 29 countries from the Americas; 6 European countries; 2 African countries and one Asian country.[409] The profile of the members shows that, since its foundation, the CIAT was joined by developed and developing countries. Although developing countries from the Americas were the majority.

[408] Zagaris, 'The Procedural Aspects of US Tax Policy Towards Developing Countries' (n 392) 362.
[409] CIAT, History <http://www.ciat.org/index.php?option=com_content&task=category&sectionid=13&id=74&Itemid=111> accessed 2 November 2009.

The first draft of a Model for Exchange of Tax Information was released by the Executive Council of the CIAT in 1990. Zagaris argued that the CIAT model attributed a new political legitimacy to TIEAs as an instrument for exchange of tax information, since until its publication the US TIEA model was the only model available.[410] The political perspective of the CIAT TIEA is completely different from the OECD TIEA. While the former represented an initiative of Latin American countries to preserve their sovereignty; the latter was developed to enhance exchange of information between taxing jurisdictions and tax havens.

In 1999 a new draft of the CIAT TIEA was released. This version did not implement theoretical innovations. It continued following Article 26 of the OECD Income Model Convention as well as the US TIEA model. In fact, in technical terms, the original aspect of this model remains in its preamble. The preamble recognises the importance of administrative cooperation to combat fraud, tax evasion and tax avoidance. The mention of tax avoidance is peculiar since other models only refer to tax evasion. Furthermore, the preamble also mentions the social importance of the agreement, emphasising that its benefits need to consider: (i) the economic relation of the contracting states; (ii) the characteristics of the transactions involving tax fraud, tax evasion and tax avoidance; (iii) the capacity of the tax administrations involved; and (iv) the economic and social effects.[411]

In relation to technical aspects, the CIAT TIEA can be signed by two or more contracting states. It provides three mechanisms for exchange of tax information: automatic, spontaneous and upon request.[412] However, the provisions on the mechanisms for exchange of information are very broad, leaving every detail related to its implementation to a later agreement. Moreover, regarding limitations on exchange of

[410] B. Zagaris, 'CIAT Adopts Model Tax Information Exchange Agreement' (1990) 6 International Enforcement Law Report 105, 105-09.
[411] CIAT, 'Modelo de Acuedo de Intercambio de Informaciones Tributarias del CIAT' (1999), Preamble and p.2.
[412] Article 4 (3), (4) and (5) of the CIAT TIEA.

information, the CIAT TIEA had already secured the override of bank secrecy and the disclosure of ownership identity.[413]

The CIAT TIEA model, therefore, can be regarded as the model developed by the tax administration of Latin American countries to enhance cooperation in the fight against tax fraud, tax evasion and tax avoidance. The contribution of the CIAT TIEA model for this analysis does not consist of the introduction of new theoretical arguments. In fact, the CIAT TIEA contributed to the expansion of the political perspective of the use of TIEA. Even though, nowadays TIEA models are constantly associated with the tax administration problems created by tax havens, they can also be used to enhance the integration of tax administration of taxing jurisdictions.

7.2.2. Multilateral Agreements

Even though countries have preferred to regulate exchange of tax information through bilateral agreements, some multilateral agreements were also signed. There are two multilateral conventions on mutual assistance in tax matters that deserve special attention: (i); the Nordic Mutual Assistance Convention on Mutual Administrative Assistance in Tax Matters[414] and (ii) the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters.[415] Both multilateral conventions were signed between developed countries. These multilateral agreements were developed to enhance exchange of information between countries with similar income tax systems. Developed countries' experience with multilateral agreements will demonstrate how the discussion moved forward and the difficulties faced in this process.

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[413] Article 4 (7) of the CIAT TIEA.
[414] Hereinafter referred as the Nordic Convention, <http://www.itdweb.org/documents/NORDIC%20MUTUAL%20ASSISTANCE%20CONVENTION.pdf> accessed 18 October 2009.
[415] Hereinafter referred as CMAATM. OECD, *The Convention on Mutual Administrative Assistance in Tax Matters* (Twentieth Anniversary Edition, OECD publishing 2008), 9-29.

7.2.2.1. The Nordic Convention

The Nordic Convention as a multilateral agreement emerged from the updating work of similar bilateral conventions on mutual assistance in tax matters signed between: (i) Norway and Sweden in 1949; (ii) Norway and Finland in 1954; (iii) Norway and Denmark in 1956; and (iv) Denmark, Finland and Sweden. The first Nordic Multilateral Convention was signed in 1972 by Denmark, Finland, Iceland, Norway and Sweden. The first Nordic Convention signed in 1972 was amended several times and in 1989 a new treaty was signed, expanding the number of contracting states to seven with the inclusion of Faroe Islands and Greenland. The 1989 version has been in force since 1991.[416]

The scope of the Nordic Convention covers administrative assistance for: (i) the service of documents; (ii) the supply of information; (iii) the supply of tax return forms; (iv) measures to avoid the imposition of preliminary taxes; (v) the collection of tax; (vi) the transfer of tax; and (vii) the recovery of tax and the provision of guarantees for the payment of tax claims. The Nordic Convention applies not only to direct taxes but also to other taxes such as value added taxes and social security contributions levied at national and sub-national levels.[417]

Focusing on exchange of information, the Nordic Convention encompasses five different ways of exchange of tax information: (i) upon request; (ii) automatic; (iii) spontaneous; (iv) simultaneous; and (v) tax examinations abroad. The range of mechanisms supports the argument that each one of them provides a different type of tax information. The type of information provided through automatic exchange is different from the outcome of spontaneous exchange or even exchange upon request. The five forms of exchange of information are complementary rather than substitutable. Thus, a treaty that provides only one form of exchange of information limits a priori its scope.

[416] O. Hengsle, 'The Nordic Multilateral Tax Treaties: For the Avoidance of Double Taxation and on Mutual Assistance' (2002) 56 Bulletin for International Fiscal Documentation 8/9, 374-75.
[417] The Nordic Convention (n 414) Article 1 and 2.

The automatic exchange of information encompass the following items: dividends, interest, credit balance with banks, ownership of immovable property, royalties, wages, salaries, fees, pensions and life annuities, compensation for damage, etc. As we can see, there is a broad range of information exchanged periodically.[418] The similarities between the tax systems of the contracting states facilitate the automatic exchange of a large amount of information. However, the conclusion of further agreements to carry out automatic exchange of information is required.

Besides the Nordic Convention on mutual assistance in tax matters, Denmark, Finland, Iceland, Norway and Sweden have also signed in 1983 a multilateral treaty for the avoidance of double taxation. This is the only multilateral double tax convention among the OECD countries. The Nordic Convention for the Avoidance of Double Taxation has no article on the exchange of information, since this issue is regulated by the Nordic Convention on Mutual Administrative Assistance.[419]

The contracting states of the Nordic Convention have thirty years of experience with automatic exchange of information. According to Hengsle, Ministry of Finance of Oslo, the implementation of automatic exchange of information has developed throughout the years, requiring constant improvement. His vision supports the idea that to implement automatic exchange of information it is necessary to start with a minimum amount of information and then to develop it with the collaboration of all participant states. Moreover, the Nordic experience also raises the argument that multilateral treaties can also work for mutual administrative assistance. However, the key issue for the Nordic success was the regular meetings between tax authorities and the willingness of these authorities to make the necessary adjustments to solve problems before they become real obstacles.[420] Of course the challenge would be greater if a larger number of countries with significant differences in their tax systems were involved.

[418] ibid Article 11.
[419] Hengsle (n 416) 371.
[420] ibid 376.

7.2.2.2. The Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters (CMAATM)

The CMAATM was developed by the Council of Europe and OECD in 1988. The Convention is a multilateral instrument, which was initially opened for signature by only 54 countries, members of the Council of Europe or the OECD.[421] Its objective covers not only mutual assistance for exchange of tax information but also for collection of tax claims.[422] The language of the CMAATM is quite similar to the other OECD Model Conventions (e.g. DTC and TIEA), however there are substantial differences between them regarding the CMAATM's scope, mechanisms for exchange of information, protection of taxpayers and justified reasons to refuse a request of information. These characteristics are discussed in the next paragraphs.

The CMAATM facilitates exchange of information only on civil matters. Criminal matters are not included in the scope of this convention which signifies that information required by judicial bodies to punish crimes committed in the tax field must be obtained through other instruments such as the convention for mutual assistance in criminal matters.[423]

There are five different forms of exchange of information covered by the CMAATM: (i) on request; (ii) automatic; (iii) spontaneous; (iv) simultaneous tax examinations; and (v) tax examinations abroad.[424] It covers the same modalities of exchange of information established in the Nordic Convention. Regarding automatic exchange of information, Article 6 describes it very briefly, leaving all terms and conditions to be negotiated in a different agreement, which signifies that the implementation of automatic exchange of information is discretionary rather than mandatory. The Nordic Convention adopted a different position, including in the body of the convention the basic rules on how automatic exchange of information should work. Therefore, considering the language

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[421] The Protocol that amended the CMAATM has opened it to third countries, as discussed next.
[422] OECD, 'The Convention on Mutual Administrative Assistance in Tax Matters' (n 415) 3.
[423] ibid 63.
[424] Ibid 14-16.

adopted, in the Nordic Convention automatic exchange of certain information is mandatory.[425]

Automatic exchange of information requires the use of standardised forms, including the type of information exchanged as well as codes for identifying taxpayers and residence countries. The OECD published a Manual on the Implementation of Exchange of Information Provisions for Tax Purposes. The purpose of this Manual is to provide tax officials with technical and practical guidance to establish an efficient method of exchange of information. Module 3 of this Manual provides rules of automatic (or routine) exchange of information.[426]

Module 3 of the OECD Manual explains the general rules for implementing automatic exchange of information. The OECD has already developed mechanisms to implement automatic exchange of information. For instance, this organisation has developed a memorandum of understanding (MOU) setting forth the terms and conditions of the proposed automatic exchange of information. Moreover, the OECD has also developed standard formats to facilitate the transmission as well as the use of the information exchanged. In 1981 the OECD designed a paper based form for automatic exchange of information. In 1992, due to technological improvements, the OECD developed a new standard format: the Standard Magnetic Format (SMF). This new device allowed the transmission of information on magnetic tape. In 1997 a revision of the 1992 standard format was performed to improve the capacity of countries to match information received automatically. The key issue was the identification of the residence country of taxpayers and the source country of income by Taxpayer Identification Number (TIN). Later on, a new transmission format was designed by the OECD to replace the SMF. The new format is the Standard Transmission Format (STF) which is based on

[425] The Nordic Convention (n 414) Article 11.

[426] OECD, 'Manual on the Implementation of Exchange of Information Provisions for Tax Purposes: Module 3 on Automatic (or Routine) Exchange of Information' (2006) <http://www.oecd.org/dataoecd/61/19/40502506.pdf> accessed 18 October 2009.

extensible language. This signifies that this new system is more flexible allowing the implementation of improvements without the necessity of replacing the old format.[427]

The importance of describing these technical issues is to demonstrate that the mechanisms to implement automatic exchange of information have been already developed by the OECD. These mechanisms can support the transmission of a large bulk of information which needs to be specified by the parties in a MOU. Thus, the problem is not the absence of mechanisms to implement automatic exchange of information, but the fact that the implementation is discretionary and the effective way of how it is going to work relies on particular understandings, i.e. it cannot be implemented based only on what is provided in the body of the CMAATM. From this angle, it would be better to have mandatory rules incorporated in the CMAATM, establishing the minimum amount of information that must be exchanged automatically. A minimum amount of information could be the identification requested by the source country of non-resident taxpayers' country of residence and the automatic transmission of this information to the country of residence. Through this information, countries of residence would be able to verify whether resident taxpayers had declared their foreign income. Whether countries wanted to exchange automatically further types of information would be arranged in the MOU.

There are other aspects of the CMAATM that deserve a brief note due to the correspondence to the other OECD models (i.e. DTC and TIEA). The language of the article that provides protection of persons and limits to the obligation to provide assistance (Article 21) is quite similar to the other OECD models, except by the fact that bank secrecy and ownership identity in the CMAATM can still justify the refusal to provide tax information.[428] At last, in relation to secrecy provisions, Article 22 of the CMAATM only allows the transmission of requested information to a third party under prior authorisation by the party that provided it. Therefore, the information cannot be

[427] ibid 3-6.
[428] This difference was eliminated by the Protocol that amended the CMAATM, entering into force in June, 2011. Consequently, bank secrecy and ownership identity cannot justify anymore the refusal to provide information under the CMAATM.

retransmitted among the countries that signed the CMAATM. A correspondent understanding can also be found for the other OECD models.[429]

Until 2008, only 13 countries signed the CMAATM. Considering that 54 countries could have already signed it, the acceptance of this convention was very limited.[430] Even though the OECD's work provides guidance on how to implement exchange of information, in practice very little is known about how much information has been exchanged through CMAATM. This lack of information makes the assessment of such instrument difficult since the only analysis that can be performed is the examination of its clauses from a theoretical perspective. It is not possible to know how much information has been exchanged through the mechanisms available or how much revenue income has been raised due to the improvement of exchange of information. From a theoretical perspective, the analysis of the CMAATM demonstrated that all mechanisms of exchange of information are important since they have different functions providing different types of information. Developed countries have the option to implement exchange of tax information though the CMAATM. The advantage of this mechanism consists in the possibility of implementing automatic exchange of information since the CMAATM provides the legal basis whereas the OECD's work developed the required devices to implement it. The flaw of this instrument, on the other hand, refers to the fact that the implementation of automatic exchange of information is discretionary rather than mandatory which means that even though they have signed the CMAATM, countries can choose whether or not to implement automatic exchange of information.[431]

The focus on exchange of information has increased since the financial crisis of 2008. In this sense, on 25th September 2009, the OECD published on its website the information that the OECD and the Council of Europe agreed to update the CMAATM in order to

[429] OECD, 'OECD Commentary on the Model Conventions of 1977 and 1992' (n 58) Commentary to Article 26, 12.2, 444-63; OECD, '2010 Report' (n 70), 11-12.
[430] The countries that signed the CMAATM before 2008 were: Azerbaijan, Belgium, Denmark, Finland, France, Iceland, Italy, Netherlands, Norway, Poland, Sweden, United Kingdom, United States and Ukraine. OECD, 'The Convention on Mutual Administrative Assistance in Tax Matters' (n 415) 129-30.
[431] Spencer, 'Tax Information Exchange and Bank Secrecy (Part 2)' (n 389) 1.

bring the Convention in line with the international standard.[432] In June 2011 a provisional edition of the Protocol amending the CMAATM was published by the OECD.[433] The major changes consisted of: (i) exclusion of obstacles to exchange of information, such as those related to bank secrecy legislation and ownership identity [aligning its content with the OECD DTC and OECD TIEA]; (ii) permission for third parties [non-OECD/EU members] to sign the Convention; and (iii) authorisation for information obtained under the Convention be given to other authorities, e.g. law enforcement authorities to counteract corruption, money laundering and terrorism financing, but only if certain conditions were met [information may be used for such other purposes under the laws of the supplying Party and the competent authority of that Party authorises such use].[434]

Notwithstanding the positive changes brought by the Protocol, the update of the CMAATM left aside important issues, required to improve the effective level of information being exchanged under this convention. For instance, neither automatic exchange of information on a mandatory basis, nor the flow of information to third countries without prior authorisation was established by the Protocol. Hence, although substantial changes were implemented, the CMAATM is still based on premises that only grant bilateral exchange of information. So, the crucial hurdle regarding exchange of information, which refers to the necessity of the residence country to have previous knowledge of investments made abroad by their residents, was not overcome by the new provisions.

[432] OECD, 'The Council of Europe and OECD are strengthening their joint Convention to combat tax evasion', <http://www.oecd.org/document/19/0,3343,en_2649_33767_43772307_1_1_1_1,00.html> accessed 20 October 2009.

[433] OECD, 'Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters, Provisional Edition', < http://www.oecd.org/dataoecd/48/11/45037332.pdf> accessed 5 June 2011.

[434] OECD, 'Brief Overview on Convention', <http://www.oecd.org/dataoecd/58/51/47690147.pdf> accessed 5 June 2011.

7.3. Supranational laws

Exchange of tax information to combat tax evasion and avoidance has also been implemented by supranational laws in the European Union (EU).[435] The expression 'supranational laws' refers to legislation enacted by the EU's institutions that binds all Member States. The EU's institutions involved in the decision making process are: the European Commission, the European Parliament (EP), and the Council of the European Union. In general, new legislation is proposed by the European Commission and approved by the Council and Parliament. There are some situations, however, in which the Council can pass legislation alone.[436]

The main forms of EU law are directives and regulations. The directive form is addressed to all Member States and its objective is to align their national legislation. Thus, the content of a directive is legally binding on all Member States, however they can determine on how to implement it. In other words, Member States can choose on how to conciliate Community aims within their domestic legislation. A directive, therefore, requires further action of Member States to have effect. Nevertheless, even if a Member State has not taken the required measures to implement a directive, any citizen can directly invoke the neglected directive before the national courts. On the other hand, a regulation is a general measure addressed to everyone not only to Member States. Unlike a directive, a regulation is directly applicable. This signifies that it works as domestic legislation, not requiring further measures by Member States to produce effect.[437]

The EU legislation on mutual assistance for exchange of tax information is analysed from two different perspectives: direct taxation and indirect taxation. In relation to direct

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[435] The analysis of EU's legislation is limited to mutual assistance on exchange of tax information. Mutual assistance on collection of tax claims will be only mentioned when its legal basis overlaps with mutual assistance on exchange of tax information. Thus, the Directive 76/308/EEC replaced by Directive 2008/55/EC on collection of tax claims is not discussed in the next sections.

[436] European Union, <http://europa.eu/institutions/decision-making/index_en.htm> accessed 21 October 2009.

[437] European Union, <http://eur-lex.europa.eu/en/droit_communautaire/droit_communautaire.htm#1.3.3> accessed 21 October 2009.

taxation, the two main acts analysed are the Council Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premium, and the Council Directive 2003/48/EC on taxation of savings income in the form of interest payments. Regarding indirect taxation, the focus is on the Council Regulation EC 1798/2003, Commission Regulation (EC) 1925/2004 and Council Regulation EC 2073/2004, which lay down the rules on administrative cooperation in the field of value added tax. Thus, whereas mutual assistance in the direction taxation field is examined through directives; in the field of indirect taxation, mutual assistance is analysed through regulations. The analysis from these two dimensions will allow a critical view on the general provision of the EU law as well as on practical measures of implementation. Whether the direct taxation should adopt the standard rules already used to indirect taxation is a question that will emerge in the context of the debate.

Considering the relationship of the EU supranational laws with other instruments for exchange of tax information such as the Joint Council of Europe/OECD CMAATM and OECD Income Model Convention, due to the fact that the EU supranational laws are superior to domestic legislation, as a general rule, principles laid down in a Directive or Regulation override the dispositions of the OECD DTC and the Joint Council of Europe/OECD CMAATM. However, there are exceptions to this general rule. If the OECD DTC or other inferior legislation establishes further obligations to exchange tax information or further individual rights, this specific rule will override the disposition of the EU law. Another interesting aspect of the relationship between different instruments for exchange of tax information is whether there is a hierarchy among them, i.e. whether there is a tendency for the usage of a certain kind of instrument. According to the general report elaborated by Seer in which he analysed national reports of 13 Member States[438] on mutual assistance in tax matters, there is no tendency or hierarchy to use

[438] The general report prepared by Seer reflects the national report of the following countries: Austria, Belgium, Finland, Germany, Hungary, Italy, Luxemburg, the Netherlands, Poland, Portugal, Spain, Sweden and the United Kingdom. R. Seer, 'General report "Mutual assistance and information exchange"' presented at the Santiago Congress of the European Association of Tax Law Professors (2009) <http://www.eatlp.org/uploads/public/santiago/sop/TextGeneralReportRomanSeer.pdf> accessed 21 October 2009, 3.

one specific instrument over another. In fact, he found out that the use depends on the constellation of the case and the nature of the information required.[439]

After this overview of the general aspects of EU legislation, the specific rules available for exchange of tax information will be examined regarding their main characteristics and advantages/shortcomings compared to other instruments for exchange of tax information also available to Member States. This analysis will raise complementary arguments about the use, implementation and efficiency of instruments for exchange of tax information.

7.3.1. Direct taxation: Council Directive 77/799/EEC

The Council Directive 77/799/EEC[440] was the first intra-Community instrument in the area of direct taxation on exchange of tax information.[441] The premises that underpinned the adoption of such measure were: (i) the combatting of tax evasion and avoidance across the frontiers of Member States that could create distortions in the movement of capital and in the conditions of tax competition; and (ii) the fact that collaboration between tax administrations on the basis of income bilateral treaties was unable to curb new forms of tax evasion and avoidance.[442] Based on these premises, a supranational instrument was required to coordinate the intra-Community measures from a multilateral perspective.

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[439] ibid 7.

[440] The Council Directive 77/799/EEC was later amended by the following acts: (i) Directive 79/1070/EEC which made some changes to the wording of Directive 77/799/EEC; (ii) Directive 92/12/EEC which amended Directive 77/799/EEC to extend its scope to cover excise duties; (iii) Directive 2003/93/EC which extended the scope of mutual assistance provided for in Directive 77/799/EEC to cover the taxes on insurance premiums referred to in Directive 76/308/EEC; (iv) Directive 2004/56/EC designed to speed up the flow of information between Member States' tax authorities; and (v) Council Directive 2004/106/EC which amended the original title and the content of Directive 77/799/EEC to cover only mutual assistance in the field of direct taxation and taxation of insurance premiums. Further details on the amendments of Council Directive 77/799/EEC can be found at <http://europa.eu/legislation_summaries/taxation/l33029_en.htm> accessed 22 October 2009.

[441] Grau Ruiz (n 324) 128.

[442] Both premises were provided in the preamble of the Council Directive 77/799/EEC.

The main characteristics of the Council Directive 77/799/EEC are: (i) the provision of three different mechanisms for exchange of tax information: on request,[443] automatic,[444] spontaneously;[445] (ii) scope restrained to civil matters, i.e. criminal matters are not covered;[446] (iii) non-predefined time limit for forwarding information, it depends on Member States' capacities;[447] (iv) the right to refuse to provide tax information if Member States' own laws or administrative practices prevent its tax administration from carrying out these enquiries or from collecting or using this information for its own purposes (this signifies that domestic bank secrecy provisions can obstruct exchange of information under this Directive) or where the provision of such information would be contrary to public policy or would lead to the disclosure of a commercial, industrial or professional secret or of a commercial process, or where the Member State for which the information is intended is unable for practical or legal reasons to provide similar information;[448] and (v) attribution of the responsibility for the implementation of the Directive to the competent authority of each Member State.[449]

Even though the Council Directive 77/799/EEC was amended many times, the core mechanisms for exchange of tax information were not modified, maintaining the same characteristics as when they were enacted. In the meantime, other supranational laws for exchange of information were developed, putting in evidence the necessity of updating the Council Directive 77/799/EEC. Thus, the analysis of the directive on taxation of savings income in the form of interest payments as well as the regulation on VAT will help to identify the aspects that need to be improved on the Council Directive 77/799/EEC as well as the challenges to implement any modification.

[443] Council Directive 77/799/EEC (n 347) Article 2.
[444] ibid Article 3.
[445] ibid Article 4.
[446] ibid preamble.
[447] ibid Article 5.
[448] ibid preamble and Article 8.
[449] ibid Article 9.

7.3.2. Council Directive 2003/48/EC on Taxation of Savings Income in the form of Interest

Savings income in the form of interest is one of the most mobile categories of income. The EU's Member States acknowledged this situation and enacted the Council Directive 2003/48/EC to tackle the problem of tax evasion involving the taxation of interest income.[450] Unlike the EU, the OECD preferred to leave aside the problem of interest income. In the OECD's work on harmful tax competition, released in 1998, the tax treatment of interest on cross-border saving instruments was not considered. The justification was that the Committee on Fiscal Affairs was examining alternative schemes to deal with cross-border interest flows, including the use of withholding taxes and exchange of information. However, until now the OECD has not presented a proposal to deal with the tax treatment of interest.[451] The EU's early strategy of developing an instrument to grant the taxation of interest demonstrates the incoherency of the OECD's approach on not dealing with the taxation of interest when examining the problem of tax competition.

The implementation of the Council Directive 2003/48/EC was not an easy task and it faced a lot of challenges. The devices incorporated in the body of this Council Directive 2003/48/EC show that some Member States were against its implementation and the final draft needed to reconcile their interests with the necessity of an instrument to enforce residence taxation of interest paid to non-resident investors. That is, the Council Directive 2003/48/EC had to give an alternative to Member States that were not willing to implement it. As a result, the Council Directive on Savings Income provided some transitional measures that give the choice to Member States between exchanging information and levying a withholding tax. The content of the Council Directive 2003/48/EC does not reflect the ideal solution but what was possible and achievable regarding the political constraints. Thus, the Council Directive 2003/48/EC can help to identify some aspects that need to be improved in the Council Directive 77/799/EEC

[450] Council Directive 2003/48/EC (n 348). Council Directive 2003/48/EC will also be referred in the body of the text as 'Council Directive on Savings Income'.
[451] OECD, '1998 Report' (n 70) 9.

however it does not contain all the answers to the current problems. The examination of the limitations of the Council Directive on Savings Income will put this fact in evidence.

The core idea of the Council Directive 2003/48/EC is to enforce the taxation of interest through automatic exchange of tax information. This mechanism would provide the required information for the residence country to enforce taxation of interest in the place of investors' residence. Thus, the assumption of the Council Directive 2003/48/EC is that interest should be taxed at the residence country rather than at the source country.[452] Source taxation, i.e. the levy of a withholding tax is permitted as an exceptional rule (transitional measure) only when the implementation of automatic exchange of information is not accepted by the Member State. The way these two mechanisms (automatic exchange of information and the levy of withholding tax) are used demonstrates that they are substitutable rather than complementary. The examination on how the Council Directive 2003/48/EC works will clarify the use of these two mechanisms.

The Council Directive 2003/48/EC entered into force in July 2005, applying to all Member States. This Directive was also adopted by 10 dependent or associated territories[453] of the EU Member States as well as by European third countries.[454] The implementation on these jurisdictions differs from the procedures adopted in the EU Member States since the supranational aspect of the EU legislation does not apply to them. Hence, in relation to dependent and associated territories of the EU Member States, the Directive was implemented through bilateral treaties signed by each one of the 25 Member States with these jurisdictions.[455] European third countries followed the same standard of implementation.[456]

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[452] A. M. Jimenez, 'Loopholes in the EU Savings Tax Directive' (2006) 60 Bulletin for International Taxation 480, 481.
[453] The dependent or associate territories referred in the body of the text are: Guernsey, the Isle of Man, Jersey, the Netherlands Antilles, Aruba, Anguilla, the British Virgin Islands, the Cayman Islands, Montserrat and Turks and Caicos Islands.
[454] The European third countries mentioned in the body of the text are: Switzerland, Andorra, Liechtenstein, Monaco and San Marino.
[455] The application of the Directive by these dependent or associated territories of the EU Member States consisted of the adoption of a system of information reporting or, during the transitional period (as

According to the rules provided in the Directive on Savings Income, all Member States are ultimately expected to automatically exchange information on interest payments by paying agents established in their territories to individuals resident in other Member States.[457] Transitional measures were, however, adopted by Belgium, Luxembourg and Austria, since they did not immediately introduce such a system of information reporting.[458] In this sense, it was agreed that Belgium, Luxembourg and Austria will only adopt a system of information reporting at the end of a transitional period, in which they levy a withholding tax at a rate of 15% for the first three years, 20% for the following three years (starting in January 2008), and 35% thereafter.[459] Belgium, Luxembourg and Austria must transfer 75% of the tax revenue of this withholding tax to the investor's state of residence.[460] Nevertheless, as an alternative to the retention or withholding tax, investors in Belgium, Luxembourg and Austria have two options: (i) to authorise the paying agent to inform his Member State of residence about the savings held abroad; or (ii) to present to his paying agent a certificate issued by the competent authority of his country of residence ensuring that the tax authority is already informed about the taxpayer's foreign income.[461]

There are some conditions that can curtail the transitional period: (i) if the EC enters into an agreement with Switzerland, Liechtenstein, San Marino, Monaco and Andorra to

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explained next), the levy of a withholding tax on the same terms as Belgium, Luxembourg or Austria. For further details: European Commission, 'Taxation and Customs Union: Taxation of Savings: Rules Applicable', <http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm> accessed 26 October 2009.

[456] An Agreement between the EC and Switzerland providing for measures equivalent to those established in the Directive on Savings Income was signed in October 2004. The key elements of this Agreement were also incorporated in the agreements with Andorra, Liechtenstein, Monaco and San Marino. The provisions consisted of: (a) a retention or withholding tax with revenue sharing at the same rates as applied by Belgium, Luxembourg or Austria during the transitional period of the Directive; (b) an option for the taxpayer to permit the disclosure of the income to his or her Member State of residence for tax purposes as an alternative to the retention or withholding tax; (c) a provision for the exchange of information on request in cases of tax fraud or similar misbehaviour; (d) a review clause to allow the Contracting Parties to review its working overtime in line with international developments. ibid.

[457] Council Directive 2003/48/EC (n 348) Preamble.

[458] ibid Article 10.

[459] ibid Article 11.

[460] ibid Article 12.

[461] ibid Article 13.

exchange information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released in 2002 in relation to interest payments, and these countries continue to apply simultaneously the withholding tax levied by them since 1 July 2005 on the basis of the already existing agreements with the EU in this field; and (ii) if the Council agrees by unanimity that the United States is committed to exchange of information upon request as defined in the 2002 OECD Model Agreement with all EU Member States in relation to interest payments.[462]

The transitional measures demonstrated that the Council Directive on Savings Income had to reconcile different interests of Member States as well as European third countries. The limitations for the implementation of this Directive are not restrained to the transitional measures. There are also other limitations incorporated in the rules provided in the Council Directive 2003/48/EC. The constraints on the legal definitions, i.e. on the concept of interest, paying agent and beneficial owner are the main loopholes of the Council Directive on Savings Income.[463] The literature has extensively criticised such issues by arguing that: (i) the concept of interest is restrained to certain debt claims leaving aside not only all negotiable debt securities issued before 1st March 2001 but also innovative financial instruments; (ii) the concept of paying agent relies on the territorial scope of the Directive which allows investors to easily circumvent the rules by using a paying agent located outside the EU even if the funds are invested in the Community; and (iii) the concept of beneficial owner refers only to individuals which allows individual taxpayers to avoid such rule by interposing intermediary structures not covered by the Directive.[464] Such limitations have been already recognised by the European Commission and a proposal trying to improve such issues has already been elaborated: COM(2008) 727 final.[465]

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[462] ibid Article 10.
[463] Jimenez (n 452) 485-93.
[464] ibid.
[465] It is not the objective of this section to exhaust the discussion on the improvement of the EU Savings Directive. For further information: European Commission, 'Proposal of a Council Directive amending Directive 2003/48/EC on taxation of savings income in the form of interest payments' COM(2008) 727 final at <http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/COM(2008)727_en.pdf> accessed 26 October 2009.

Whereas there is quite extensive literature discussing the legal aspects of the Directive on Savings Income; the empirical assessment of the effects of this Directive is very limited. One possible explanation for such limitation is the lack of data. Hemmelgarn and Nicodeme challenged this limitation by developing a study in which they assessed the first years of the EU-Savings Taxation Directive.[466] These authors concluded that exchange of information has not led to major shifts in international savings, even though the limitation of the data needs to be considered.

An important aspect analysed by Hemmelgarn and Nicodeme's research refers to the figures available for information exchanged and withholding tax levied. In relation to information exchanged, their analysis pointed out two different aspects of the data. First, that the way the Directive allows countries to report the data on information exchanged makes its assessment difficult;[467] and second, that the largest economies report the highest values of sent information on interest payments and sales proceeds. Regarding withholding tax, the information available displays the amount of revenue shared with Member States. In this sense, most part of the revenue raised in the period analysed (second half of 2005, 2006 and 2007) was from Switzerland and Luxembourg.[468]

The importance of statistics to assess the functioning of the 2003 Directive is declared in Article 18 of the Council Directive on Savings Income which establishes that the Commission has to present to the Council, every three years, an assessment of the operation of this Directive. These statistics should be provided by Member States and market operators, however the Directive does not contain provisions compelling them to

[466] T. Hemmelgarn and G. Nicodeme, 'Tax Co-ordination in Europe: Assessing the First Years of the EU-Savings Taxation Directive' (2009) Taxation Paper 18 <http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_18.pdf> accessed 18 August 2011.

[467] The difficulty derives from the fact that the Directive 2003/48/EC allows countries to choose between two ways of reporting: (i) to restrict the minimum amount of information reported by paying agents to the total amount of interest or income and to the total amount of the proceeds from sales, redemption or refund (Article 8 (2), last paragraph); or (ii) by the type of interests (Article 8 (2) (a) to (e) and these two sets of data can differ.

[468] Hemmelgarn and Nicodeme (n 466) 19-24.

provide such information.[469] The Council tried to improve such situations by elaborating a list of Statistics that Member States should send to the Commission every year on a voluntary basis.[470] Despite all the effort made by Member States and market operators to provide the Commission with statistics, the quality and quantity of the statistics received were not sufficient to make a quantitative analysis of the Directive during its first years of application.

The analysis developed by Hemmelgarn and Nicodeme added to the effort made by the Council to improve the quality and quantity of data available on the operation of the Council Directive on Savings Income demonstrates that a policy of transparency is missing. Thus, the reform of the Council Directive 2003/48/EC should improve not only the rules of reporting information exchanged but also statistics for the assessment of the Directive.

Besides all the limitations pointed out, the contribution of the Council Directive 2003/48/EC consists of the demonstration that automatic exchange of information is an adequate instrument to curb tax evasion on interest payments. As an alternative, the use of withholding taxes by source countries can also help. Furthermore, the sharing of tax revenue also emphasises a different strategy from what has been suggested by the OECD. The new proposal for the Council Directive 77/799/EEC could enforce a mandatory adoption of automatic exchange of information for some categories of income as the Council Directive 2003/48/EC has done for savings income in the form of interest payments as well as a policy of transparency regarding data on information exchanged.

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[469] Commission of the European Communities, 'Impact Assessment accompanying the Proposal for a Council Directive amending Council Directive 2003/48/EC on taxation of savings income in the form of interest payments' Commission Staff Working Document - SEC(2008) 2767 <http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/SEC(2008)2767_en.pdf> accessed 27 October 2009, 4-5.

[470] The information requested was: for countries levying a withholding tax: the tax revenue shared; for countries exchanging information: the interest payments and sales proceeds reported; the number of beneficial owners; the number of paying agents; the part of the total annual tax collected from resident taxpayers on interest payments made by domestic paying agents (optional) and the part of the total annual tax collected from resident taxpayers on interest payments made by foreign paying agents (optional). ibid.

7.3.3. Indirect Taxation: Council Regulation EC 1798/2003 and Commission Regulation EC 1925/2004

Before the enactment of the Council Regulation EC 1798/2003, administrative cooperation on tax matters was established by the Council Directive 77/799/EEC concerning mutual assistance by the authorities of the Member States in the field of direct and indirect taxation, and Council Regulation 218/92/EEC on administrative cooperation in the field of indirect taxation. However, the existence of these two separate legal provisions was curbing effective cooperation on VAT. Thus, in order to improve the cooperation between tax authorities, Council Regulation EC 1798/2003 was enacted, bringing together those provisions and improving aspects of implementation.[471]

The VAT regulation went further than other legal devices on the implementation of exchange of information since it provided the structure requested for cooperation between tax administrations. Instead of discussing principles of exchange of information, the VAT legislation focused on the structure to implement effective exchange of information. Consequently, the first impression that you have after reading the Council Regulation EC 1798/2003, complemented by the detailed provisions established in the Commission Regulation EC 1925/2004, is that you can visualise information being exchanged. In the other legislation, you understand the assumptions that will guide the exchange of information but its effective implementation is not clear at all.

The structure for cooperation between tax administrations in the field of VAT encompasses the following major issues: (i) the designation of a single central liaison office which is responsible for contacts with other Member States; (ii) predefined terms and categories for automatic exchange of information; (iii) adoption of a standard form for requests of information; (iv) time limit for providing information; (v) maintenance of an electronic database containing a register of persons to whom VAT identification

[471] European Commission, 'Administrative cooperation in the field of value added tax (VAT)' <http://europa.eu/legislation_summaries/taxation/l31003_en.htm> accessed 28 October 2009.

numbers have been issued by Member States; and (vi) predefined form for exchange of statistical data to evaluate the system. From this list, it can be inferred that all major problems existing in the other legislation have been surpassed in the VAT regulation.

There is, however, an essential element missing in the list described above. In fact, the elements described cannot work properly without an operational system. Thus, the missing element is the CCN/CSI network which is the common platform based on the common communication network (CCN) and common system of interface (CSI) implemented by the Member States to grant the electronic transmission of all data requested by tax authorities in the field of VAT.[472] A system like this would improve exchange of information between tax authorities in the area of direct taxation.

In 2010, Council Regulation 904/2010 was enacted, repealing Council Regulation 1798/2003. This new regulation improved even more the rules that enable the competent authority of EU members to cooperate and exchange information on VAT. The main innovations implemented consisted of: (i) the development of a new network system (Eurofisc) that allows national officials of EU countries to detect and combat new cases of cross border VAT fraud; and (ii) the cooperation with non-EU Member States, provided that previous arrangements allow the flow of information.[473] More specifically, regarding aspect (i), Eurofisc determines the cases in which Member States must exchange information spontaneously, the procedures for providing feedback on such information and situations that Member States must conduct multilateral controls.[474] In relation to aspect (ii), cooperation with non-EU members allows the competent authority of EU member to forward information received from that country to another EU country that requests it or to any other country to which the information may be of interest.[475] This last point is remarkable since one of the main difficulties regarding exchange of information is for the interested country to have previous knowledge that something that might interest them has occurred in that particular country. This provision, therefore,

[472] Council Regulation (EC) 1728/2003 (n 349) Article 2.
[473] Council Regulation (EU) n. 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L 268, 1.
[474]EUROPA, <http://www.eurofisc.eu/news/council_adopted_a_regulation.html> accessed 6 June 2011.
[475] EUROPA <http://europa.eu/legislation_summaries/taxation/lf0003_en.htm> accessed 6 June 2011.

breaks the barrier that only source countries have significant evidence to request information from a third country. In other words, information does not need to flow bilaterally only, it can change its course, relying only on the identification of the effective country interested in that information.

The contribution of the VAT legislation to the discussion about exchange of tax information consists of the establishment of provisions that can effectively promote exchange of tax information and the implementation of an operational system that enforces the electronic transmission of the data. Based on the VAT approach, it becomes clear that the discussion involving mutual assistance on exchange of tax information needs to evolve from the definition of general principles to the implementation of practical measures.

7.3.4. Reforms on the Council Directive 77/799/EEC concerning mutual assistance in the field of direct taxation

The previous arguments presented in relation to the Council Directive on Savings Income and VAT regulations help to identify the major issues that could be reformed in the Council Directive 77/799/EEC. In fact, these instruments have influenced the new proposal (COM (2009) 29 Final) for the Council Directive on mutual assistance in the field of taxation.[476]

The most significant improvements in the new proposal are: (i) its scope will be extended to cover taxes of any kind apart from those already covered by the European Union legislation (e.g. VAT and excise duties); (ii) the designation of a single liaison office to concentrate the responsibility for contacts with other Member States; (iii) the establishment of automatic exchange of information for certain categories of income

[476] Other instruments have also influenced the new proposal (COM (2009) 29 Final) as the Joint Council of Europe/OECD Mutual Administrative Assistance in Tax Matters, the OECD Income Model Convention and the OECD TIEA model. For further details: European Commission, 'Proposal for a Council Directive on Administrative Cooperation in the Field of Taxation' COM (2009) 29 Final, 2009/0004 (CNS) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0029:FIN:EN:PDF> accessed 28 October 2009, 6-8.

which will be defined in a later regulation; (iv) the adoption of a standard form for requests of information; (v) the definition of time limits for providing information; (vi) the implementation of the rules that refusal to exchange information cannot be justified by own tax purpose, domestic interest and bank secrecy; (vii) the introduction of most favourable nation principle which requires that a Member State has to provide cooperation to another Member State under the same conditions as to a third country; (viii) the possibility to transmit information to third countries if previously allowed; and, of course, (ix) the adoption of the CCN/CSI network to integrate the communication of all tax systems.[477]

Further legislation will be required to implement: automatic exchange of information (e.g. categories of income, frequency and practical arrangements); the standard form for requesting information; and the procedure for the provision of statistical data by Member States for the assessment of the effectiveness of administrative cooperation under this Directive. Regulations might be an adequate instrument for this purpose since they produce immediate effect, not requiring their implementation by national acts.

The recent number of changes in the legislation of exchange of information adopted worldwide is undeniable. The European Union has followed the world tendency by improving its supranational legislation. In fact, the European effort can provide positive spillovers outside the territory of the European Union. The effective implementation of exchange of information in the field of VAT added to the reforms suggested in the proposal for a new Directive on administrative cooperation in the field of direct taxation can be used as a guideline to the improvement of the instruments of exchange of information available to third countries.

7.4. Conclusion

The legislation examined demonstrates that to implement mechanisms for exchange of tax information it is necessary to move step by step. The process of implementation is

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[477] ibid.

long. Consequently, the ideal instruments that would provide effective exchange of information (e.g. automatic exchange) could not be proposed at the beginning of the process of implementing exchange of tax information. Countries were not prepared either to implement it or to accept it. Improvements are still necessary in the instruments available. However, what is important is to be aware of the relevance of these instruments and whether the measures adopted contribute to the implementation of effective exchange of information. In other words, even though the current mechanisms for exchange of tax information need to be improved, changes cannot be implemented through one single action. Therefore, what is necessary is to comprehend whether the legal debate is proceeding in the right direction. To this extent, the next chapter will examine these instruments through a dynamic perspective in order to verify how they work in practice.

Chapter VIII. Recasting the position of developing countries

8.1. Introduction

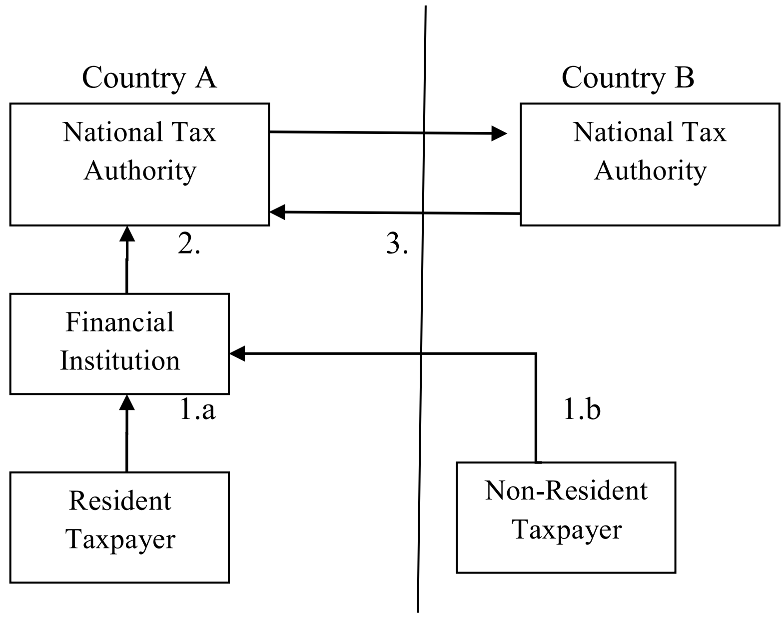
The previous chapter created the framework required to develop a critical overview of the instruments available for exchange of tax information. In this section, the knowledge acquired will be used to develop a further analysis on exchange of tax information. The proposed analysis will have two dimensions: domestic and international. The domestic dimension will examine the rules required for tax information to flow from taxpayers to tax authorities, passing through financial institutions. The availability of such information is the cornerstone element for exchange of information between national tax authorities of different countries. The international dimension will examine exchange of information from another angle, i.e. it will contextualise the flow of investment with the mechanisms available for exchange of information between tax authorities of developed countries, developing countries and tax havens. The international dimension will develop a dynamic perspective of exchange of tax information based on the interaction of different instruments available for exchange of information with the flow of capital. The objective here is to show that current instruments of exchange of tax information only work properly if the requesting country is the source country, i.e. the place where capital is invested.

8.2. Dynamic perspective on how the existing mechanisms for exchange of information work

8.2.1. Domestic dimension

Keen and Ligthart argued that in order to achieve effective exchange of information between national tax authorities, first it is necessary to observe three conditions: (i) financial institutions must hold the complete details of the taxpayer’s essential information (ii) tax authorities need to have the legal power to access tax information from domestic financial institutions; and (iii) national tax authorities must have the legal power to share with other countries tax information that they have access to.[478] The diagram below illustrates the relationships that these conditions apply:

Diagram 8.2.1. Domestic dimension of the flow of tax information



The diagram shows that each condition applies to a different relationship. The first condition applies to the relationship between financial institutions and resident taxpayers (1.a) and non-resident taxpayers (1.b). Financial institutions must hold the complete details of the taxpayer's essential information. Usually domestic legislation requires detailed information only from resident taxpayers. The absence of a provision that forces non-resident taxpayers to identify themselves as well as their place of residence represents one of the major loopholes in the process of exchange of information. Spencer has argued that this situation results in de facto bank secrecy since for one country to request information from another it needs to have some previous knowledge of the information being requested otherwise the country would have to engage in 'fishing expeditions', which are prohibited by most countries' agreements.[479]

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[478] Keen and Ligthart (n 341) 11.
[479] Spencer, 'Tax Information Exchange and Bank Secrecy (Part 2)' (n 389) 5.

The US's experience illustrates how difficult it is to implement a rule that forces the complete identification of non-resident investors. In 2001, in the last days of the Clinton administration, a new regulation was proposed which required that banks within the US report annually to the revenue authority all interest paid to non-residents on bank deposits within the US not effectively connected to a US trade or business.[480] Later, however, this proposal was withdrawn and an alternative regulation was proposed restricting its scope to non-residents of certain countries. The US would only exchange information automatically with these countries.[481]

Recently, in 2010, another measure was enacted by the US to identify non-resident investors, however this time the rule was restricted to US persons holding investments in offshore accounts. Under the Foreign Account Tax Compliance Act (FATCA), foreign financial institutions are required to report directly to the US tax authority information about financial accounts with more than US$50,000 held by US taxpayers, or by foreign entities in which American taxpayers hold substantial ownership interest. According to the new rule, foreign financial institutions will be obligated to: (i) identify their accountholders; (ii) report annually to the IRS on its accountholders who are US persons or foreign entities with substantial ownership; and (iii) withhold and pay to the US tax authority 30% of any payments of US source income as well as gross proceeds from the sale of securities that generate US source income, made to (a) non-participating foreign financial institutions, (b) individual accountholders failing to provide sufficient information to determine whether or not they are a US citizen, or (c) foreign entity accountholders failing to provide sufficient information about the identity of their substantial US owners.[482] Foreign financial institutions and foreign governments have

[480] ibid.
[481] The countries included in the second proposal were: Australia, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, and the United Kingdom. ibid.
[482] Internal Revenue Service – US Department of the Treasury, <http://www.irs.gov/businesses/corporations/article/0,,id=236664,00.html> accessed 27 July 2011.

battled over this new regulation.[483] For instance, Canada is pushing to be exempted from the FATCA based on the argument that Canada and the US already had an agreement to share tax information.[484] Thus, the problem affecting this kind of regulation is the exceptions, since in practice they create loopholes that allow taxpayers to curb the new provisions through the use of different channels to allocate capital without being identified. On the other hand, this new regulation demonstrates that governments are aware of the necessity of improving the identification of non-resident investors, which is the core issue to achieve effective exchange of tax information.

Another issue that can be raised here is how to identify the non-resident genuine owner when a chain of conduit companies established in different low tax jurisdictions are used to mask the true identity of the beneficiary.[485] The power to disentangle this situation belongs to the source country, i.e. the country where investment in made, since it could enforce different tax treatments based on the identification or not of the genuine owner, as suggested by FATCA. For instance, it could be established that if the genuine owner were identified, the tax rate applied would be the one established in the legislation. On the other hand, if the investor does not disclose the true identity of the genuine owner, a

[483] T. Braithwaite 'Banks battle over US tax law' (Financial Times, 12 June 2011) <http://www.ft.com/cms/s/0/60896702-9521-11e0-a648-00144feab49a.html#axzz1TJY8btpF> accessed 27 July 2011.

[484] S. Bond and T. Braithwaite, 'Canada seeks US law exemption' (Financial Times 16 June 2011) <http://www.ft.com/intl/cms/s/0/3d433926-97a1-11e0-9c37-00144feab49a.html#axzz1TJY8btpF> accessed 27 July 2011.

[485] The term 'genuine owner' is used here to designate the individual or legal entity located in a jurisdiction with a substantial tax system, i.e. where income is taxable and there is no secrecy rule on ownership identity. The idea behind the term 'genuine owner' is to identify who exercises ultimate control over assets. Thus, if you have a chain of conduit companies established in low tax jurisdictions, the identity of shareholders would be required until the ultimate owner is identified as a company established in a country with a substantial tax system, or an individual. Tax favoured entities would not be regarded as a genuine owner, even if located in high tax jurisdictions. In a sense, what has guided the idea of 'genuine owner' was the combination of look through rules and exclusion of tax-favoured entities rules. The ideal concept would not rely on a case-by-case analysis. Moreover, the use of the term 'genuine owner' aims to avoid confusion with the term 'beneficial owner' used in Articles 10, 11 and 12 of the OECD Model Convention. The term 'beneficial owner' has a specific meaning there and it became clear in the recent discussion draft, published in 2011 by the OECD, that it has a different meaning from other instruments (e.g. the Glossary of Financial Action Task Force's Forty Recommendations and the 2001 report of the OECD Steering Group on Corporate Governance – 'Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes'), not being used to identify persons that exercise ultimate control over entities or assets. OECD, 'Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention: Discussion Draft 29 April 2011 to 15 July 2011', <http://www.oecd.org/dataoecd/49/35/47643872.pdf> accessed 30 July 2011. For further details on beneficiary owner and other specific countermeasures: J. Schwarz, *Schwarz on Tax Treaties* (Wolters Kluwer Limited 2009), 274-301.

40% withholding tax would be levied. Subsequently, as discussed next, this information could be forward to the residence country of such investor.

The responsibility for acquiring investors' information is attributed to financial institutions, which signifies that extra costs are not borne by national government. However, the difficulties in introducing such a measure can rely on three different explanations: (i) absence of political willingness to implement such rule, even though the income tax system of the country requires this information from resident taxpayers; (ii) absence of domestic interest in the information provided by financial institutions based on the fact that the income tax system of such country does not require it from its residents; and (iii) restrictions on the administrative capacity of the country's tax authority to implement this measure. The first justification can be associated with developed countries (e.g. American situation), the second with tax havens and the third with some developing countries. Hence, the first condition represents the initial step for a country to be able to exchange information automatically, which is an essential mechanism to achieve effective exchange of information.

Regarding collection of information, a model must be adopted at the first stage that information is gathered, otherwise information becomes useless. Therefore, there must be an uniform language as well as a standard form agreed and used by financial institutions and national tax authorities in order to make possible international exchange of information. In other words, the procedures adopted to exchange information internationally need to be implemented also at the domestic level.

The second condition applies to the relationship between national tax authorities and financial institutions. Tax authorities need to have the legal power to access tax information from domestic financial institutions. The assumption here is that financial institutions hold the required information, i.e. the first condition is fulfilled. The override of bank secrecy provisions and the disclosure of ownership identify by a tax treaty's provisions represent a decisive step in the accomplishment of this condition.

The third condition relates the domestic aspect with the international one. This condition emphasises the necessity of a legal basis to allow exchange of information between tax authorities of different countries. The previous sections discussed in detail the variety of instruments available for countries to exchange information. Moreover, it was already argued that there is no hierarchy among the instruments for exchange of information, their use depends on the constellation of the case and the nature of the information required.[486]

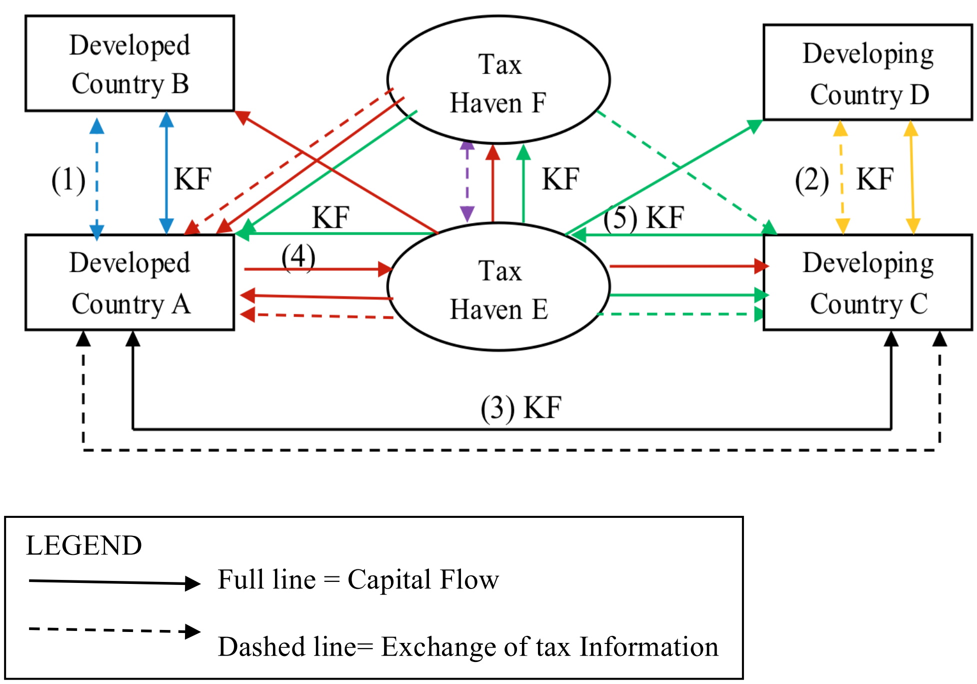
The accomplishment of these three conditions by countries represents the ideal scenario for exchange of information. In practice, however, countries vary on the compliance of these conditions. There are different reasons for that and the explanation might be connected to the characteristics of their income tax systems. The recent improvements in the mechanisms for exchange of tax information have focused on the second and third conditions, i.e. the provision of clauses in international agreements (e.g. the UN and OECD DTC Income Model Convention and the OECD TIEA Model) that grant the override of domestic bank secrecy provisions and the disclosure of ownership identity as well as on the supply of different instruments for exchange of tax information added to the international community's pressure for countries to sign it. The first condition (information gathered by financial institutions) has been left aside, even though it is the cornerstone element for the implementation of exchange of information. Thus, in the same way as international organisations have provided clauses that override domestic obstacles for exchange of tax information, a mandatory provision requesting the identification of non-resident investors could also be developed. Besides all the practical difficulties that might be raised, the recognition of the importance of such issue at the international level would already represent a further step in the direction of effective exchange of tax information.

[486] Seer (n 438) 19.

8.2.2. International Dimension

In this section, the instruments available for exchange of tax information will be analysed from a systematic perspective, i.e. in a structure involving developed countries, developing countries and tax havens. The aim is to verify the effectiveness of these instruments when information needs to pass through tax havens. Next, the instruments for exchange of information will be contextualised with the flow of capital. The objective of this analysis is to link the effectiveness of each instrument with the characteristic of a country as the source of investments and residence of investors. The outcomes will help to understand the flaws of instruments for exchange of information from the perspective of developing countries. The analysis proposed is illustrated in the diagram below:

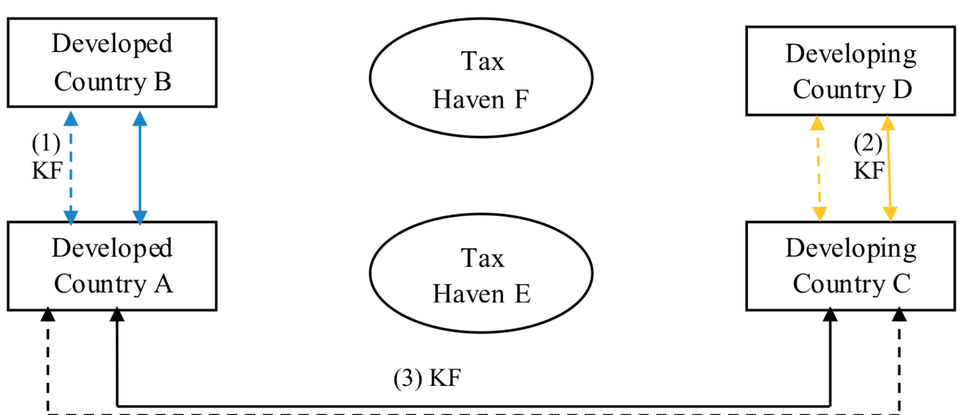
Diagram 8.2.2. (a) Instruments for exchange of information & Flow of Capital



(Note: Complete diagram comparing the flow of information with the flow of capital between developed countries, tax havens and developing ones.)

There is some basic information that needs to be explained before examining the coloured transactions between countries. At first glance, the diagram shows two different flows: (i) flow of capital (full line arrows) and (ii) flow of information (dashed line arrows). An important aspect is the direction of the arrows. Some of them have double arrows, while others have only one. The double arrows represent bilateral flows of capital and information. In other circumstances, however, there are two arrows drawn to demonstrate capital flowing out and then returning. This situation is different from the bilateral flow (double arrows). Even though in practice in the second situation there also is bilateral flow, the flow is substantially different. The two arrows in opposite directions between two countries, therefore, indicate the fact that the residence of the investor has been manipulated, i.e. capital flight has left the country and returned as foreign investment (also known as round-tripping). In relation to the dashed arrows, each one of them is associated with an instrument for exchange of tax information. The direction of the arrows demonstrates the way that information might flow. Further explanation about the way exchange of information works will be provided when examining the specific transactions. At last, there are different colours applied to the arrows. Each colour is used to designate a specific situation, where there is flow of capital and exchange of information. A number is associated with each colour in order to facilitate the identification of the situations.

Diagram 8.2.2. (b) Flows between developed countries and developing countries



(Note: Flow of capital and tax information between developed countries and developing ones. The blue arrow represents capital flight from developed countries; while the yellow arrow refers to capital flight from developing countries. The dark arrow illustrates capital flight originated in a developed country and invested in a developing one (or vice-versa). The dashed arrows, on the other hand, represent exchange of tax information. The direction of the dashed arrows indicates the way information might flow).

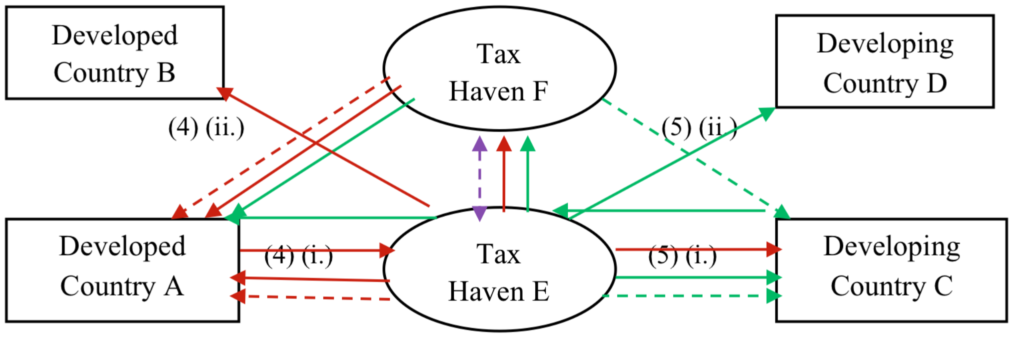
The first situation (illustrated in blue and indicated with number (1)) refers to the bilateral flow of capital between developed countries. Chapter III demonstrated that there is a substantial flow of capital among developed countries. In order to avoid double taxation and tax avoidance, developed countries have celebrated a myriad of DTCs among them. Developed countries can justify exchange of tax information through different instruments. Thus, besides Article 26 of OECD Income Model Convention, there are also the CMAATM; the supranational laws for Member States of the European Union; and the Nordic Convention for the Nordic Countries. The dashed blue arrow can be associated with any of these instruments. The double arrows indicate that both countries are interested in receiving information. These instruments can provide more than one form of exchange of information. In terms of automatic exchange of information, only EU countries have implemented it for certain categories of income. Thus, excepted by the European experience with automatic exchange of information, the mechanisms in force for exchange of information only work if the residence country has previous knowledge of investments made abroad by their residents.

Parallel to this first situation, there is the bilateral flow of capital between developing countries illustrated in yellow and indicated with number (2) in the diagram. Double taxation and tax evasion can be curbed through the use of DTCs, which can follow the UN or the OECD Income Model Conventions. However, there are fewer DTCs signed between developing countries than between developed ones. Regarding exchange of information, besides the DTC models, there is also the CIAT Model that could be used as the legal basis for exchange of tax information. The difference between situations (1) and (2) refers to the existence of broader network of instruments to promote exchange of information. Thus, the volume of information that can be exchanged between developed countries is significantly higher than information exchanged between developing countries. It is important to note that this fact might be connected to the different level of flow of capital between these countries as well as to the administrative capacity of tax authorities in developing countries.

The third situation (illustrated in black and indicated with number (3)) refers to the flow of capital between developed and developing countries. In this case, the different incentives created by source and residence taxation in relation to the allocation of mobile capital needs to be considered. In a sense, whereas source taxation discourages the inflow of capital, residence taxation encourages it, without compromising a country's tax base. Consequently, the enforcement of source taxation by developing countries followed by the enforcement of residence taxation by developed countries creates the perfect scenario for capital flight to be invested in developed countries.

In terms of exchange of information, this signifies that developed countries as the source county, i.e. where capital is invested, are in a better position than developing ones to investigate capital flight since they can demand further information of investments made in their economies. In these circumstances, information upon request can provide further evidence of the genuine identity of the capital received. In practical terms, this signifies that foreign investment made by residents of developing countries can only be taxed when these countries have previous knowledge where the investment is made, for instance in round-tripping situations, where capital flight returns as foreign investment to developing countries. Only in these conditions the mechanism for exchange of information upon request provided in DTCs (or even TIEAs in specific cases such as TIEA US-Peru, US-Colombia and US-Brazil) signed between developed and developing countries might provide assistance to curb tax evasion. In sum, the mechanisms for exchange of tax information between developed and developing countries works properly when the residence country of the investor has enough information on the investment made abroad. The problems when this information is not available are discussed in the next section.

Diagram 8.2.2. (c) Flows channel through tax havens



(Note: Flow of capital and information passing through tax havens. The red arrows represent the route of capital flight from developed countries; whereas the green arrows refer to the route of capital flight from developing countries. The dashed arrows, as indicated above, represent the direction of information being exchanged. Finally the purple arrow illustrates exchange of information between tax havens based on TIEAs).

In relation to the other transactions (i.e. situation (4) in red and situation (5) in green), the common characteristic between them is the fact that the flow of capital passes through a tax haven at least once. The problem raised by tax havens is not a matter of substantive laws but of tax administration.[487] In other words, the problem is not the fact that tax havens do not tax income but the fact that administrative laws of flight jurisdictions are not prepared to deal with them since they obstruct the identification of the place of investment by the residence country. In this situation, the information held by source countries represents a crucial element in the identification of investments made abroad by residence countries. The transactions (4) and (5) will draw attention to this fact.

The transactions illustrated in red and indicated with number (4) refer to the flow of capital flight (KF) from developed countries. The meaning of capital flight adopted here is the same used in Chapter IV, which signifies capital that flows out of the country without any record. This capital, as demonstrated in the diagram, can adopt different routes: (i) to flow to a tax haven and return as foreign investment; or (ii) to flow to a tax haven and then to a third country (developed or developing one). In both hypotheses capital flight can become part of a complex structure involving more than one tax haven.

[487] S. A. Dean, 'Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation' (2007) 58 Hastings Law Journal 911, 925.

What differentiates both routes is the fact that in the first one, the same developed country is the source and residence of the investment, while in the second route, the source country is one country and the residence country is another one. The crucial aspect here is that capital flight is not invested in tax havens. It only passes through them to mask its real identity. To this extent, the OECD TIEA Model Convention has been developed to assist flight jurisdictions to identify the true source of investments made in their territory through tax havens. The efficiency of such instrument will become evident in the examination of the routes described above.

Focusing on the first red route, i.e. capital flight that flows to a tax haven and then returns as foreign investment, exchange of information through a TIEA can be very helpful since the developed country has enough information as the source country to request further details from the tax haven through the mechanism of exchange upon request. In the hypothesis of a chain of conduit companies located in tax havens, i.e. capital flight passing through more than one tax haven jurisdiction to mask its real identify, to try to identify the genuine owner of the chain of legal entities located in more than one tax haven, the developed country will need to have a TIEA with each one of the haven jurisdictions which is part of the 'chain'. The current version of the TIEA adopted by the OECD does not allow third countries to have access to information exchanged without prior authorisation. So, for instance, in the case of the UK receiving investment from a company located in the Cayman Islands, which is controlled by another company located in the Bahamas, the existence of a TIEA between the Cayman Islands and the Bahamas will not facilitate the process requested for the UK to have access to information from the Bahamas. According to the current version of the OECD TIEA, it is necessary for the UK to have two independent TIEAs with each one of the two jurisdictions to obtain full information of the transactions. This example draws attention to the fact that the recent OECD TIEA signed between tax haven jurisdictions cannot enhance the level of transparency and exchange of information worldwide. The recent TIEAs signed between different tax haven jurisdictions, in fact, represent only the compliance of these jurisdictions with the OECD's request to avoid their classification as uncooperative jurisdictions. Thus, in order to comply with the standard of effective exchange of information, tax haven jurisdictions need to sign at least 12 TIEAs with any other jurisdictions.[488] These TIEAs would only represent a further step in the implementation of effective exchange of information, if they allowed information exchanged through them to be disclosed to a third jurisdiction. Only then, the 'chain' of TIEAs made by them would improve the access of tax information from tax havens.

What this first red route demonstrates is the fact that the OECD TIEA only works when the requesting country has enough knowledge of the transaction being investigated. In the absence of this information, the OECD TIEA cannot provide information to the residence country. The OECD TIEA will only work in this hypothesis based on the fact that the position of the source country and the residence country coincide. When the source of capital flight is one country and the residence of the investor is another one, the OECD TIEA will only work if the source country provides previous information to the residence country through mechanisms of automatic exchange of information, for instance. This is specifically the case of the second red route.

The second red route, i.e. capital flight that flows to a third country (developed or developing one) through a tax haven jurisdiction, refers to a situation where the position of the source country does not coincide with the position of the residence country. Here the second route can divert in two different ways since the final destination of the capital flight can be a developed country or a developing one. In the first case, the mechanisms for automatic exchange of information between two developed countries will increase the probability of identification of the residence country of such capital. Initially, the source country will have to request information from the chain of tax havens, one by one. Assuming that after disentangling all parts of the transaction, the source country identifies another developed country as the residence of the capital flight, it could send this information upon request or automatically if this mechanism is applicable to that situation. Of course, this example relies on many different assumptions. However, here the objective is only to demonstrate that due to the fact that a vast amount of information

[488] Even though OECD emphasises that a jurisdiction cannot be 'whitened' by signing agreements with any 12 partners. OECD, 'The Global Forum on Transparency and Exchange of Information for Tax Purposes' (2011), <http://www.oecd.org/dataoecd/32/45/43757434.pdf> accessed 7 June 2011.

can be exchanged between developed countries, the OECD TIEA might help developed countries to fight against capital flight, despite the limitations of this instrument. The other deviation of the second red route led capital flight to a developing country, after passing through tax haven jurisdictions. The problem here is the fact that capital is invested in a jurisdiction where exchange of information can occur only upon request. In this case, assuming that the residence country (developed one) has no idea of the destination of the capital, it becomes hard to investigate its location.

The last transactions in the diagram, i.e. the green transactions identified with number (5), refer to the flow of capital flight (KF) from developing countries. Capital flight here can also adopt two different routes: (i) to flow to a tax haven and return as foreign investment; or (ii) to flow to a tax haven and then to a third country (developed or developing one). This situation, therefore, has a lot in common with the situation number (4) illustrated in red. Here also capital flight can become part of a complex structure involving more than one tax haven. What differentiates both routes is the fact that in the first one, the same developing country is the source and residence of the investment; whereas in the second route, the source country is a developing country and the residence country is a third country, which can be a developed country or a developing one. To this extent, the OECD TIEA can be useful in the first situation but not in the second. Thus, in relation to developing countries, the OECD TIEA can contribute in a certain way to identify capital flight only when the source and the residence country of an investment are the same. When capital flight is invested in a third jurisdiction, the absence of information where capital is invested makes the use of the OECD TIEA by them completely ineffective since they do not know what to request for which country.

In sum, examining the routes of capital with the instruments available for exchange of information between developed, developing countries and tax havens what became evident is the fact that capital flight can be hardly curbed. The mechanisms for exchange of information with tax havens are only efficient when the residence country received enough information from the source country (or when these two positions coincide in the same country). The way the current mechanisms for exchange of information work leaves capital flight untouched. The only hypothesis that the mechanisms available for exchange of information can help developing countries to curb capital flight is when capital flight returns as foreign investment. Currently there are only a very limited number of OECD TIEAs celebrated between developing countries and tax havens.[489] This signifies that not even in the situation where capital flight is reinvested in its country of origin might the developing country be able to curb capital flight.

8.3. Conclusion: Moving forward on exchange of information

The legal debate on exchange of tax information has focused on how to extract information from tax havens.[490] As already mentioned, capital flight is not invested in tax havens, it only flows through it to mask its true identify.[491] Thus, exchange of information can be improved by focusing on source countries. In fact, there are two crucial elements involving source countries: (i) type of information held by them; and (ii) availability of this information to residence countries.

Considering the first element, in order to provide effective measures to improve exchange of information worldwide, source countries would have to require the identification of non-resident investors. This measure would disclose the place of residence of foreign investors. This could be done, as already mentioned, by the source country enforcing two different tax treatments: one for investors that reveals their

[489] Up to May 2011, 479 TIEA have been signed, according to the OECD's data. However, only 10 TIEAs were signed by developing countries, including China, India and Mexico. The majority of TIEAs was signed between developed countries and offshore financial centres, including tax havens. OECD, 'Recent Tax Information Exchange Agreements', <http://www.oecd.org/dataoecd/43/59/43775845.pdf> accessed 7 June 2011.

[490] In this sense, Dean suggested a mechanism in which a tax haven's cooperation would be paid with a portion of the revenue raised by their help. Dean, 'Philosopher Kings and International Tax' (n 487) 957.

[491] The fact that capital flight is ultimately invested in developed countries had led authors such as Avi Yonah to suggest the adoption of a uniform withholding tax on portfolio investment by developed countries. Even though in practice this measure would help to solve the problem of tax havens, from the perspective of tax competition, developed countries would bravely resist its implementation. Furthermore, the recent developments in the area of exchange of information lead to assumptions that the problem of tax havens can be easily handled by focusing on the mechanisms for exchange of information rather than on the mandatory levy of withholding taxes by developed countries. Avi-Yonah, 'Globalization, Tax Competition and the Fiscal Crisis of the Welfare State' (n 122) 1667-70.

genuine identity, to whom the regular taxation determined in domestic statutes would apply; and another one for investors who do not reveal their genuine identity. In this case, a higher tax rate must be applied, such as 40-50%. The rate has to be expensive enough to encourage investors to identify themselves. Furthermore, the expression 'genuine identity' means the ultimate owner of such investment. To this extent, investors would have to provide information not only from the intermediary legal entity interposed in a low country jurisdiction, but the identification of the ultimate owner located in a jurisdiction with a substantial tax system, where income is taxed and there is no secrecy on ownership.[492] This kind of information would empower the source country with the required information that the residence country needs to enforce taxation.

The second element refers to availability of information collected by source countries to residence countries. This could be done through automatic exchange of information. The implementation of automatic exchange of information is not easy and the diverse levels of tax administrations have justified the enforcement of exchange upon request rather than automatic exchange of information, when developing countries are involved. However, the cornerstone element to implement automatic exchange of information also in developing countries is not to collect the greatest amount of information possible, but rather the smallest amount that would facilitate the necessary observation.[493] In terms of the minimum amount of information gathered, we could think of establishing a system that only identifies the residence country of investors. This information could be sent straight forward to the interested country. This hypothesis breaks down a paradigm situation that is faced nowadays regarding exchange of information only on a bilateral basis, i.e. a country needs to ask first, to receive information that it wants. In fact, this is what makes it really complicated to promote effective exchange of information with the current instruments that are available. Tax information does not need to flow bilaterally. It could be stored by clearing houses, which after receiving it would forward it to the interested country. Until now, the only instrument that overcame the necessity of

[492] For further information on the discussion about 'genuine owner', check (n 485).
[493] Dean, 'The Incomplete Global Market for Tax Information' (n 355) 55.

information being exchanged bilaterally was the new Council Regulation n. 904/2010, on administrative cooperation and combating fraud in the field of VAT. This instrument allows countries to forward information received to the interested country without further requirements.

Regarding implementation, a system for automatic exchange of information was already developed as well as the format and language requested for its implementation. This challenge was faced by the European Union, which implemented the CCN/CSI network, which is a platform based on the common communication network that allows the electronic transmission of information by competent authorities in the areas of customs and taxation. The limited success experienced in the VAT field has led to its adoption in the area of direct taxation, as suggested in the new proposal for a council directive on administrative cooperation in the field of taxation.

In order to make exchange of information work from the perspective of developing countries, it is necessary to overcome the obstacle that low tax jurisdictions represent in the flow of information. The solution, however, does not consist only in improving mechanisms to receive information from them. It is necessary to focus where capital flight is invested, i.e. developed countries. To this extent, developed countries must request information when investments are made and be authorised to send it forward to the interested country, without further requirements.

The way we have been thinking about exchange of information needs to be rethought. Bilateral exchange of information is not enough. The flaws identified in the current network of instruments for exchange of information demonstrated that if developing countries do not have access to source countries' information, i.e. where capital is invested, they will not be able to fight against capital flight.

Another important aspect to improve the debate on exchange of tax information is the recognition that the current knowledge on international information sharing is very limited. This situation can be explained by different arguments, i.e. by the position of countries' revenue authorities that use such mechanisms very carefully in order: (i) to avoid the breach of any clause of confidentiality; and (ii) to create uncertainty in taxpayers to improve their voluntary compliance with the tax laws. However, a policy of transparency in the field of exchange of tax information is required. Without this measure, it is hard to assess the effectiveness of the arrangements of exchange of information, and consequently, the correct measures to improve it.[494]

Finally, it is essential to understand that the effective measures taken in the area of exchange of information have only been implemented due to a common consensus achieved among developed countries. Thus, although technical arguments are usually used to justify the limitations in the current mechanisms for exchange of tax information, in fact, the real obstacle is the political willingness of countries. The recent measure enforced by the OECD (e.g. the acceptance of a TIEA celebrated between two tax havens as the fulfilment of the criterion that considers a tax haven a cooperative jurisdiction) supports this line of reasoning. The involvement of developing countries which requires their understanding of the flaws of the current system of exchange of information is necessary to push the debate to a further stage, in which measures to curb capital flight from their jurisdictions are also implemented.

[494] Keen and Ligthart (n 341) 16.

Chapter IX. Final conclusion

This thesis aimed to provide a broader perspective of the relationship between international taxation and developing countries, by moving forward from arguments exhausted in the current literature, which are based on the assumption that developing countries are capital importers and, therefore, prefer source taxation, whereas developed countries are capital exporters, benefiting from residence taxation, to arguments based on the current profile of the international flow of capital.

The first challenge faced by this study was to understand the phenomenon of globalisation in order to identify what facts led to the current level of financial integration, and, consequently, to the existing characteristics of the international flow of capital. In a sense, one of the main changes that has empowered the current level of financial integration was the liberalisation of exchange controls by developed countries. Before the liberalisation of exchange controls, countries were easily classified as debtor and creditor based on their economic profile, which was also explained by their level of development: developing countries were debtors and developed ones were creditors. To this extent, the allocation of taxing rights between source and residence countries corresponded to the division of tax base between developed and developing countries.

One consequence of the assumption that developing countries continued to be capital importers, even in the current process of globalisation, was that their interest in international taxation was restricted to inflows of capital. The importance of outflows was left aside. Consequently, developing countries had a very limited involvement in the project on harmful tax competition, which in fact addresses the problem of international tax evasion and avoidance, involving tax havens and preferential tax regimes. In other words, under the label 'harmful tax competition' the OECD has dealt with the crisis of residence taxation in developed countries. The limited involvement of developing countries is comprehensible from this angle, since until now the basic assumption was that they were interested only in attracting inflows of FDI, which is not addressed by these rules. Thus, one of the first arguments that this study wanted to make clear was the effective meaning of harmful tax competition in the legal debate.

In order to drive the legal debate to address the current economic relationship between countries, the international flow of capital was analysed. The idea was to examine a long-term period in order to understand the evolution of the international flow of capital and whether the assumption surrounding developed and developing countries which characterised them as capital exporters and capital importers, respectively, was still valid in the current process of globalisation. The challenge faced at this point referred to the availability of data of a broad range of countries. The limitation of data of financial flows required the analysis of stocks of assets and liabilities held by countries. In a sense, there was previous evidence from economic studies that the flow of capital was not following the North/South direction anymore, i.e. that capital did not flow only from the developed world to developing countries. However, there was very limited discussion in the legal debate, considering this economic evidence.

The analysis of the international flow of capital as well as stocks of foreign assets and liabilities held by countries allowed the conclusion that nowadays it is very difficult to justify international tax policies based on countries' economic profiles, i.e. countries classification as capital importers and capital exporters. Therefore, developing countries' tax policies cannot be defined only in terms of inflows, but also in terms of outflows. In other words, developing countries should not only worry about incentives to attract foreign direct investment, but also about rules that ensure the taxation of residents' foreign investments.

Furthermore, it became evident that the international tax debate has to focus on the characteristics of the flow of capital rather than on countries' economic profile. This signifies that intrinsic characteristics of investment as well as incentives created to allocate investments in different jurisdictions need to be regarded by policymakers. It is not possible anymore to think on allocation of taxing rights as division of tax base, without considering the mobile aspect of capital and the incentive created by tax policies in its allocation. Policymakers must have in mind the trade-off between raising of tax revenue and the incentives to attract foreign investment. To this extent, residence taxation provides a better balance between these two goals, since the exemption of non-resident investors does not reduce countries' tax base.

The focus on the characteristics of the flows of capital also put in evidence that: (i) tax havens are important players and, consequently, they need to be treated as a separate group; and (ii) the total sum of countries' international investment position (IIP) resulted in the identification of a net asset discrepancy, which signifies that countries have reported better inflows (liabilities) than outflows (assets). The constraints on data have caused the discrepancy to be treated as badly reported data. However, the analysis of tax havens' behaviour indicated that there might be other explanations for the problem faced in the data. It was verified that while the IIP of developed and developing countries contributed to the increasing value of the discrepancy over time, the IIP of tax havens reduced it. Even though the analysis considered, initially only 14 tax havens, out of a sample of 50 countries identified as tax havens by this study, it was possible to identify their impact on the discrepancy, leading to the assumption that if more tax havens were included in the analysis, the discrepancy would be further reduced. Moreover, the analysis of complementary data from other sources (for instance, Coordinated Portfolio Investment Survey, organised by the IMF) has also contributed to the argument that missing assets in high tax jurisdictions are in fact allocated in tax havens. To this extent, considering also the outcome of different studies, it was possible to conclude that besides the problem of badly reported data, other explanations could be provided for the current profile of the international flow of capital as well as to the stocks of financial assets and liabilities held by countries: the phenomenon of capital flight. In a sense, official figures of governments' reports cannot capture the phenomenon of capital flight since it represents unreported outflows. Therefore, even if a complete dataset were adopted, a discrepancy would be identified, assuming that part of the problem is capital flight.

Putting together the outcomes from the analysis of the flows of capital and the phenomenon of capital flight, i.e. the massive amount of outflow that leaves developed and developing countries unregistered, it became evident that the allocation of taxing rights between source and residence is not the right approach to understand the position of developing countries in the international tax system. It is necessary to regard the behaviour of tax havens and their relationship with the problem of capital flight. Both developed and developing countries are affected by this problem, even though until now tax policies dealing with international tax evasion and avoidance have received much more attention from developed countries than developing ones. The OECD has tried to push the debate about transparency and exchange of tax information to involve developing countries, however until now the reason that justifies their involvement was not addressed clearly.

Developing and developed countries cannot deal with the problem of capital flight by discussing international taxation in terms of allocation of taxing rights between source and residence countries. Nowadays, the main problem affecting international taxation is not how to solve situations of double taxation, but how to reduce the loopholes in countries' tax policies that allows increasing opportunities for tax evasion and avoidance.

In terms of tax policy, i.e. examining developing countries' tax policies on portfolio investment, it became clear that developing countries have no clear idea of the importance of residents' foreign income and how to enforce its taxation. Moreover, it also became evident that developing countries have no clear understanding of the incentive created by the interplay of source and residence taxation in the allocation of capital flight.

To tackle capital flight a broader understanding of this problem is necessary in order to comprehend its dynamics. To this extent, it was demonstrated that capital flight is invested in developed and developing countries. It only passes through tax havens.

Thus, the key issue to curb capital flight is to empower tax administrations of high tax jurisdictions with instruments that force the identification of non-resident investors.

The recent developments of international taxation indicate that developed countries opted for instruments that enforce transparency and exchange of tax information as the answer to deal with the problems of international tax evasion and avoidance, involving tax havens and other financial centres. However, the current instruments for exchange of tax information available are not enough to solve the problem of capital flight. In a sense, the developments in this area indicate the pressure of the international community for countries to sign TIEAs, which also ensures that domestic legal constraints (such as the dual criminality principle, domestic tax interest of information held by financial institutions and ownership identity) cannot cause restrictions for information exchange. Of course this was an important step for the implementation of effective exchange of information and, consequently, in the fight against tax avoidance and evasion, however the focus has also to be on the first level of the domestic scenario where the identification of non-resident investors can be required by financial institutions.

Further improvements on rules to combat international tax avoidance and evasion are expected in the near future, though the answer to this problem relies on political willingness, since it requires the acceptance of major countries for its implementation. Otherwise, the measures proposed will only provide the reallocation of capital to other jurisdictions. To this extent, developing countries cannot be at the margin of this process. The involvement of developing countries will only occur if they understand the relationship between these rules to combat international tax avoidance and evasion and the phenomenon of capital flight. The reason for their involvement in the combatting of international tax avoidance and evasion needs to be clear. In this context, their effective interest in international taxation becomes evident. The crisis of residence taxation suffered by developed countries is also affecting developing ones. This study aimed to demonstrate that, and it suggests that developing countries should adopt a more proactive conduct in relation to tax policies to combat tax evasion and avoidance, defined at the international level.

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ANNEXES

1. Flows of FDI.
Source: International Financial Statistics (May 2010). Annual series. ESDS International, University of Manchester.

High Income OECD	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Australia	2.184	10.343	(3.706)	9.199	(9.193)	25.771	(1.661)	2.482	21.110	9.170
Austria	860	2.927	2.774	(5.426)	(45)	(4.533)	(194)	(3.050)	(7.610)	(18.685)
Belgium	-	-	-	9.178	(4.499)	9.733	3.607	7.087	12.233	(19.096)
Canada	(1.080)	21.658	(8.441)	(4.765)	(16.417)	(43.380)	(1.725)	15.221	51.803	(33.664)
Czech Republic	762	4.944	5.476	8.285	1.813	3.940	11.629	4.043	8.964	8.967
Denmark	844	7.632	(3.867)	1.781	329	1.126	(3.372)	(5.726)	(8.194)	(11.929)
Finland	(2.858)	(14.773)	(4.719)	753	5.744	4.017	390	2.839	5.497	(10.753)
France	(8.641)	(131.931)	(36.623)	(1.044)	(10.316)	(24.100)	(28.830)	(39.576)	(66.058)	(104.425)
Germany	(11.649)	150.340	(13.079)	33.978	25.780	(29.764)	(30.483)	(69.643)	(124.784)	(136.879)
Greece	981	(1.015)	974	(615)	957	1.077	(818)	1.175	(3.303)	2.527
Iceland	(24)	(219)	(166)	(250)	(48)	(1.830)	(3.990)	(1.669)	(11.644)	5.042
Italy	(3.039)	1.099	(6.884)	(2.548)	7.551	(2.457)	(21.144)	(3.471)	(52.076)	(27.476)
Japan	(17.177)	(23.307)	(32.306)	(22.930)	(22.528)	(23.153)	(42.224)	(56.954)	(51.308)	(130.793)
Korea, Republic of	(1.652)	4.285	1.108	(224)	100	4.596	2.018	(4.540)	(13.836)	(15.633)
Netherlands	(10.455)	(11.392)	1.215	(6.301)	(24.200)	(24.471)	(82.597)	(57.029)	93.801	(21.540)
New Zealand	811	3.101	830	1.100	1.485	2.815	3.045	4.556	(260)	5.265
Norway	571	(2.471)	1.260	(4.728)	(2.503)	(2.706)	(16.614)	(14.552)	(8.712)	(28.359)
Portugal	983	(1.502)	(55)	1.965	680	(5.716)	1.806	3.794	(2.495)	1.907
Spain	5.165	(18.576)	(4.726)	6.340	(3.152)	(36.712)	(17.350)	(72.311)	(72.863)	(100)
Sweden	(417)	(17.837)	6.126	1.036	(14.073)	(10.362)	(16.640)	3.626	(15.311)	1.519
United Kingdom	(24.171)	(124.108)	(7.974)	(24.797)	(38.025)	(36.612)	96.615	68.497	(77.736)	(163.053)
United States	(34.050)	162.062	24.670	(70.087)	(85.814)	(170.256)	76.402	(1.772)	(122.839)	(331.692)
TOTAL	(102.053)	21.261	(78.113)	(70.099)	(186.374)	(362.978)	(72.128)	(216.974)	(445.619)	(1.019.680)

Tax Heavens	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Antigua and Barbuda	25	43	98	66	166	80	221	359	356	253
Aruba	(73)	(120)	(259)	342	161	162	124	585	(120)	184
Bahamas	24	250	102	153	190	274	563	706	713	839
Bahrain	10	354	(136)	27	(225)	(170)	(87)	1.935	87	174
Barbados	12	18	17	17	58	(16)	53	91	36	-
Belize	15	23	61	25	(11)	111	126	108	139	187
China,P.R.:Hong Kong	-	2.572	12.431	(7.781)	8.132	(11.683)	6.417	75	(6.754)	9.065
China,P.R.:Macao	-	-	-	346	519	849	1.706	2.131	4.990	3.494
Costa Rica	293	404	451	625	548	733	904	1.371	1.634	2.015
Cyprus	69	683	696	555	318	407	614	975	1.032	65
Dominica	23	18	17	20	31	26	19	26	53	52
Grenada	19	37	59	54	89	65	70	90	174	161
Ireland	401	20.860	5.470	18.413	16.817	(29.102)	(44.824)	(15.590)	4.014	(33.255)
Jordan	26	806	148	108	447	798	1.611	3.357	1.902	1.953
Latvia	279	400	114	250	254	527	585	1.491	1.945	1.092
Luxembourg	7.142	7.469	(12.456)	(10.277)	(10.674)	(5.212)	(7.994)	14.317	(66.024)	(33.330)
Maldives	9	13	12	12	14	15	9	14	15	15
Malta	153	580	231	(401)	432	388	703	1.843	911	584
Mauritius	19	253	(31)	23	69	(18)	(5)	97	281	325
Netherlands Antilles	21	(11)	60	64	2	1	1	(78)	235	-
Panama	402	624	467	99	818	1.019	918	2.557	1.777	2.402
Seychelles	17	14	56	39	50	30	78	138	241	-
Singapore	3.973	10.569	(4.872)	4.052	9.105	9.251	3.156	14.382	7.092	13.796
St. Kitts and Nevis	15	96	88	80	76	56	93	110	158	88
St. Lucia	33	54	59	52	106	77	78	234	253	105
St. Vincent & Grens.	47	38	21	34	55	66	40	109	110	119
Switzerland	(7.066)	(24.225)	(8.984)	(1.799)	1.797	(24.212)	(51.369)	(44.235)	(5.235)	(43.427)
Vanuatu	30	20	18	14	17	19	12	43	34	-
TOTAL	5.915	21.843	(6.060)	5.212	29.363	(55.458)	(86.176)	(12.759)	(49.951)	(73.043)

Developing Countries	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Albania	53	143	207	135	178	328	258	315	647	888
Angola	170	879	2.145	1.643	3.481	1.414	(1.523)	(228)	(1.805)	(891)
Argentina	2.622	9.517	2.005	2.776	878	3.449	3.954	3.099	4.969	8.335
Armenia	8	104	70	111	121	246	233	450	701	925
Azerbaijan	-	129	227	1.067	2.352	2.351	459	(1.289)	(5.035)	(541)
Bangladesh	11	280	79	50	266	445	811	697	653	973
Belarus	11	119	96	453	170	163	303	351	1.770	2.149
Benin	14	56	42	12	44	65	53	55	261	-
Bolivia	128	734	703	674	195	63	(242)	278	363	509
Bosnia&Herzegovina	-	146	118	268	382	708	607	718	2.088	1.042
Botswana	(24)	55	(349)	347	212	362	334	536	596	105
Bulgaria	105	998	803	876	2.070	2.879	4.005	7.583	12.903	9.195
Burundi	(0)	12	(0)	-	0	0	1	0	0	3
Cambodia	69	142	142	139	74	121	375	475	866	795
Cameroon	(9)	149	38	635	328	77	257	64	197	82
Cape Verde	2	32	9	15	38	68	80	132	192	214
Chile	1.671	873	2.590	2.207	2.701	5.610	4.801	4.556	9.961	7.194
Colombia	1.298	2.111	2.526	1.277	783	2.873	5.590	5.558	8.136	8.329
Congo, Republic of	-	162	71	327	321	(13)	514	1.488	2.638	-
Côte d'Ivoire	78	235	273	213	165	283	312	319	427	402
Croatia	108	1.105	1.398	552	1.927	732	1.551	3.194	4.746	4.681
Djibouti	1	3	3	3	14	39	22	108	195	253
Dominican Republic	207	953	1.079	917	613	909	1.123	1.528	1.579	2.885
Ecuador	576	(23)	539	783	872	837	493	271	194	993
Egypt	1.213	1.184	498	619	217	1.094	5.284	9.894	10.913	7.574
El Salvador	-	178	289	496	123	366	398	267	1.408	719
Estonia	212	324	342	153	763	698	2.254	676	1.000	876
Fiji	68	(1)	44	35	42	252	150	415	344	333
Ghana	233	166	89	59	137	139	145	636	970	2.112
Guatemala	65	230	456	111	131	255	470	552	720	737
Guinea	0	10	2	30	79	-	-	-	386	256
Guyana	107	67	56	44	26	30	77	102	152	168
Haiti	-	13	4	6	14	6	26	161	75	30
Honduras	35	375	301	269	391	553	599	669	928	875
Hungary	1.095	2.182	3.580	2.731	516	3.405	5.396	1.120	4.659	1.667
Indonesia	1.500	(4.550)	(2.977)	145	(597)	(1.512)	5.271	2.188	2.253	3.419
Israel	(300)	2.584	3.493	929	2.001	(2.005)	1.873	(166)	194	3.667
Jamaica	77	394	525	407	604	542	581	797	751	1.361
Kazakhstan	-	1.278	2.861	2.164	2.213	5.436	2.117	6.663	7.975	10.821
Kenya	7	111	5	20	80	42	12	27	693	52
Kuwait	1.519	319	1.802	80	4.893	(2.558)	(4.908)	(8.089)	(9.663)	(8.687)
Kyrgyz Republic	38	(7)	(1)	5	46	132	43	182	208	232
Lao People's Dem.Rep	59	34	24	5	19	17	28	187	324	-
Libya	(98)	43	(308)	281	80	71	910	1.590	756	(1.777)
Lithuania	31	375	439	695	142	511	689	1.551	1.409	1.383
Macedonia	-	216	446	105	117	322	94	424	321	612
Madagascar	6	83	93	15	13	53	85	-	-	-
Malaysia	4.342	1.762	287	1.299	1.104	2.563	994	53	(2.687)	(7.827)
Mali	17	78	104	242	131	100	225	82	65	-
Mauritania	2	-	-	-	-	-	-	-	-	-
Moldova	12	127	54	84	74	84	191	234	522	691
Mongolia	7	54	43	78	132	93	185	344	-	-
Morocco	527	162	47	51	2.300	756	1.546	1.915	2.175	2.150
Mozambique	35	139	255	348	337	245	108	153	428	587
Myanmar	127	258	210	152	251	214	237	279	-	-
Namibia	104	117	49	56	45	111	178	(18)	167	529
Nepal	-	-	-	(6)	15	(0)	2	(7)	6	1
Nicaragua	47	267	150	204	201	250	241	287	382	626
Niger	(9)	9	27	4	15	13	35	52	121	-
Nigeria	1.959	1.140	1.191	1.874	2.005	1.874	4.968	8.807	5.568	3.309
Oman	76	82	5	107	(63)	69	1.305	1.414	2.881	2.599
Pakistan	420	297	352	795	515	1.062	2.157	4.164	5.492	5.390
Papua New Guinea	57	96	63	19	104	55	27	-	-	-
Paraguay	137	98	78	5	22	32	47	167	199	171
Peru	3.289	810	1.070	2.156	1.275	1.599	2.579	3.467	5.343	4.079
Philippines	1.289	2.115	335	1.477	188	109	1.665	2.818	(620)	1.144
Poland	1.846	9.327	5.804	3.901	4.284	11.761	6.951	10.727	17.987	11.747
Romania	341	1.048	1.174	1.128	1.805	6.373	6.512	10.971	9.647	13.606
Rwanda	-	8	5	3	5	8	8	26	80	103
Saudi Arabia	349	(1.881)	20	(614)	(587)	(334)	12.457	18.356	24.470	35.958
Senegal	49	62	39	44	50	64	52	210	273	-
Sierra Leone	(3)	39	10	10	9	61	91	59	97	(3)
Slovak Republic	256	2.031	-	4.101	536	3.051	2.266	3.799	2.960	2.980
Slovenia	130	71	371	1.508	(174)	282	(89)	(256)	(269)	513
Solomon Islands	2	13	(10)	(2)	(2)	6	17	19	-	-
Sri Lanka	158	173	172	185	201	227	234	450	548	691
Sudan	-	392	574	713	1.349	1.511	2.305	3.534	2.426	2.511
Suriname	(30)	(148)	(27)	(74)	(76)	(37)	28	(163)	(247)	(234)
Swaziland	(1)	74	47	93	(77)	71	(24)	122	14	-
Syrian Arab Republic	251	270	110	115	160	275	500	600	1.242	-
Tanzania	50	463	389	388	308	331	494	597	647	744
Thailand	873	3.389	4.639	3.171	4.609	5.784	7.554	8.479	8.462	5.999
Togo	15	41	71	51	40	70	93	92	50	-
Trinidad and Tobago	516	654	685	684	583	973	599	513	830	-
Tunisia	426	751	452	790	539	592	713	3.240	1.515	2.601
Turkey	559	112	2.854	957	1.252	2.005	8.967	19.065	20.089	15.414
Uganda	88	161	151	185	202	295	380	644	733	788
Ukraine	151	594	769	698	1.411	1.711	7.533	5.737	9.218	9.903
Uruguay	155	268	291	180	401	315	811	1.495	1.231	2.204
Venezuela	455	4.180	3.479	(244)	722	864	1.435	(2.032)	978	(923)
Vietnam	-	1.298	1.300	1.400	1.450	1.610	1.889	2.315	6.516	9.279
West Bank and Gaza	-	(151)	(358)	(350)	(31)	95	34	(106)	36	-
Yemen, Republic of	16	6	155	114	(89)	144	(302)	1.121	917	1.555
Zambia	-	122	72	303	347	363	357	616	1.324	939
TOTAL	32.057	55.500	54.432	53.263	58.113	79.552	124.519	164.539	205.836	204.775

BCIMRS	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Brazil	2.035	30.498	24.715	14.108	9.894	8.695	12.550	(9.420)	27.518	24.601
China,P.R.: Mainland	31.787	37.483	37.357	46.790	47.229	53.131	67.821	56.935	121.418	94.320
India	891	3.075	4.074	3.948	2.444	3.592	4.629	5.992	7.847	22.807
Mexico	10.973	18.047	25.381	22.876	15.275	19.293	15.633	13.712	18.838	21.359
Russian Federation	409	(463)	216	(588)	(1.769)	1.662	118	6.550	9.158	19.371
South Africa	(886)	692	10.785	1.882	231	(604)	5.613	(6.112)	2.755	11.764
TOTAL	45.208	89.332	102.528	89.015	73.304	85.770	106.363	67.657	187.534	194.223

2. Flows of Portfolio Investment.

Source: International Financial Statistics (May 2010). Annual series. ESDS International, University of Manchester.

High Income OECD	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Australia	16.095	3.955	6.184	307	41.222	15.439	37.708	53.314	(17.077)	33.432
Austria	(222)	3.218	5.744	(4.203)	4.786	(1.329)	(13.479)	14.826	30.295	37.795
Belgium	-	-	-	14.442	582	(30.488)	(44.706)	(9.181)	(43.023)	47.804
Canada	10.568	(32.717)	(208)	(6.763)	298	22.883	(33.338)	(41.752)	(75.251)	39.592
Czech Republic	847	(1.754)	923	(1.559)	(1.181)	1.988	(3.388)	(1.127)	(2.687)	(40)
Denmark	(11.771)	(17.799)	(4.262)	488	(15.920)	(14.713)	(11.955)	(16.846)	(7.510)	10.843
Finland	6.955	(1.804)	(5.609)	(4.439)	(1.902)	(11.393)	(7.461)	(11.238)	(4.981)	5.949
France	(49.864)	34.889	21.447	(7.875)	6.130	(66.140)	(18.398)	(159.080)	(167.677)	115.841
Germany	(30.832)	(150.663)	26.686	63.518	60.597	19.247	(35.663)	(14.673)	215.343	58.059
Greece	-	8.078	8.538	10.423	13.651	17.465	9.114	9.364	23.910	25.035
Iceland	171	475	601	143	3.010	6.725	12.228	11.359	(6.631)	(639)
Italy	(7.823)	(23.243)	(6.838)	17.660	2.742	32.175	56.314	53.566	25.643	171.249
Japan	(27.449)	(35.976)	(46.285)	(105.975)	(95.110)	22.948	(13.268)	127.520	73.129	(292.602)
Korea, Republic of	6.232	12.177	6.706	346	18.300	8.457	(23)	(19.950)	(26.058)	(2.406)
Netherlands	(10.404)	(10.393)	13.199	(14.516)	21.857	(30.980)	76.484	24.660	(101.789)	112.929
New Zealand	1.384	(2.112)	801	1.686	1.031	6.486	(54)	(997)	10.785	(6.421)
Norway	474	(15.300)	(27.079)	(18.310)	(6.160)	(28.678)	(5.786)	(73.988)	(24.525)	(112.346)
Portugal	478	(1.791)	2.810	3.215	(7.127)	284	(1.519)	5.523	13.981	22.841
Spain	(22.347)	(1.172)	(17.021)	5.016	(46.070)	102.035	53.357	232.428	118.172	5.088
Sweden	(1.738)	(3.755)	(12.704)	(10.729)	(9.567)	(23.182)	666	(20.259)	15.652	(34.683)
United Kingdom	78.480	170.912	(65.677)	75.543	114.365	(81.154)	(36.376)	28.544	227.106	563.513
United States	76.220	308.665	337.699	379.040	427.034	689.975	574.502	627.840	758.700	645.068
TOTAL	35.455	243.891	245.656	397.459	532.569	658.051	594.959	819.852	1.035.507	1.445.902

Tax Heavens	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Antigua and Barbuda	(1)	2	(3)	(2)	3	12	11	25	(1)	12
Aruba	(9)	(8)	57	64	36	26	3	(48)	(242)	63
Bahamas	-	-	-	-	-	-	-	(19)	(7)	(9)
Bahrain	(454)	194	(1.479)	(4.225)	(2.407)	(3.505)	(4.614)	(8.831)	(8.560)	9.277
Barbados	47	71	120	(39)	(127)	(42)	35	83	(210)	-
Belize	6	113	(19)	124	79	77	18	(22)	79	0
China,P.R.:Hong Kong	-	24.485	(41.294)	(38.786)	(34.000)	(39.332)	(31.467)	(26.713)	(2.733)	(38.151)
China,P.R.:Macao	-	-	-	(903)	(1.192)	(2.181)	(617)	(1.435)	(1.251)	(1.388)
Costa Rica	(1)	(86)	(139)	(97)	(396)	(186)	(681)	(509)	(170)	442
Cyprus	(160)	(284)	268	(577)	281	1.166	(54)	(148)	(496)	(17.790)
Dominica	0	14	(0)	12	3	(2)	4	(0)	2	1
Grenada	(0)	19	(0)	108	29	30	18	(1)	(1)	(5)
Ireland	(1.399)	(5.169)	(22.262)	(36.101)	(44.444)	17.531	63.917	(17.667)	(10.346)	(52.950)
Jordan	-	(179)	(284)	(411)	(472)	(289)	313	(37)	840	562
Latvia	(22)	(324)	130	(199)	(216)	234	(138)	48	(659)	373
Luxembourg	(23.518)	9.733	15.520	70.414	21.064	52.064	48.054	74.553	133.061	37.662
Maldives	-	-	-	-	-	-	-	-	-	-
Malta	304	(711)	(498)	(383)	(1.591)	(2.090)	(2.572)	(2.473)	536	(5)
Mauritius	2	(139)	(19)	(17)	(18)	(37)	(16)	(30)	58	(170)
Netherlands Antilles	(58)	(38)	(32)	(37)	4	(1)	(24)	58	(77)	-
Panama	(49)	71	(26)	90	64	125	(557)	(501)	(632)	(527)
Seychelles	(1)	1	1	1	1	1	1	198	31	-
Singapore	(7.726)	(14.591)	(7.933)	(13.298)	(7.625)	(8.668)	909	(5.222)	(9.528)	(23.171)
St. Kitts and Nevis	0	5	43	30	48	(10)	(15)	(21)	(11)	6
St. Lucia	0	28	12	17	63	16	24	(3)	0	(9)
St. Vincent & Grens.	0	1	3	1	21	33	(8)	13	(8)	(4)
Switzerland	(18.201)	(12.922)	(41.194)	(21.676)	(34.565)	(39.554)	(47.627)	(41.631)	(18.718)	(34.862)
Vanuatu	-	1	(4)	(0)	2	0	(1)	(0)	2	-
TOTAL	(51.241)	289	(99.033)	(45.889)	(105.355)	(24.583)	24.915	(30.332)	80.959	(120.645)

Developing Countries	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Albania	-	(25)	(24)	(37)	(22)	(4)	(6)	34	26	(54)
Angola	-	-	-	-	1	(3)	(1.267)	(1.439)	(2.015)	(1.758)
Argentina	9.461	(2.584)	(9.503)	(4.640)	(7.758)	(9.416)	(363)	7.920	7.096	(7.074)
Armenia	-	(19)	(6)	2	0	(3)	(2)	9	(9)	8
Azerbaijan	-	-	-	(0)	(0)	(18)	31	(12)	(26)	(347)
Bangladesh	106	1	(3)	(3)	2	4	19	28	141	10
Belarus	-	44	(20)	(9)	6	63	(42)	(26)	(39)	5
Benin	(26)	6	3	(2)	(8)	(0)	17	6	(53)	-
Bolivia	-	55	(23)	(19)	(68)	(35)	(153)	25	(30)	(208)
Bosnia&Herzegovina	-	-	-	-	-	(3)	3	(0)	(1)	(9)
Botswana	(0)	(40)	(62)	(413)	(520)	(467)	(388)	(557)	(413)	272
Bulgaria	(232)	(177)	65	1.679	(115)	67	614	395	(470)	(664)
Burundi	-	-	-	-	-	-	-	-	-	-
Cambodia	-	(7)	(8)	(8)	(8)	(8)	(7)	(8)	(6)	(12)
Cameroon	(75)	(2)	94	5	(2)	31	(13)	(5)	(18)	(14)
Cape Verde	-	(0)	1	-	-	-	-	0	4	0
Chile	908	639	139	(2.317)	(2.645)	(3.308)	(2.833)	(9.239)	(16.461)	(8.843)
Colombia	212	280	(10)	1.098	(1.624)	(259)	(1.742)	(2.431)	891	(1.007)
Congo, Republic of	-	(5)	(12)	(7)	(0)	2	(1)	(1)	(1)	-
Côte d'Ivoire	(28)	(8)	(8)	31	33	(29)	(2)	21	103	30
Croatia	11	727	617	(432)	975	313	(1.498)	(644)	23	(826)
Djibouti	-	-	-	-	-	-	-	-	-	-
Dominican Republic	(39)	265	604	(26)	544	(24)	244	773	954	(457)
Ecuador	6	(5.583)	40	0	(304)	(190)	366	(1.384)	(118)	213
Egypt	3	266	1.461	(678)	(43)	239	3.468	(700)	(3.574)	(7.650)
El Salvador	-	(26)	29	266	189	57	105	777	(196)	138
Estonia	(14)	91	(34)	153	167	734	(2.254)	(1.280)	(478)	695
Fiji	-	-	-	-	0	1	1	(2)	6	(7)
Ghana	-	-	-	-	-	-	-	66	800	(49)
Guatemala	(3)	43	130	(146)	7	(132)	(146)	(191)	(228)	(39)
Guinea	-	9	5	5	(5)	15	-	-	8	-
Guyana	16	(9)	(11)	(9)	(27)	(6)	(17)	(4)	(95)	7
Haiti	-	-	-	-	-	-	-	-	-	-
Honduras	-	(59)	(13)	(6)	(7)	(12)	(23)	(21)	(25)	(14)
Hungary	2.464	(450)	1.374	1.802	2.917	6.826	4.501	6.324	(2.343)	(2.945)
Indonesia	3.877	(1.911)	(244)	1.222	2.251	4.409	4.190	4.277	5.566	1.721
Israel	(1.291)	679	(618)	(1.246)	(3.185)	750	(5.662)	(3.979)	(128)	123
Jamaica	-	(64)	30	(196)	(286)	96	(126)	(129)	(640)	(33)
Kazakhstan	-	(55)	(1.317)	(1.247)	(1.891)	(417)	(3.953)	(4.501)	(4.583)	(9.323)
Kenya	(2)	(14)	(1)	(5)	(38)	(66)	(30)	(21)	(25)	(26)
Kuwait	394	(12.668)	(8.719)	(3.227)	(13.374)	(13.880)	(13.134)	(29.126)	(34.441)	(29.762)
Kyrgyz Republic	-	(1)	1	(12)	6	(9)	2	(3)	(18)	(26)
Lao People's Dem.Rep	-	-	-	-	-	-	-	-	-	-
Libya	(126)	(706)	(1.359)	72	(607)	(187)	(393)	(5.198)	(1.440)	(10.964)
Lithuania	4	265	264	24	252	211	(237)	(254)	(229)	(179)
Macedonia	-	(1)	4	1	6	11	239	92	150	(72)
Madagascar	-	-	-	-	-	-	-	-	-	-
Malaysia	(1.649)	(2.532)	(412)	(1.399)	978	8.389	(3.700)	3.436	5.380	(23.961)
Mali	-	16	12	54	1	(3)	(15)	(11)	(46)	-
Mauritania	(0)	-	-	-	-	-	-	-	-	-
Moldova	0	(4)	(7)	(27)	(24)	(10)	(7)	(5)	(5)	6
Mongolia	-	-	-	-	50	(53)	-	-	-	-
Morocco	238	18	(7)	(8)	8	597	60	(295)	(80)	(109)
Mozambique	-	-	-	32	5	(25)	(88)	(124)	(3)	(8)
Myanmar	-	-	-	-	-	-	-	-	-	-
Namibia	47	(435)	(426)	(411)	(608)	(821)	(1.048)	(1.128)	(1.478)	(1.018)
Nepal	-	-	-	-	-	-	-	-	-	-
Nicaragua	-	35	14	1	0	(1)	(8)	(10)	(12)	(0)
Niger	-	8	4	0	2	5	42	(4)	(8)	-
Nigeria	(27)	502	832	134	183	178	(488)	1.288	800	(6.208)
Oman	-	(36)	80	(77)	(229)	(12)	94	(219)	2.140	(1.646)
Pakistan	1.471	(451)	(192)	(567)	(121)	401	925	1.969	2.086	(268)
Papua New Guinea	(2)	(124)	(73)	(1)	(47)	(104)	27	-	-	-
Paraguay	-	3	1	(0)	(0)	(0)	-	-	-	-
Peru	504	(406)	(372)	1.408	(76)	820	1.762	(1.837)	3.435	956
Philippines	269	(553)	40	733	563	(574)	3.301	4.577	4.756	(3.799)
Poland	(624)	3.339	1.115	1.894	2.444	9.281	12.600	(3.122)	(5.415)	(2.082)
Romania	75	101	575	382	578	(531)	949	(239)	623	(722)
Rwanda	-	0	-	-	-	-	-	-	-	(19)
Saudi Arabia	(2.524)	(9.378)	(2.797)	7.552	(18.738)	(26.654)	350	(11.949)	(5.476)	(1.630)
Senegal	(1)	23	8	(38)	(46)	(47)	(57)	(67)	31	-
Sierra Leone	-	-	-	0	-	-	-	-	-	2
Slovak Republic	278	821	-	553	(574)	850	(937)	1.556	(734)	2.430
Slovenia	(32)	188	81	(68)	(257)	(772)	(1.998)	(1.829)	(3.089)	566
Solomon Islands	-	-	(0)	0	0	-	(0)	-	-	-
Sri Lanka	27	(44)	(11)	25	2	11	60	51	4	(662)
Sudan	-	-	1	15	35	20	51	(35)	46	(33)
Suriname	-	-	-	-	-	-	(2)	(0)	(1)	(17)
Swaziland	(4)	(1)	(8)	2	(0)	(1)	4	(4)	5	-
Syrian Arab Republic	-	-	-	-	-	-	-	-	-	-
Tanzania	-	-	8	2	3	2	3	3	3	3
Thailand	2.661	(706)	(886)	(1.608)	(88)	3.088	5.548	4.275	(6.739)	(2.166)
Togo	1	7	11	12	14	(0)	2	63	19	-
Trinidad and Tobago	-	(30)	(206)	(70)	(509)	(690)	(258)	(200)	(272)	-
Tunisia	15	(20)	(15)	6	14	24	12	65	30	(39)
Turkey	1.158	1.022	(4.515)	(593)	2.465	8.023	13.437	7.373	717	(5.046)
Uganda	-	-	-	2	16	6	(13)	22	45	(27)
Ukraine	-	138	(45)	337	867	2.067	2.757	3.583	5.753	(1.280)
Uruguay	158	191	508	329	(311)	(422)	806	1.686	1.151	(571)
Venezuela	253	(3.134)	1.107	(2.310)	(966)	(2.084)	928	(9.949)	2.568	3.046
Vietnam	-	-	-	-	-	-	865	1.313	6.243	(578)
West Bank and Gaza	-	(101)	(136)	(153)	(25)	57	3	(8)	(131)	-
Yemen, Republic of	3	0	(1)	(6)	(0)	(6)	(14)	(34)	(8)	(44)
Zambia	-	6	8	(0)	2	(0)	122	50	42	(6)
TOTAL	17.922	(32.581)	(22.841)	(2.187)	(39.571)	(13.639)	15.581	(40.165)	(39.963)	(124.071)

BCIMRS	1994	2000	2001	2002	2003	2004	2005	2006	2007	2008
Brazil	44.732	6.955	77	(5.119)	5.308	(4.750)	4.885	9.573	48.390	1.133
China,P.R.: Mainland	3.543	(3.991)	(19.405)	(10.342)	11.427	19.690	(4.933)	(67.558)	18.672	42.660
India	5.491	2.345	2.853	1.022	8.216	9.037	12.144	9.546	35.139	(15.077)
Mexico	7.415	126	7.408	811	3.042	7.038	4.103	(4.276)	11.330	4.094
Russian Federation	22	(13.220)	(653)	4.949	(4.509)	623	(11.379)	15.702	5.984	(35.194)
South Africa	2.836	(1.864)	(8.302)	(417)	723	6.359	4.807	19.627	10.242	(14.303)
TOTAL	64.039	(9.649)	(18.022)	(9.096)	24.207	37.996	9.627	(17.385)	129.758	(16.687)

3. International Investment Position.
Source: Lane P R and Milesi-Ferretti G M, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 - 2004', (2007) 73 Journal of International Economics 223.

High Income OECD	1970	1980	1990	2000	2001	2002	2003	2004
Australia	10.248,29	43.366,42	145.255,39	197.595,62	176.106,90	229.958,01	338.720,09	394.822,46
Austria	1.090,60	10.145,01	14.394,31	40.787,88	50.398,11	47.162,87	41.479,11	50.315,58
Belgium	(1.942,24)	(6.986,86)	3.050,70	(140.085,71)	(116.232,54)	(101.589,26)	(124.205,99)	(108.860,01)
Canada	30.453,27	91.956,48	203.610,79	52.443,29	60.827,61	98.821,84	125.908,90	124.534,62
Czech Republic	-	-	-	5.193,84	6.854,21	13.333,26	20.746,23	37.076,36
Denmark	3.049,77	20.919,70	55.501,80	22.978,40	27.319,39	32.599,46	29.598,17	30.154,51
Finland	3.174,90	7.782,64	39.915,36	182.236,82	101.327,82	54.624,92	43.872,36	22.550,16
France	(9.002,76)	(31.134,02)	85.949,65	(92.124,80)	(170.906,39)	(130.613,58)	(110.639,59)	(108.867,44)
Germany	(10.967,62)	(40.876,19)	(334.265,43)	(26.210,97)	(132.141,55)	(78.703,19)	(135.250,62)	(220.859,98)
Greece	291,40	5.092,95	17.549,21	47.183,31	57.368,85	81.765,48	118.831,67	151.154,97
Iceland	111,32	855,33	3.004,01	5.416,96	5.810,52	7.218,56	7.802,87	11.387,71
Italy	(3.777,02)	2.976,53	124.910,06	89.126,29	77.994,04	178.498,54	231.785,27	304.688,86
Japan	(12.147,30)	(11.436,45)	(328.150,59)	(1.151.850,54)	(1.354.824,56)	(1.455.727,81)	(1.603.855,17)	(1.775.858,97)
Korea	2.346,67	24.066,80	15.252,03	10.650,10	27.366,35	26.318,75	30.757,85	27.446,88
Netherlands	(5.296,73)	(25.493,78)	(52.603,61)	67.247,50	60.812,23	127.938,10	70.436,68	33.657,03
New Zealand	601,74	6.790,47	27.295,22	38.480,28	38.850,09	53.525,41	66.431,85	89.084,37
Norway	1.172,02	19.412,83	14.072,74	(27.402,95)	(49.813,75)	(83.288,58)	(132.261,30)	(162.103,46)
Portugal	-	7.070,82	9.493,10	47.818,16	52.807,36	71.775,21	95.179,63	116.482,14
Spain	4.172,41	16.597,37	64.294,61	150.267,07	168.725,41	245.837,03	358.627,35	487.375,14
Sweden	288,11	11.194,42	56.938,98	1.408,91	(50.420,27)	5.985,64	30.289,78	33.004,47
United Kingdom	(5.947,80)	(32.143,88)	31.761,49	51.168,39	104.514,09	79.563,43	117.268,37	280.509,78
United States	(65.493,40)	(102.892,78)	266.896,70	1.652.806,58	2.411.775,32	2.545.753,67	2.481.052,94	2.655.945,96
TOTAL	(57.574)	17.264	464.127	1.225.134	1.554.519	2.050.758	2.102.576	2.473.641

Tax Haven	1970	1980	1990	2000	2001	2002	2003	2004
Bahrain	(25,36)	(2.293,48)	(4.266,38)	(7.029,88)	(6.737,75)	(6.405,12)	(7.100,03)	(8.534,80)
Costa Rica	396,04	2.611,18	2.854,22	5.753,20	6.509,00	7.416,23	8.348,29	8.651,19
Cyprus	-	(54,95)	281,39	3.838,09	4.198,25	1.105,53	2.218,44	(1.972,12)
Hong Kong S.A.R. of China	-	(11.159,53)	(153.955,07)	(221.793,89)	(265.193,69)	(343.309,48)	(394.120,22)	(424.731,87)
Ireland	563,45	9.352,70	20.422,67	7.835,75	10.851,47	24.637,77	33.479,31	35.867,74
Jordan	(212,75)	(395,90)	5.777,05	3.710,07	3.652,78	3.623,47	2.751,47	2.746,86
Latvia	-	-	-	2.393,15	3.108,89	4.055,64	5.231,21	7.508,39
Lebanon	238,27	1.435,37	5.844,57	11.199,12	12.494,49	13.760,15	17.260,19	20.659,86
Luxembourg	-	-	-	(17.934,76)	(14.114,77)	(17.896,11)	(30.363,05)	(37.780,12)
Malta	42,21	(553,78)	(894,85)	3,56	(147,16)	(1.337,39)	(1.340,17)	(1.608,71)
Mauritius	(23,74)	386,99	172,94	0,11	(361,32)	(732,21)	(1.097,26)	(1.230,91)
Panama	1.512,89	4.487,70	5.784,29	10.049,41	11.508,88	11.530,26	11.898,81	12.643,53
Singapore	(556,74)	(1.490,45)	(10.656,44)	(145.188,30)	(144.807,84)	(143.762,69)	(170.748,05)	(186.723,05)
Switzerland	(15.659,54)	(80.887,10)	(209.110,20)	(261.600,56)	(294.486,82)	(358.195,53)	(402.595,02)	(450.027,62)
TOTAL	(13.725)	(78.561)	(337.746)	(608.765)	(673.526)	(805.509)	(926.176)	(1.024.532)

Developing Countries	1970	1980	1990	2000	2001	2002	2003	2004
Albania	-	-	-	693,21	765,61	735,45	970,11	1.206,19
Algeria	1.461,11	13.002,60	26.813,29	11.455,11	3.642,97	(754,27)	(9.923,18)	(19.314,18)
Angola	-	-	12.031,87	13.107,52	14.920,45	15.516,34	19.756,07	19.193,21
Argentina	6.538,65	18.056,02	42.651,79	112.706,04	122.110,74	67.172,19	72.227,58	72.378,64
Armenia	-	-	-	1.293,31	1.438,96	1.497,91	1.548,73	1.638,64
Azerbaijan	-	-	-	3.882,93	3.567,93	4.792,05	7.730,90	9.266,59
Bangladesh	-	3.571,86	11.019,23	15.266,35	15.185,29	16.253,94	17.028,08	17.031,07
Belarus	-	-	-	2.427,87	3.117,88	3.466,38	3.912,03	4.475,20
Benin	33,92	423,32	1.303,66	1.344,46	1.299,98	1.383,96	1.312,94	(1.207,09)
Bolivia	615,65	2.651,41	3.537,81	8.703,75	8.149,24	9.281,36	9.473,38	9.156,34
Bosnia and Herzegovina	-	-	-	1.450,61	365,83	856,22	1.226,19	999,24
Botswana	-	464,21	(1.468,72)	(3.794,11)	(4.393,06)	(5.371,85)	(5.760,99)	(6.805,54)
Brunei Darussalam	-	-	(15.691,47)	(22.675,55)	(25.440,83)	(27.862,55)	(30.724,07)	(34.462,68)
Bulgaria	-	-	-	5.036,68	4.446,48	5.461,65	8.159,50	11.352,25
Burkina Faso	-	263,04	467,10	1.227,10	995,44	1.212,70	833,46	974,08
Cambodia	-	-	-	2.004,53	1.960,19	1.899,72	1.973,91	2.105,98
Cameroon	243,67	1.312,71	5.363,63	7.436,08	6.837,85	4.792,52	5.592,91	5.711,97
Chad	28,89	374,63	520,94	1.442,08	1.860,72	2.839,41	3.774,29	4.405,21
Chile	4.457,19	12.238,31	12.402,43	28.402,92	28.046,52	26.063,23	33.822,34	35.084,63
Colombia	2.369,63	299,94	9.775,11	21.660,28	24.735,89	26.984,22	29.580,98	33.093,25
Congo, Dem. Rep. of	104,37	3.386,99	7.966,57	11.590,93	12.293,10	9.071,10	9.040,41	-
Congo, Republic of	91,92	1.644,13	5.198,04	6.164,73	6.077,63	6.977,89	7.482,38	-
Côte d'Ivoire	273,23	7.713,64	15.914,77	12.605,19	9.161,57	10.129,01	10.990,09	11.836,03
Croatia	-	-	-	6.094,94	4.432,76	8.548,22	15.046,66	21.373,57
Dominican Republic	529,82	2.659,99	5.293,61	8.661,44	9.914,07	10.310,62	8.487,85	11.158,47
Ecuador	518,45	6.038,36	12.497,56	19.004,32	20.557,90	23.608,59	24.635,11	25.448,10
Egypt	1.300,66	16.377,67	34.562,30	22.321,15	21.583,84	19.843,98	16.348,64	14.461,30
El Salvador	160,14	548,05	1.450,14	4.732,85	5.589,43	6.608,21	8.105,99	8.676,09
Equatorial Guinea	(40,10)	58,90	243,65	1.488,10	2.339,89	2.595,09	3.951,21	-
Estonia	-	-	-	2.777,78	3.099,57	4.412,65	7.296,48	11.411,29
Ethiopia	47,15	641,72	8.243,28	5.162,11	4.731,04	4.540,36	4.981,17	5.148,68
Fiji	112,70	241,22	393,06	392,27	429,31	420,41	400,24	-
Gabon	366,63	1.992,00	4.373,63	3.124,16	2.796,22	2.838,84	3.112,19	3.184,04
Georgia	-	-	-	1.977,48	2.100,24	2.292,57	2.739,54	3.388,15
Ghana	787,60	1.359,36	3.260,72	7.397,98	7.345,61	7.964,92	8.263,88	8.076,93
Guatemala	236,54	1.003,96	2.202,31	2.792,86	3.139,34	3.234,95	3.287,85	3.775,93
Guinea	191,49	1.028,97	2.277,71	3.222,38	2.905,35	3.148,35	3.223,82	3.160,71
Haiti	69,50	327,47	644,31	850,83	928,28	968,38	1.194,04	-
Honduras	228,29	1.362,72	3.484,34	3.365,68	2.660,97	3.171,15	3.739,14	3.818,87
Hungary	-	-	16.178,27	33.316,74	35.776,87	49.436,32	69.665,76	96.266,63
Indonesia	4.487,97	13.697,90	57.760,98	114.055,21	101.742,07	99.412,26	103.915,79	117.516,23
Iran, Islamic Republic of	(139,96)	(14.967,89)	(10.032,04)	(27.871,97)	(30.947,87)	(35.451,25)	(36.818,65)	(47.989,82)
Israel	782,51	7.586,04	14.604,23	43.401,09	29.791,94	20.950,99	26.527,19	25.503,09
Jamaica	1.676,74	2.905,45	4.220,59	4.660,35	4.602,84	5.431,42	5.995,08	6.212,66
Kazakhstan	-	-	-	18.752,13	22.617,64	25.079,50	26.970,44	24.983,92
Kenya	240,67	2.943,35	6.673,29	5.439,56	4.574,74	5.005,45	5.228,85	4.853,71
Kuwait	-	(51.087,06)	(95.990,56)	(75.397,67)	(84.451,62)	(89.395,31)	(104.750,52)	(125.760,95)
Kyrgyz Republic	-	-	-	1.670,83	1.724,81	1.800,12	1.867,27	1.769,59
Lao People's Dem.Rep	-	344,40	1.700,89	2.796,08	2.876,17	2.954,97	3.120,06	3.152,59
Libya	-	(18.839,72)	(14.690,35)	(40.452,63)	(42.113,41)	(39.508,75)	(52.086,25)	(66.405,64)
Lithuania	-	-	-	4.062,70	4.256,61	5.218,44	6.936,58	8.625,09
Macedonia	-	-	-	846,62	747,41	1.252,54	1.400,82	1.618,56
Madagascar	12,85	948,34	3.045,78	3.962,63	3.806,21	3.898,17	3.789,26	3.982,34
Malawi	104,17	799,77	1.451,90	2.554,30	2.502,69	2.916,24	3.161,15	-
Malaysia	125,47	3.623,61	7.987,84	34.677,05	34.724,35	28.854,98	19.132,47	2.404,59
Mali	243,21	686,83	2.115,44	2.694,45	2.665,80	2.552,69	2.585,03	3.052,11
Moldova	-	-	-	1.448,27	1.451,12	1.588,64	1.690,66	1.564,41
Morocco	778,47	8.974,20	20.082,39	17.462,59	14.723,31	13.778,39	14.731,61	13.931,13
Mozambique	-	548,78	3.947,06	4.557,04	4.635,10	3.203,27	4.212,90	4.371,42
Myanmar	137,30	1.459,48	5.184,10	9.386,16	9.468,14	9.601,65	9.871,70	10.421,42
Namibia	-	-	399,28	(1.410,37)	(1.510,97)	(1.791,09)	(2.453,97)	(2.934,59)
Nepal	(91,66)	(53,66)	1.035,66	1.474,37	1.288,40	1.620,83	1.540,46	1.315,03
Nicaragua	126,21	1.718,18	10.237,97	7.112,60	7.354,58	5.864,17	4.393,14	4.628,20
Niger	35,90	902,91	1.604,99	1.698,98	1.548,21	1.825,67	2.150,19	-
Nigeria	1.971,42	(3.278,08)	32.536,54	31.223,14	30.235,49	35.671,87	38.712,87	30.286,60
Oman	-	(833,40)	(1.955,54)	3.455,21	1.705,96	(154,17)	(522,33)	(1.668,59)
Pakistan	3.448,38	9.309,60	19.729,49	32.095,37	28.555,56	27.778,08	28.277,04	29.722,46
Papua New Guinea	-	834,65	3.575,35	3.896,04	3.566,93	3.572,39	3.677,70	3.475,32
Paraguay	109,83	154,80	75,17	2.093,92	919,33	828,82	1.967,45	1.807,91
Peru	3.590,63	7.063,31	19.363,12	31.150,95	31.705,18	33.519,48	34.738,55	36.001,46
Philippines	2.235,62	12.029,71	26.678,13	48.271,09	47.221,24	49.039,58	52.286,96	49.943,58
Poland	-	26.509,75	37.972,27	55.927,00	58.536,82	74.345,03	95.156,56	129.031,45
Qatar	(255,14)	(20.703,61)	(56.421,68)	(43.424,79)	(47.687,68)	(49.807,22)	(55.061,87)	(61.895,56)
Romania	-	-	(2.360,97)	7.603,07	8.568,90	10.719,45	18.796,15	24.852,64
Rwanda	(10,11)	(114,44)	636,91	958,42	963,71	1.093,41	1.167,99	1.291,35
Saudi Arabia	(6.468,47)	(116.762,12)	(82.016,75)	(66.798,04)	(77.140,33)	(89.022,80)	(104.247,74)	(159.825,31)
Senegal	283,96	1.651,60	3.481,40	3.398,94	3.411,42	3.525,27	3.122,63	2.709,17
Slovak Republic	-	-	-	3.914,37	5.327,69	6.306,73	9.816,82	15.429,81
Slovenia	-	-	-	2.397,28	1.362,50	987,58	3.883,47	5.897,85
Sri Lanka	503,69	1.443,96	4.724,86	9.423,15	8.841,55	9.701,50	10.519,61	11.233,27
Sudan	349,07	4.520,49	13.225,23	15.997,85	16.718,12	17.888,16	19.734,45	20.629,14
Swaziland	32,16	310,08	(18,53)	(615,62)	(928,50)	(719,48)	(523,18)	(351,68)
Syrian Arab Republic	220,61	2.679,00	10.905,61	15.838,15	13.447,71	11.944,55	12.365,84	12.757,70
Taiwan Province of China	-	(11.641,75)	(118.923,96)	(234.202,07)	(255.101,92)	(308.044,21)	(375.863,87)	(431.975,11)
Tajikistan	-	-	-	1.234,73	1.000,08	1.049,18	1.032,89	992,76
Tanzania	131,56	4.667,79	5.172,98	6.440,73	6.105,40	6.562,54	6.453,71	6.565,42
Thailand	384,13	7.181,02	26.608,81	66.026,73	58.141,17	49.710,29	54.104,60	47.680,52
Togo	44,46	1.197,34	917,39	1.467,91	1.592,65	1.701,85	1.940,61	1.864,92
Trinidad and Tobago	788,57	(82,63)	4.567,52	7.835,19	7.771,69	8.096,47	8.225,23	8.678,93
Tunisia	967,85	5.254,43	12.691,07	20.419,09	21.868,60	25.207,64	29.126,13	31.174,14
Turkey	2.265,72	15.525,05	40.070,88	92.259,06	78.983,65	98.249,57	116.191,89	142.015,82
Turkmenistan	-	-	-	39,82	(454,94)	(1.181,94)	(1.722,39)	(1.709,91)
Uganda	120,62	537,02	2.321,48	2.385,92	2.596,58	3.057,60	3.564,65	3.994,30
Ukraine	-	-	-	15.997,60	15.966,29	15.944,67	15.903,82	11.972,75
United Arab Emirates	-	(22.123,12)	(90.540,93)	(168.298,94)	(149.730,07)	(142.384,10)	(178.377,41)	(221.384,65)
Uruguay	429,66	1.607,88	2.670,49	2.451,54	1.848,06	1.335,10	1.407,08	2.776,53
Uzbekistan	-	-	-	3.749,89	3.842,89	3.782,55	3.158,92	2.788,89
Venezuela, Rep. Bol.	(472,39)	11.457,18	1.048,56	16.483,72	17.356,47	(4.724,40)	(11.779,13)	(18.025,20)
Vietnam	-	-	-	18.949,85	19.234,65	20.506,56	24.374,90	26.353,14
Yemen, Republic of	-	-	6.955,89	(1.370,36)	(2.272,28)	(3.787,96)	(4.247,96)	(5.155,62)
Yugoslavia	-	-	-	12.222,36	12.055,95	11.605,36	14.197,36	15.053,36
Zambia	123,57	3.292,82	7.552,99	7.644,04	7.182,42	6.345,75	6.446,14	6.111,34
Zimbabwe	-	693,28	3.119,22	4.352,41	4.273,93	4.468,59	5.044,55	-
TOTAL	40.042	3.616	188.613	540.590	457.148	357.726	330.670	175.384

BCIMRS	1970	1980	1990	2000	2001	2002	2003	2004
Brazil	6.652	73.905	101.885	270.528	259.521	227.924	280.706	295.506
China,P.R.: Mainland	-	-	(1.323)	45.754	51.776	360	(26.692)	(131.659)
India	9.180	14.356	81.050	78.837	76.374	71.231	74.478	71.981
Mexico	7.256	55.928	88.864	225.578	233.296	239.480	261.376	292.800
Russia	-	-	-	(30.957)	(14.489)	(22.512)	4.803	(2.769)
South Africa	8.255	24.477	12.880	20.935	12.578	3.896	3.437	10.858
Total	31.342	168.667	283.355	610.675	619.057	520.379	598.108	536.716

4. Stocks of FDI.
Source: Lane P R and Milesi-Ferretti G M, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 - 2004', (2007) 73 Journal of International Economics 223.

High Income OECD	1970	1980	1990	2000	2001	2002	2003	2004
Australia	5.754,70	25.201,36	43.136,99	25.753,24	2.136,35	32.768,83	49.147,50	68.929,04
Austria	830,00	2.632,85	5.497,80	5.018,00	5.229,94	541,73	- 1.765,67	- 4.737,38
Belgium	- 298,33	1.268,92	17.751,96	15.446,30	22.078,33	31.804,97	43.199,65	101.841,49
Canada	20.623,27	30.379,80	28.036,11	- 24.923,55	- 36.935,30	- 50.165,51	- 37.897,54	- 65.958,69
Czech Republic	-	-	-	20.905,83	25.956,56	37.196,24	43.003,12	53.353,94
Denmark	754,14	1.120,18	- 3.608,06	569,29	- 2.813,72	- 3.869,84	- 2.404,32	- 2.507,68
Finland	19,23	- 196,36	- 6.094,94	- 27.836,84	- 28.154,89	- 29.916,26	- 25.828,35	- 25.840,40
France	- 10.008,78	- 6.506,32	7.158,58	- 405.698,00	- 437.301,06	- 331.598,94	- 413.127,30	- 458.482,86
Germany	2.913,20	- 6.014,26	- 49.513,19	- 24.219,98	- 134.259,00	- 73.373,34	- 71.614,63	- 78.984,09
Greece	277,94	2.114,89	7.635,08	6.627,95	6.920,85	6.559,62	10.304,82	14.157,67
Iceland	12,41	5,69	71,86	- 173,10	- 154,97	- 457,93	- 517,06	- 2.089,29
Italy	1.977,63	2.392,26	2.735,93	- 59.109,08	- 68.942,34	- 63.677,06	- 57.996,96	- 59.764,86
Japan	- 364,00	- 16.340,00	- 191.590,00	- 228.124,73	- 249.794,56	- 226.094,04	- 245.770,31	- 273.554,57
Korea	142,00	777,14	303,83	1.736,00	3.245,50	5.045,51	2.419,04	10.953,65
Netherlands	- 5.021,60	- 22.967,83	- 38.168,64	- 61.728,44	- 49.273,48	- 46.561,23	- 73.166,85	- 94.290,01
New Zealand	339,84	1.479,43	7.836,88	16.324,41	14.553,95	21.927,09	34.965,23	41.808,01
Norway	155,02	2.855,54	- 1.487,15	- 11.543,65	- 19.514,27	- 23.634,85	- 43.997,22	- 53.598,06
Portugal	-	655,38	8.528,97	11.440,06	12.419,72	20.232,18	23.309,26	19.657,97
Spain	2.348,98	8.915,82	50.264,45	- 11.371,16	- 14.397,04	17.062,98	35.718,73	15.800,11
Sweden	375,15	- 2.926,41	- 41.429,73	- 115.154,69	- 135.270,68	- 83.399,43	- 73.304,40	- 89.347,81
United Kingdom	- 9.941,04	- 16.194,15	- 2.812,95	- 443.274,42	- 347.643,48	- 454.008,60	- 559.794,36	- 535.407,26
United States	- 75.236,51	- 160.539,82	- 192.162,04	89.221,00	245.360,00	4.832,00	- 260.986,00	- 600.483,00
TOTAL	**- 64.346,76**	**- 151.885,90**	**- 347.908,26**	**- 1.220.115,56**	**- 1.186.553,58**	**- 1.208.785,89**	**- 1.626.103,62**	**- 2.018.544,07**

Tax Haven	1970	1980	1990	2000	2001	2002	2003	2004
Bahrain	122,00	- 598,17	- 228,29	3.965,05	3.829,45	3.856,24	3.631,74	3.461,41
Costa Rica	182,20	662,85	1.152,75	4.821,94	5.346,04	5.787,23	6.181,19	6.725,92
Cyprus	-	474,81	1.158,23	3.501,63	3.935,58	5.688,19	7.093,44	8.283,94
Hong Kong S.A.R. of China	-	4.674,00	36.999,85	67.089,66	66.745,65	26.848,56	41.692,77	49.940,31
Ireland	352,89	4.712,15	8.503,89	99.163,39	93.233,61	124.017,16	148.470,70	128.993,59
Jordan	24,00	136,54	404,34	2.031,41	2.193,40	2.192,03	2.647,34	3.253,87
Latvia	-	-	-	2.060,23	2.288,62	2.692,20	3.182,94	4.355,07
Lebanon	100,00	119,96	109,72	765,28	972,01	2.230,40	4.744,21	6.030,58
Luxembourg	-	-	-	20.843,20	33.443,57	12.108,98	34.675,15	67.838,96
Malta	46,10	185,33	516,32	2.418,02	2.658,52	2.421,41	3.234,11	3.592,25
Mauritius	- 0,60	24,88	173,70	486,33	430,96	485,77	617,36	548,89
Panama	1.272,30	2.511,71	2.248,41	6.774,90	7.314,30	7.412,90	8.183,70	9.196,00
Singapore	312,56	3.647,84	22.343,27	56.364,38	44.139,49	44.279,59	54.592,25	65.437,08
Switzerland	- 3.991,20	- 14.761,67	- 31.842,38	- 128.036,05	- 145.341,44	- 145.032,67	- 154.101,63	- 175.145,90
TOTAL	**- 1.579,75**	**1.790,23**	**41.539,80**	**142.249,37**	**121.189,75**	**94.988,00**	**164.845,28**	**182.511,97**

Developing Country	1970	1980	1990	2000	2001	2002	2003	2004
Albania	-	-	-	490,50	702,45	837,44	1.029,38	1.462,53
Algeria	850,50	2.028,11	1.899,15	3.860,23	5.059,15	5.990,75	6.553,70	7.095,45
Angola	-	60,82	1.024,35	7.977,91	10.123,38	11.766,77	15.250,16	16.657,85
Argentina	1.965,20	3.283,16	9.964,96	69.637,34	69.526,35	23.482,29	29.117,79	32.706,51
Armenia	-	-	-	510,28	574,35	662,43	770,98	979,83
Azerbaijan	-	-	-	3.261,44	3.475,52	4.542,31	7.379,40	8.839,96
Bangladesh	-	307,70	323,69	2.402,80	2.494,84	2.496,04	2.944,21	3.401,81
Belarus	-	-	-	1.281,70	1.377,10	1.642,20	1.892,40	2.048,80
Benin	19,00	43,67	168,66	543,08	584,63	596,79	641,21	701,21
Bolivia	106,47	397,51	372,62	5.158,30	5.861,57	6.535,63	6.730,53	6.844,21
Bosnia and Herzegovina	-	-	-	389,59	508,09	775,86	1.157,64	1.655,07
Botswana	-	641,57	1.508,47	1.748,99	925,49	125,30	460,01	469,32
Brunei Darussalam	-	-	39,35	3.427,79	3.945,53	4.954,14	6.964,10	7.067,35
Bulgaria	-	-	-	2.170,30	2.661,00	3.537,30	6.200,00	9.783,30
Burkina Faso	-	26,83	46,92	129,03	137,25	150,56	177,77	211,77
Cambodia	-	-	-	1.386,64	1.518,20	1.645,86	1.716,81	1.834,11
Cameroon	193,00	487,17	1.065,83	970,16	923,73	950,80	989,51	1.002,01
Chad	1,00	121,77	205,54	500,07	959,94	1.884,00	2.596,66	3.074,81
Chile	2.516,05	5.593,25	8.578,30	34.599,45	32.779,51	30.420,30	41.088,03	48.292,88
Colombia	781,00	1.328,00	4.502,00	8.002,21	12.242,57	14.276,28	16.028,74	20.418,96
Congo, Dem. Rep. of	-	-	-	-	-	-	-	-
Congo, Republic of	5,10	314,83	571,85	1.886,86	1.958,20	2.285,18	2.486,18	3.154,57
Côte d'Ivoire	178,72	735,76	1.179,39	1.571,98	1.828,97	2.474,23	3.103,70	4.250,61
Croatia	-	-	-	2.692,97	3.272,40	5.083,78	8.438,39	10.614,45
Dominican Republic	274,94	940,89	1.257,91	5.945,68	7.065,92	7.085,91	6.238,31	10.117,11
Ecuador	210,57	1.169,76	1.328,57	6.948,35	8.281,73	9.555,62	11.096,50	12.330,55
Egypt	52,74	2.280,86	10.909,45	18.576,77	19.107,47	19.663,93	19.810,21	20.830,48
El Salvador	86,55	242,75	385,54	2.101,49	2.417,35	2.927,28	3.005,11	3.583,83
Equatorial Guinea	-	-	25,35	1.319,81	2.264,84	2.588,23	4.018,89	-
Estonia	-	-	-	2.385,66	2.718,16	3.550,37	5.972,78	8.648,53
Ethiopia	17,00	122,71	137,51	519,54	868,94	1.123,94	1.588,94	2.134,04
Fiji	101,00	241,02	462,90	725,06	765,64	781,87	800,92	-
Gabon	334,00	765,50	1.375,93	- 150,39	- 272,45	- 153,25	156,81	489,11
Georgia	-	-	-	693,96	787,48	962,22	1.352,82	2.091,75
Ghana	314,00	479,10	565,46	1.527,73	1.570,77	1.613,45	1.793,79	1.953,41
Guatemala	218,30	951,65	1.403,31	3.227,01	3.661,69	4.005,41	4.155,74	4.953,77
Guinea	-	1,24	69,31	256,78	253,45	276,45	355,42	455,42
Haiti	47,00	122,80	184,98	244,69	249,09	253,79	261,59	-
Honduras	193,00	277,05	567,65	1.609,43	1.802,53	1.977,85	2.224,99	2.517,99
Hungary	-	-	531,78	21.328,91	25.583,23	33.849,65	43.913,94	55.991,31
Indonesia	342,99	2.476,28	4.819,96	7.345,88	4.477,81	6.079,06	5.963,27	6.095,55
Iran, Islamic Republic of	54,00	3.799,02	2.876,27	2.870,28	2.956,99	3.465,96	4.303,48	4.901,91
Israel	250,08	895,63	774,89	12.313,66	13.635,51	11.336,48	14.151,58	12.145,93
Jamaica	864,25	1.246,45	454,65	2.572,03	3.233,32	3.514,72	3.685,17	4.606,59
Kazakhstan	-	-	-	10.062,14	12.926,30	15.047,12	17.286,70	23.319,66
Kenya	188,00	542,39	761,90	937,92	938,11	972,33	1.064,15	1.117,14
Kuwait	-	- 1.015,77	- 3.635,69	- 907,16	- 1.417,95	- 1.253,01	- 1.279,73	- 3.173,75
Kyrgyz Republic	-	-	-	413,40	401,54	439,80	452,20	593,74
Lao People's Dem.Rep	-	2,20	14,20	594,56	618,43	643,43	662,83	679,83
Libya	-	- 156,05	- 235,33	- 1.167,20	- 1.271,26	- 817,13	- 561,16	870,46
Lithuania	-	-	-	2.304,98	2.617,65	3.921,82	4.840,13	5.966,02
Macedonia	-	-	-	343,30	776,52	982,30	1.278,35	1.501,93
Madagascar	10,00	40,72	74,13	312,42	405,48	413,77	426,50	471,50
Malawi	28,00	132,83	217,50	339,24	358,54	364,44	374,44	-
Malaysia	772,68	4.414,31	10.082,50	27.964,31	28.948,59	29.193,53	27.517,37	28.715,71
Mali	6,00	- 3,08	23,01	336,92	441,39	683,62	814,46	993,46
Moldova	-	-	-	415,77	513,23	651,52	725,19	876,04
Morocco	250,31	387,81	766,89	6.492,38	9.542,67	11.340,24	16.161,25	18.855,57
Mozambique	-	14,67	40,20	1.069,95	1.325,37	1.672,96	2.009,64	2.254,34
Myanmar	9,70	14,83	294,89	3.878,59	4.070,59	4.261,99	4.553,19	5.109,59
Namibia	-	-	146,60	1.231,38	1.612,98	1.792,12	1.948,98	2.251,98
Nepal	-	10,60	20,94	106,27	127,12	121,16	135,94	145,94
Nicaragua	-	100,50	110,60	1.487,80	1.638,00	1.841,90	2.043,20	2.293,20
Niger	30,00	210,39	254,15	260,18	286,70	290,82	305,73	-
Nigeria	1.414,00	3.658,32	8.111,93	17.509,12	18.605,87	20.307,75	22.146,70	23.760,86
Oman	70,00	546,84	1.779,87	2.617,65	3.007,85	3.032,79	3.560,79	3.543,79
Pakistan	398,59	479,05	1.196,90	4.473,64	4.547,80	5.542,97	6.420,42	7.526,35
Papua New Guinea	233,01	721,75	1.568,76	1.720,96	1.724,96	1.750,09	1.901,03	1.937,91
Paraguay	42,78	275,39	229,74	1.374,50	1.165,99	839,27	1.044,84	1.130,67
Peru	734,91	1.289,29	1.037,59	14.576,29	15.682,87	17.354,45	18.947,61	21.800,33
Philippines	460,64	1.054,27	3.004,59	11.912,24	13.052,42	14.322,18	13.871,88	14.267,01
Poland	-	- 82,35	- 35,25	33.209,00	40.091,00	46.863,00	55.731,00	82.389,00
Qatar	94,69	171,99	156,46	1.797,05	2.063,17	2.743,26	3.251,56	4.609,86
Romania	-	-	- 66,10	6.343,70	7.521,50	7.654,80	12.607,01	18.226,50
Rwanda	15,00	70,83	228,56	263,82	268,45	271,06	275,72	283,38
Saudi Arabia	818,00	-	26.461,73	28.866,68	28.929,97	28.265,84	27.625,57	25.693,03
Senegal	190,00	326,70	409,48	918,22	948,10	1.007,45	1.077,53	1.149,81
Slovak Republic	-	-	-	4.140,03	5.133,72	8.044,26	11.236,30	14.775,02
Slovenia	-	-	-	2.125,10	1.599,81	2.581,27	4.078,86	4.530,21
Sri Lanka	138,80	140,88	534,41	1.973,87	2.082,69	2.365,25	2.637,12	2.915,58
Sudan	34,00	61,30	87,64	1.366,23	1.996,39	2.818,48	4.362,88	6.216,09
Swaziland	-	224,47	272,23	265,27	101,56	353,97	457,06	661,33
Syrian Arab Republic	-	0,22	374,28	8.223,63	9.170,63	10.200,63	11.284,63	12.490,63
Taiwan Province of China	42,69	- 7.058,74	- 11.986,43	- 44.461,03	- 46.398,56	- 51.260,38	- 57.961,41	- 62.298,60
Tajikistan	-	-	-	146,00	155,50	191,56	223,21	495,24
Tanzania	59,85	104,01	149,50	1.812,44	2.154,56	2.397,38	2.651,19	2.900,31
Thailand	331,49	1.386,86	8.037,96	28.428,79	31.218,31	32.435,76	36.784,88	37.626,58
Togo	57,00	230,08	312,21	465,34	536,17	587,17	627,24	690,24
Trinidad and Tobago	824,59	2.363,21	3.293,15	7.787,71	8.621,35	9.434,61	10.675,87	12.230,10
Tunisia	433,93	2.425,71	6.087,00	11.512,31	11.487,43	13.824,30	16.185,55	17.578,79
Turkey	247,53	740,74	3.558,20	9.415,98	9.545,90	11.544,27	17.498,14	20.595,81
Turkmenistan	-	-	-	943,92	1.113,92	1.213,92	1.313,92	1.463,92
Uganda	56,20	62,92	57,97	678,16	790,81	951,00	1.169,76	1.565,28
Ukraine	-	-	-	3.697,22	4.731,65	5.854,89	7.470,89	9.410,45
United Arab Emirates	7,78	409,23	740,43	- 218,20	712,01	1.708,14	1.875,02	2.822,67
Uruguay	95,23	990,19	802,48	2.415,14	2.347,39	1.660,78	1.916,01	2.529,30
Uzbekistan	-	-	-	699,00	782,00	847,00	917,00	1.057,00
Venezuela, Rep. Bol.	3.612,21	3.037,05	1.281,54	28.610,97	32.583,34	20.305,01	24.883,74	24.958,17
Vietnam	-	-	251,51	14.615,09	15.915,36	17.115,47	18.565,47	20.175,57
Yemen, Republic of	-	-	60,14	1.042,54	1.197,68	1.311,98	1.222,87	1.366,45
Yugoslavia	-	-	-	1.319,36	1.484,36	2.046,36	3.451,36	4.479,36
Zambia	9,52	364,41	1.021,92	2.358,82	2.430,52	2.512,52	2.684,52	3.018,52
Zimbabwe	145,90	186,20	29,87	892,94	905,36	907,49	889,12	-
TOTAL	**21.839,52**	**50.260,03**	**127.569,31**	**519.278,61**	**569.739,49**	**566.047,93**	**674.889,73**	**789.829,50**

BCIMRS	1970	1980	1990	2000	2001	2002	2003	2004
Brazil	2.928,28	15.252,41	17.881,15	63.576,97	72.259,83	46.423,86	77.907,08	92.062,63
China,P.R.: Mainland	-	1.074,00	12.648,86	295.156,48	327.485,84	363.289,27	413.047,47	460.568,93
India	1.734,97	1.710,50	3.335,04	17.710,00	21.412,42	25.395,72	32.024,71	34.942,36
Mexico	1.774,24	8.167,48	25.208,53	105.117,38	128.432,00	143.634,70	153.325,80	166.437,90
Russia	-	-	-	12.063,05	8.699,44	8.535,41	5.856,09	11.070,73
South Africa	-	-	-	2.125,10	1.599,81	2.581,27	4.078,86	4.530,21
TOTAL	**6.437,49**	**26.204,38**	**59.073,58**	**495.748,97**	**559.889,34**	**589.860,24**	**686.240,01**	**769.612,75**

5. Stocks of Portfolio Equity.
Source: Lane P R and Milesi-Ferretti G M, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 - 2004', (2007) 73 Journal of International Economics 223.

High Income OECD	1970	1980	1990	2000	2001	2002	2003	2004
Australia	2.975,56	9.345,13	7.419,81	25.877,34	29.192,02	22.286,76	46.043,25	32.246,71
Austria	-140,03	-430,45	-1.386,16	-23.128,97	-16.270,52	-12.812,04	-17.679,47	-9.567,39
Belgium	-317,75	-3.481,14	-28.241,75	-110.450,35	-94.562,61	-86.911,01	-118.758,63	-127.913,45
Canada	2.102,17	2.801,58	-22.820,35	-144.331,04	-143.920,45	-116.159,52	-119.077,70	-89.927,97
Czech Republic	0,00	0,00	0,00	620,10	1.656,54	1.381,27	3.642,74	6.061,38
Denmark	22,52	17,31	-2.196,38	-30.456,83	-24.135,12	-15.124,36	-20.859,98	-20.969,33
Finland	0,00	28,84	1.180,51	184.097,56	107.881,70	66.236,94	67.226,96	48.404,95
France	-2.486,01	-6.138,96	14.630,00	292.083,95	214.244,03	145.035,21	156.233,10	149.286,16
Germany	-266,57	4.880,00	35.740,00	-272.309,89	-196.048,71	-225.086,68	-212.351,98	-261.613,10
Greece	0,00	-401,25	302,82	7.094,56	4.701,84	5.765,62	12.061,75	22.874,27
Iceland	0,00	0,00	0,00	-2.024,18	-1.677,49	-1.407,72	-2.769,52	-3.768,66
Italy	-245,92	-384,44	4.447,33	-119.209,75	-119.758,81	-134.035,25	-176.347,24	-160.447,85
Japan	1.358,89	12.417,73	27.429,93	287.979,98	148.698,70	129.111,72	286.559,58	378.610,96
Korea	0,00	47,65	917,12	32.681,06	63.078,29	68.056,68	105.224,48	133.433,46
Netherlands	2.967,54	5.754,11	22.721,77	96.982,29	48.954,45	44.863,39	-37.807,91	-68.869,14
New Zealand	0,00	0,00	1.137,21	-4.309,60	-3.448,20	-3.597,50	-9.169,56	-8.547,86
Norway	-100,06	80,20	6.434,52	-20.712,15	-25.492,44	-39.041,60	-53.731,33	-54.700,92
Portugal	-184,14	-606,58	464,42	11.249,12	8.049,00	9.020,97	23.554,65	32.872,29
Spain	421,82	185,85	17.748,33	52.531,39	57.177,07	67.645,53	99.158,75	135.090,20
Sweden	99,39	266,94	-3.685,50	25.914,94	-28.755,47	-40.859,15	-52.822,57	-55.139,09
United Kingdom	-9.710,13	-20.568,24	-81.276,77	261.296,16	181.020,07	167.314,51	210.021,71	127.970,70
United States	12.252,00	55.055,67	46.193,99	-209.637,00	-39.992,00	-38.873,00	-252.487,00	-449.343,00
TOTAL	**8.749,28**	**58.869,97**	**47.160,86**	**341.838,67**	**170.591,89**	**12.810,78**	**-64.135,90**	**-243.956,68**

Tax Haven	1970	1980	1990	2000	2001	2002	2003	2004
Bahrain	0,00	-312,63	-1.235,92	-3.510,93	-3.246,74	-3.216,99	-4.670,67	-7.522,73
Costa Rica	0,00	0,00	0,00	-120,68	-117,90	89,55	305,38	282,19
Cyprus	0,00	0,00	0,00	-762,00	-608,11	-762,88	-846,65	-1.569,98
Hong Kong S.A.R. of China	0,00	-1.921,56	-5.375,54	49.752,95	8.217,27	-16.431,65	-37.143,11	-56.278,77
Ireland	0,00	-346,45	-2.912,75	86.604,43	145.466,50	190.914,79	259.209,28	306.996,91
Jordan	0,00	0,00	0,00	5,04	9,69	-52,30	-40,17	-126,38
Latvia	0,00	0,00	0,00	-16,64	-8,48	16,49	72,68	68,41
Lebanon	0,00	0,00	0,00	109,27	-399,07	-245,47	-185,11	-480,58
Luxembourg	0,00	0,00	0,00	330.978,85	398.889,92	544.548,61	655.133,87	806.700,69
Malta	0,00	0,00	0,00	91,50	-80,39	-244,96	-424,02	-472,96
Mauritius	0,00	0,00	0,00	60,30	37,94	27,37	-9,16	-58,29
Panama	0,00	0,00	0,00	-50,40	-51,60	-48,60	-45,60	-47,30
Singapore	-49,68	166,26	-1.582,57	-74.500,11	-67.762,88	-54.735,92	-76.555,07	-89.484,47
Switzerland	-152,40	10.002,78	37.387,03	114.763,80	77.975,28	96.498,33	108.967,19	117.199,10
TOTAL	**-202,08**	**7.588,40**	**26.280,25**	**503.405,37**	**558.321,44**	**756.356,38**	**903.768,83**	**1.075.205,83**

Developing Country	1970	1980	1990	2000	2001	2002	2003	2004
Albania	0,00	0,00	0,00	8,77	11,69	13,59	16,93	16,93
Algeria	0,00	0,00	0,00	11,07	14,83	32,38	-0,11	-0,25
Angola	0,00	0,00	0,00	7,30	9,31	16,45	19,77	16,20
Argentina	0,00	369,32	-629,84	-9.387,20	-9.374,62	-8.268,31	-9.856,72	-11.230,27
Armenia	0,00	0,00	0,00	-2,00	-2,05	-1,53	-1,44	-0,27
Azerbaijan	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bangladesh	0,00	0,00	1,99	5,94	2,42	0,11	1,26	5,26
Belarus	0,00	0,00	0,00	-0,50	3,10	9,00	9,90	16,60
Benin	0,00	0,00	0,00	2,88	1,50	8,93	9,69	9,50
Bolivia	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bosnia and Herzegovina	0,00	0,00	0,00	1,67	2,22	1,13	52,02	52,02
Botswana	0,00	0,00	0,00	-116,93	-182,82	-406,96	-926,83	-1.376,76
Brunei Darussalam	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Bulgaria	0,00	0,00	0,00	57,21	28,55	8,62	-81,48	-124,23
Burkina Faso	0,00	0,00	0,00	0,15	-1,54	-0,88	-1,64	-2,05
Cambodia	0,00	0,00	0,00	-154,01	-164,18	-213,02	-228,42	-243,23
Cameroon	0,00	0,00	0,00	6,06	6,19	8,00	6,28	6,28
Chad	0,00	0,00	0,00	0,07	0,09	0,01	0,03	0,00
Chile	0,00	310,67	456,71	-3.754,83	-5.156,59	-7.677,88	-14.281,14	-20.128,81
Colombia	0,00	-22,72	-280,38	-320,17	-86,69	223,84	458,41	1.674,17
Congo, Dem. Rep. of	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Congo, Republic of	0,00	0,00	0,00	-36,24	-39,45	-32,35	-48,69	-55,27
Côte d'Ivoire	0,00	-22,47	-84,63	-154,48	-96,88	-63,56	-100,35	85,27
Croatia	0,00	0,00	0,00	324,90	546,37	453,67	548,42	656,74
Dominican Republic	0,00	0,00	0,00	-198,85	-27,57	17,33	-42,70	-63,60
Ecuador	0,00	0,00	0,00	9,72	11,76	17,29	36,29	48,04
Egypt	0,00	0,00	0,00	1.917,21	1.572,10	1.867,10	1.841,60	4.940,41
El Salvador	0,00	0,00	0,00	202,80	332,39	688,50	1.142,10	1.311,75
Equatorial Guinea	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Estonia	0,00	0,00	0,00	405,22	380,45	598,13	795,26	1.494,25
Ethiopia	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Fiji	0,00	0,00	0,00	0,00	0,00	0,00	9,39	0,00
Gabon	0,00	0,00	0,00	113,33	103,05	60,64	94,85	93,78
Georgia	0,00	0,00	0,00	0,00	13,19	31,69	0,54	0,54
Ghana	0,00	0,00	0,00	269,41	225,28	631,61	1.368,61	1.368,61
Guatemala	0,00	0,00	0,00	68,25	89,80	5,78	1,82	1,82
Guinea	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Haiti	0,00	0,00	0,00	0,09	0,12	0,12	0,12	0,00
Honduras	0,00	0,00	0,00	0,09	0,00	1,10	41,40	41,40
Hungary	0,00	0,00	0,00	2.934,69	2.740,65	3.472,29	4.816,95	10.892,79
Indonesia	0,00	39,62	275,08	5.901,18	5.648,79	8.661,32	16.248,47	26.042,04
Iran, Islamic Republic of	0,00	0,00	0,00	105,49	140,65	15,37	91,38	91,38
Israel	-89,04	-257,16	-480,73	25.803,74	14.156,01	9.453,49	15.669,01	21.129,45
Jamaica	0,00	0,00	0,00	3,41	35,96	26,00	1,13	1,13
Kazakhstan	0,00	0,00	0,00	98,41	134,44	-203,60	-600,24	-1.037,82
Kenya	0,00	2,51	1,69	26,95	29,17	31,18	15,90	-11,81
Kuwait	0,00	0,00	0,00	0,00	-5,25	102,35	15,10	15,10
Kyrgyz Republic	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Lao People's Dem.Rep	0,00	0,00	0,00	2,30	2,30	2,30	2,30	2,30
Libya	0,00	-537,12	-7.264,22	-20.304,61	-17.615,17	-13.888,73	-18.189,62	-20.494,81
Lithuania	0,00	0,00	0,00	122,08	90,65	100,41	132,17	136,28
Macedonia	0,00	0,00	0,00	1,22	1,97	3,01	3,03	18,11
Madagascar	0,00	0,00	0,00	3,19	3,91	106,16	9,84	9,84
Malawi	0,00	0,00	0,00	17,36	21,16	10,29	0,74	0,00
Malaysia	0,00	479,66	2.121,42	12.429,06	11.298,57	11.187,71	17.761,40	24.132,17
Mali	0,00	0,00	0,00	21,53	36,43	33,29	34,52	35,65
Moldova	0,00	0,00	0,00	11,46	13,67	14,13	16,05	18,66
Morocco	0,00	0,00	0,00	706,68	580,11	416,80	606,31	1.296,44
Mozambique	0,00	0,00	0,00	0,00	0,00	0,00	0,00	-27,82
Myanmar	0,00	0,00	0,00	7,01	5,47	4,79	7,84	7,84
Namibia	0,00	0,00	-8,44	12,28	-80,57	-118,24	-490,34	-848,54
Nepal	0,00	0,00	0,00	0,16	0,00	0,00	0,00	0,00
Nicaragua	0,00	0,00	0,00	2,26	3,01	3,01	7,40	7,40
Niger	0,00	0,00	0,00	3,38	1,47	3,72	0,42	0,00
Nigeria	0,00	0,00	0,00	6,85	4,22	7,90	15,00	15,00
Oman	0,00	0,00	0,00	287,09	219,62	280,32	507,85	781,98
Pakistan	0,00	0,00	82,07	1.017,43	552,34	1.313,65	1.666,33	1.822,83
Papua New Guinea	0,00	0,00	0,00	277,63	307,69	358,49	482,22	482,22
Paraguay	-0,44	-0,74	-2,14	-10,30	-14,30	-12,60	-4,00	-4,00
Peru	0,00	-37,62	-215,33	616,84	478,57	696,29	-897,18	-1.394,20
Philippines	0,00	6,88	362,14	2.348,21	2.191,72	1.694,76	2.922,19	4.106,79
Poland	0,00	0,00	0,00	5.162,05	4.083,25	3.986,73	6.382,67	12.614,31
Qatar	0,00	0,00	0,00	37,89	46,46	24,31	35,22	35,22
Romania	0,00	0,00	0,00	154,36	174,46	387,06	578,11	1.393,64
Rwanda	0,00	0,00	0,00	-0,56	-0,53	0,08	-119,03	-124,40
Saudi Arabia	0,00	0,00	0,00	-2.055,27	-1.280,46	-1.050,23	-1.453,53	-1.175,64
Senegal	0,00	26,34	20,38	2,69	13,36	24,50	10,24	4,38
Slovak Republic	0,00	0,00	0,00	-480,33	-34,95	537,40	659,18	2.143,70
Slovenia	0,00	0,00	0,00	160,47	159,91	286,30	299,16	126,04
Sri Lanka	0,00	0,00	0,00	85,95	187,86	74,96	108,03	116,46
Sudan	0,00	0,00	0,00	107,53	143,38	2,00	2,00	2,00
Swaziland	0,00	0,00	15,70	14,51	13,42	12,94	11,11	10,11
Syrian Arab Republic	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Taiwan Province of China	0,00	-9,92	-448,60	-14.530,03	-4.931,66	-12.843,33	-11.367,06	-29.719,39
Tajikistan	0,00	0,00	0,00	0,00	0,00	1,51	1,86	1,86
Tanzania	0,00	0,00	0,00	7,09	8,36	21,21	51,32	51,32
Thailand	31,16	200,34	6.240,19	8.100,08	10.158,07	12.176,11	24.047,18	26.100,86
Togo	0,00	28,53	35,41	89,62	92,42	97,99	105,48	104,34
Trinidad and Tobago	0,00	0,00	0,00	1,90	4,53	7,09	4,14	2,53
Tunisia	0,00	17,29	318,91	512,35	413,70	461,74	567,73	617,63
Turkey	0,00	6,87	27,22	5.850,30	4.324,28	2.377,60	7.512,04	14.486,53
Turkmenistan	0,00	0,00	0,00	9,54	12,72	14,78	20,78	20,78
Uganda	0,00	0,00	0,00	0,00	19,82	2,81	-1,64	-1,72
Ukraine	0,00	0,00	0,00	577,78	723,82	637,07	418,79	491,41
United Arab Emirates	0,00	-2.385,50	-35.089,08	-107.404,40	-89.675,12	-74.361,14	-103.514,19	-127.666,45
Uruguay	0,00	0,00	-25,28	-22,53	-42,59	38,76	-27,76	-64,70
Uzbekistan	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00
Venezuela, Rep. Bol.	0,00	-189,92	-327,46	1.328,03	1.523,71	1.130,86	1.384,03	2.545,06
Vietnam	0,00	0,00	0,00	84,50	85,01	67,98	2.291,40	2.291,40
Yemen, Republic of	0,00	0,00	0,00	-0,65	-1,86	-6,67	-9,25	-17,49
Yugoslavia	0,00	0,00	0,00	0,00	0,59	0,00	0,00	0,00
Zambia	0,00	0,00	0,00	13,87	13,87	13,87	13,87	13,87
Zimbabwe	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00

BCIMRS	1970	1980	1990	2000	2001	2002	2003	2004
Brazil	-	5,81	70,33	42.389,89	34.216,26	23.162,54	55.014,45	75.686,58
China,P.R.: Mainland	-	(10,00)	2.088,90	9.168,42	5.660,55	10.927,46	40.848,43	51.210,59
India	-	179,92	522,27	16.621,64	17.870,57	20.479,59	44.611,16	62.806,77
Mexico	-	2.025,08	5.024,21	45.454,59	48.004,50	37.153,50	47.979,90	65.399,60
Russia	-	-	-	10.717,21	26.973,64	35.538,21	57.633,97	67.713,49
South Africa	2.488,28	4.134,82	1.022,28	(6.380,33)	(11.831,03)	(10.899,65)	(14.802,71)	(7.131,05)
TOTAL	**2.488,28**	**6.335,63**	**8.727,98**	**117.971,41**	**120.894,49**	**116.361,65**	**231.285,20**	**315.685,98**

6. Stocks of Portfolio Debt and Other Investments.
Source: Lane P R and Milesi-Ferretti G M, 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970 - 2004', (2007) 73 Journal of International Economics 223.

High Income OECD	1970	1980	1990	2000	2001	2002	2003	2004
Australia	2.971,56	10.509,88	110.963,13	163.358,53	164.613,36	194.247,37	272.272,50	329.809,90
Austria	1.444,43	13.223,11	19.659,08	73.217,42	73.947,84	69.116,39	69.394,27	72.478,70
Belgium	50,42	3.048,04	25.691,94	(35.645,59)	(30.339,63)	(34.151,96)	(37.046,32)	(70.776,08)
Canada	11.616,12	61.868,04	216.240,41	253.622,21	275.645,18	302.130,94	319.106,23	314.850,94
Czech Republic	-	-	-	(3.285,44)	(6.300,18)	(1.405,30)	1.053,51	6.198,48
Denmark	2.692,14	23.168,96	71.897,60	68.703,95	71.752,65	80.855,52	93.091,99	96.692,63
Finland	3.580,25	9.820,34	54.473,85	34.843,51	30.016,20	28.556,10	13.099,84	13.565,15
France	4.920,47	8.851,58	100.938,79	55.271,70	88.923,17	80.120,68	164.947,80	224.882,71
Germany	(3.984,50)	8.850,00	(252.590,00)	327.209,39	249.570,06	270.927,45	199.410,02	168.559,88
Greece	207,06	4.725,19	13.023,38	46.897,20	50.988,49	77.837,66	101.152,41	116.135,37
Iceland	151,63	1.023,45	3.368,26	8.003,13	7.981,21	9.524,31	11.881,70	18.291,91
Italy	(3.043,47)	24.094,57	180.653,91	293.904,01	290.890,69	406.945,94	503.304,24	553.453,92
Japan	(8.834,66)	17.122,27	(85.489,94)	(856.680,10)	(859.119,88)	(897.901,36)	(983.245,21)	(1.052.043,11)
Korea	2.810,98	26.166,87	28.824,08	72.363,50	63.793,26	74.542,51	78.276,78	82.230,24
Netherlands	(1.788,33)	3.365,25	(19.673,07)	46.440,32	65.302,57	124.437,69	184.284,33	194.145,56
New Zealand	518,78	5.663,12	22.449,91	30.828,52	30.574,65	38.279,61	44.716,93	58.850,62
Norway	1.904,94	22.525,09	24.457,65	25.016,97	10.681,00	11.387,71	2.687,24	(9.861,19)
Portugal	-	7.817,34	14.984,97	34.572,63	42.749,82	54.203,94	54.156,71	68.254,08
Spain	2.721,10	19.358,96	47.509,67	140.095,75	155.527,68	195.664,19	243.538,26	348.873,68
Sweden	374,81	17.272,37	120.042,15	108.821,08	129.009,70	146.482,49	175.490,60	197.454,27
United Kingdom	15.182,12	25.270,00	151.704,68	277.037,38	308.421,76	405.617,53	508.891,14	733.288,84
United States	906,00	18.187,33	485.123,00	1.829.823,00	2.264.041,00	2.647.757,00	3.069.420,00	3.781.662,00
TOTAL	34.401,86	331.931,77	1.334.253,45	2.994.419,06	3.478.670,58	4.285.176,40	5.089.884,96	6.246.998,51

Tax Haven	1970	1980	1990	2000	2001	2002	2003	2004
Bahrain	(84,56)	(429,28)	(1.567,31)	(5.919,86)	(5.636,48)	(5.318,62)	(4.282,71)	(2.532,98)
Costa Rica	228,00	2.093,90	2.222,10	2.369,70	2.610,68	3.035,99	3.697,99	3.561,00
Cyprus	-	(161,43)	630,08	2.839,55	3.138,54	(798,04)	(789,92)	(4.761,24)
Hong Kong S.A.R. of China	-	(8.935,75)	(161.011,39)	(226.799,86)	(223.531,69)	(240.508,25)	(280.061,83)	(293.547,95)
Ireland	891,25	7.847,28	20.054,90	(172.572,39)	(217.331,22)	(280.585,98)	(362.805,59)	(387.641,40)
Jordan	(9,00)	610,36	6.221,55	5.004,90	4.511,93	5.459,66	5.338,59	4.885,98
Latvia	-	-	-	1.201,62	1.973,93	2.570,87	3.383,28	5.020,19
Lebanon	236,23	2.903,62	6.394,77	16.268,23	16.935,35	19.019,05	25.220,53	26.844,43
Luxembourg	-	-	-	(369.680,21)	(446.342,64)	(567.800,70)	(725.465,51)	(915.312,67)
Malta	144,31	250,98	20,59	(1.035,78)	(1.059,12)	(1.304,52)	(1.447,95)	(2.027,34)
Mauritius	23,05	452,78	736,84	350,91	5,40	(17,98)	(128,18)	(115,58)
Panama	256,34	2.093,38	3.879,40	4.047,51	5.337,94	5.348,79	4.771,68	4.125,48
Singapore	192,42	1.262,24	(3.668,76)	(46.920,43)	(45.809,62)	(51.285,29)	(53.039,28)	(50.443,81)
Switzerland	(9.114,94)	(60.471,78)	(185.431,99)	(216.056,26)	(195.115,07)	(269.506,46)	(309.808,09)	(336.584,21)
TOTAL	(7.236,90)	(52.483,70)	(311.519,22)	(1.006.902,37)	(1.100.312,08)	(1.381.691,49)	(1.695.417,00)	(1.948.530,12)

Developing Countries	1970	1980	1990	2000	2001	2002	2003	2004
Albania	-	-	-	809,58	791,37	723,20	933,23	1.084,41
Algeria	758,51	14.747,10	25.638,90	19.607,70	16.650,40	16.460,10	16.648,40	16.837,00
Angola	-	8.936,39	11.121,20	6.320,53	5.519,63	4.108,66	5.120,34	3.883,88
Argentina	5.106,02	21.123,00	37.909,00	77.602,80	76.512,07	62.447,54	67.119,94	69.786,74
Armenia	-	-	-	1.103,35	1.187,48	1.262,03	1.289,37	1.234,15
Azerbaijan	-	-	-	1.301,10	989,10	971,25	1.172,35	1.516,18
Bangladesh	-	3.563,81	11.322,20	14.343,57	13.963,07	15.441,00	16.660,50	16.796,44
Belarus	-	-	-	1.497,17	2.128,36	2.433,99	2.604,54	3.157,47
Benin	30,43	387,80	1.199,91	1.256,66	1.292,17	1.394,31	1.380,45	(512,62)
Bolivia	542,00	2.360,00	3.332,00	4.471,88	3.174,09	3.326,19	3.459,65	3.184,50
Bosnia and Herzegovina	-	-	-	1.555,92	1.076,68	1.400,60	1.812,11	1.700,07
Botswana	-	156,67	354,27	892,04	761,52	383,72	45,60	(236,67)
Brunei Darussalam	-	-	(15.504,30)	(25.681,44)	(29.005,65)	(32.372,75)	(37.204,01)	(40.996,79)
Bulgaria	-	-	-	5.962,30	5.028,50	6.322,80	8.332,00	10.469,42
Burkina Faso	-	304,41	720,66	1.341,52	1.120,22	1.376,41	1.409,51	1.433,46
Cambodia	-	-	-	1.273,58	1.192,98	1.243,04	1.301,06	1.458,31
Cameroon	131,48	1.014,40	4.323,35	6.671,86	6.239,76	4.463,38	5.236,76	5.532,99
Chad	30,20	257,91	443,18	1.052,64	1.023,07	1.174,10	1.364,71	1.552,13
Chile	2.282,95	9.457,60	9.435,90	12.593,22	14.802,60	18.827,79	23.146,49	23.252,40
Colombia	1.777,69	3.825,49	10.181,00	22.641,70	22.594,35	23.159,11	23.865,81	24.393,92
Congo, Dem. Rep. of	290,23	3.604,40	8.191,02	11.823,64	12.530,09	9.878,41	9.782,29	-
Congo, Republic of	95,70	1.415,20	4.632,10	4.536,12	4.227,80	4.756,69	5.079,68	(422,53)
Côte d'Ivoire	213,34	7.020,05	14.824,00	11.855,55	8.448,51	9.581,65	10.217,21	9.922,21
Croatia	-	-	-	6.601,43	5.317,22	8.895,65	14.250,37	18.860,56
Dominican Republic	284,00	1.920,90	4.097,30	3.541,80	3.975,20	3.675,80	2.545,39	1.903,23
Ecuador	363,10	5.881,56	12.007,47	12.993,18	13.104,18	14.750,31	14.314,89	14.139,11
Egypt	1.322,00	15.142,81	26.336,46	14.944,76	13.830,06	11.555,36	8.285,56	2.963,62
El Salvador	119,00	383,00	1.479,41	4.350,91	4.580,70	4.615,20	5.901,70	5.707,70
Equatorial Guinea	5,00	75,60	219,00	191,29	145,90	95,40	170,02	-
Estonia	-	-	-	906,51	823,59	1.271,63	1.911,86	3.068,12
Ethiopia	93,45	599,13	8.125,93	4.948,89	4.295,33	4.298,17	4.347,84	4.511,42
Fiji	11,70	168,20	191,00	79,04	30,10	(2,60)	13,60	-
Gabon	47,37	1.334,00	3.271,46	3.351,32	2.975,47	3.071,10	3.057,10	3.044,58
Georgia	-	-	-	1.392,94	1.458,94	1.496,21	1.576,90	1.678,75
Ghana	510,20	1.060,70	2.914,10	5.832,90	5.847,80	6.259,60	6.454,30	6.381,57
Guatemala	79,00	497,00	1.081,00	1.244,00	1.680,00	1.522,90	1.963,50	2.246,61
Guinea	327,80	1.089,50	2.320,20	3.115,90	2.860,30	3.041,90	3.006,70	2.821,19
Haiti	26,80	220,90	462,50	788,20	820,50	796,20	994,37	-
Honduras	55,42	1.235,50	2.957,10	3.069,20	2.274,00	2.716,30	2.902,78	3.229,86
Hungary	-	-	16.715,50	20.825,91	18.862,03	22.747,49	33.276,31	45.165,80
Indonesia	4.301,00	16.573,70	60.125,00	129.310,00	118.823,20	115.663,07	116.667,69	120.323,10
Iran, Islamic Republic of	-	(8.544,00)	(7.989,55)	(12.147,98)	(10.905,75)	(10.999,81)	(10.262,74)	(11.104,19)
Israel	1.026,67	10.298,98	20.585,20	28.564,90	25.379,00	24.243,90	23.021,70	19.322,10
Jamaica	951,68	1.764,00	3.934,10	3.138,60	3.234,10	3.535,80	3.503,64	3.451,42
Kazakhstan	-	-	-	10.185,69	11.554,12	12.766,26	14.479,33	11.188,57
Kenya	272,50	2.890,15	6.115,11	5.372,42	4.672,32	5.069,91	5.630,70	5.267,70
Kuwait	-	(46.142,79)	(90.403,19)	(67.408,15)	(73.131,08)	(79.036,54)	(95.908,85)	(114.360,37)
Kyrgyz Republic	-	-	-	1.516,01	1.603,95	1.619,48	1.755,10	1.724,51
Lao People's Dem.Rep	-	342,20	1.688,46	2.338,18	2.386,37	2.500,83	2.663,53	2.693,71
Libya	-	(5.056,00)	(1.351,58)	(6.520,00)	(8.426,49)	(10.495,49)	(13.751,49)	(21.092,49)
Lithuania	-	-	-	2.947,20	3.166,03	3.535,39	5.326,25	6.032,46
Macedonia	-	-	-	931,48	714,08	989,26	1.017,10	1.003,48
Madagascar	39,97	916,72	3.063,74	3.932,20	3.795,16	3.741,52	3.767,19	4.004,53
Malawi	105,37	735,90	1.372,20	2.445,20	2.330,30	2.707,30	2.913,10	-
Malaysia	(30,95)	3.117,00	5.538,00	23.806,35	25.000,32	23.048,20	18.426,93	15.999,06
Mali	238,11	704,45	2.282,94	2.717,25	2.536,87	2.430,24	2.688,53	2.883,70
Moldova	-	-	-	1.243,53	1.152,75	1.191,85	1.251,69	1.139,97
Morocco	647,47	8.985,00	21.382,00	15.086,70	13.074,40	12.154,00	11.815,20	10.115,74
Mozambique	-	789,10	4.138,60	4.212,20	4.025,30	2.349,50	3.201,71	3.275,26
Myanmar	159,00	1.705,22	5.202,01	5.723,54	5.792,54	5.804,86	5.860,90	5.976,13
Namibia	-	-	336,33	(2.394,02)	(2.809,13)	(3.141,83)	(3.587,40)	(3.992,97)
Nepal	(2,96)	118,50	1.310,00	2.313,35	2.199,00	2.517,30	2.627,00	2.631,26
Nicaragua	174,80	1.682,20	10.234,00	6.111,00	6.093,50	4.467,40	2.844,60	2.995,80
Niger	24,70	818,90	1.573,60	1.515,81	1.367,03	1.665,03	1.958,10	-
Nigeria	759,58	3.298,40	28.288,90	23.618,07	22.082,04	22.687,56	23.679,61	23.415,37
Oman	(300,30)	(798,88)	(2.063,00)	2.930,33	843,44	(293,80)	(997,47)	(2.397,02)
Pakistan	3.186,00	9.326,38	18.746,43	28.117,65	27.095,45	28.999,75	31.131,25	30.172,29
Papua New Guinea	208,80	536,33	2.409,63	2.184,32	1.956,92	1.785,32	1.788,62	1.687,75
Paraguay	85,00	642,00	509,00	1.492,55	481,14	631,34	1.895,47	1.849,29
Peru	3.152,00	7.791,48	19.580,66	24.331,81	24.215,59	24.807,78	26.464,92	27.771,74
Philippines	1.969,98	13.814,70	24.235,75	47.057,20	45.406,10	46.158,10	48.950,30	44.486,79
Poland	-	26.719,70	42.499,66	44.118,00	40.011,00	52.145,00	65.622,00	69.352,00
Qatar	(319,36)	(20.532,15)	(55.947,07)	(44.101,74)	(48.484,62)	(51.007,99)	(55.404,50)	(63.144,70)
Romania	-	-	(1.770,90)	5.027,18	6.314,86	8.802,88	13.651,01	19.848,86
Rwanda	(17,41)	10,80	452,70	885,80	907,90	1.066,00	1.226,00	1.447,01
Saudi Arabia	(6.743,97)	(93.325,50)	(96.810,80)	(74.023,97)	(87.194,11)	(95.627,97)	(107.799,78)	(157.051,86)
Senegal	116,01	1.306,63	3.062,50	2.862,75	2.897,92	3.130,60	3.144,89	2.941,37
Slovak Republic	-	-	-	4.276,96	4.366,43	6.517,16	9.550,24	12.928,55
Slovenia	-	-	-	3.307,72	3.932,77	5.100,25	8.002,37	10.035,00
Sri Lanka	407,63	1.548,57	4.613,36	8.402,33	7.857,81	8.892,24	10.039,39	10.466,15
Sudan	336,81	4.507,92	13.149,00	14.771,40	14.696,20	15.508,60	16.217,10	16.037,13
Swaziland	32,16	244,35	(89,98)	(543,61)	(771,70)	(810,55)	(713,83)	(699,56)
Syrian Arab Republic	248,25	3.023,49	10.694,33	10.390,52	7.739,08	5.964,92	5.640,20	5.201,06
Taiwan Province of China	-	(2.368,10)	(34.047,93)	(68.469,00)	(81.560,70)	(82.284,50)	(99.903,40)	(110.844,05)
Tajikistan	-	-	-	1.181,58	937,15	945,61	919,67	653,20
Tanzania	136,68	4.584,08	5.216,28	5.595,44	5.099,10	5.672,78	5.789,61	5.909,49
Thailand	845,00	7.154,00	25.635,72	61.346,73	48.753,58	42.885,84	34.195,47	32.417,09
Togo	22,86	1.016,85	923,60	1.065,26	1.090,45	1.221,79	1.390,35	1.393,61
Trinidad and Tobago	7,00	334,96	1.766,39	1.431,88	1.052,89	682,49	(3,71)	(385,48)
Tunisia	589,12	3.401,56	7.079,96	10.205,48	11.956,68	13.211,90	15.318,22	16.913,46
Turkey	2.322,32	15.854,44	42.535,00	99.481,22	83.992,67	111.396,30	125.172,70	142.602,62
Turkmenistan	-	-	-	852,44	431,04	(107,25)	(454,96)	(415,40)
Uganda	121,07	477,10	2.307,50	2.515,80	2.769,30	3.037,80	3.476,80	3.738,84
Ukraine	-	-	-	13.075,32	13.466,16	13.694,13	14.744,88	11.373,31
United Arab Emirates	(766,93)	(18.132,10)	(51.608,41)	(47.153,68)	(46.620,60)	(54.511,74)	(61.650,43)	(78.010,95)
Uruguay	348,23	1.001,48	2.416,80	2.537,79	2.640,34	404,70	1.602,00	2.820,40
Uzbekistan	-	-	-	3.932,20	4.003,20	3.960,10	3.890,30	3.546,50
Venezuela, Rep. Bol.	(3.448,00)	15.214,00	8.415,00	(366,80)	(7.511,10)	(17.673,20)	(22.012,20)	(27.153,00)
Vietnam	-	-	6.660,78	7.666,77	6.908,85	7.444,16	9.742,21	10.927,63
Yemen, Republic of	-	(1.061,00)	7.317,95	488,00	190,00	(682,73)	(474,64)	(839,80)
Yugoslavia	-	-	-	11.419,00	11.740,00	11.839,00	14.303,00	14.876,00
Zambia	622,05	3.006,61	6.724,20	5.516,17	4.921,48	4.354,49	3.995,48	3.416,06
Zimbabwe	232,00	720,58	3.238,56	3.652,61	3.433,29	3.644,45	4.226,00	-
TOTAL	**28.533,35**	**90.780,95**	**307.571,33**	**661.032,13**	**542.806,41**	**533.492,57**	**542.018,86**	**429.518,49**

BCIMRS	1970	1980	1990	2000	2001	2002	2003	2004
Brazil	4.864,89	64.416,30	91.373,90	197.049,16	188.781,20	195.876,68	196.851,77	180.286,02
China,P.R.: Mainland	-	-	13.525,00	(90.292,99)	(65.765,28)	(82.729,04)	(72.437,43)	(28.938,53)
India	8.208,00	19.409,21	78.713,89	82.407,20	82.961,29	93.021,46	96.779,94	100.824,67
Mexico	6.050,00	48.695,71	68.493,66	110.515,36	101.600,60	109.286,00	119.025,50	125.102,80
Russia	-	-	-	(29.473,13)	(17.619,23)	(22.532,50)	14.511,65	39.219,93
South Africa	1.489,06	10.146,52	18.665,58	22.272,45	17.465,72	13.069,44	6.205,42	6.542,45
TOTAL	**20.611,95**	**142.667,74**	**270.772,03**	**292.478,05**	**307.424,29**	**305.992,05**	**360.936,84**	**423.037,34**

7. Taxation of Portfolio Investment.
Source: Tax Summary – Pricewaterhousecoopers and IBFD.

Developing Countries	Worldwide or Territorial Taxation of individuals	Nonresident Individuals		Nonresident Corporations		Capital gains on sale of shares in resident companies	N. of Treaties in force
		Interest	Dividend	Interest	Dividend		
Albania	worldwide	10%	10%	10%	10%	10%	28
Algeria	worldwide	10-50%	15%	10-40%	15%	20%	24
Angola	territorial	10%-15%	10%	0%-15%	0%-10%	none	0
Argentina	worldwide	0%-15.05%-35%	0%	0%-15.05%-35%	0%	0%	18
Armenia	worldwide	10%	0%	10%	0%-10%	levied	30
Azerbaijan	worldwide	10%	10%	10%	10%	10%	31
Bangladesh	worldwide	0%-25%	25%	10%-37.5%	0%-20%	0%-15%	25
Belarus	worldwide	0%-12%	15%	0%-10%	15%	24%	57
Benin	worldwide	6%	10%	6%	10%	N/A	2
Bolivia	territorial	12,5%	12,5%	12,5%	12,5%	0%-12.5%	9
Botswana	territorial	15%	15%	15%	15%	N/A	8
Brazil	worldwide	15%-25%	0%	0%-15%-25%	0%	15%-25%	28
Brunei Darussalam	no income tax system	no	no	15%	no	no	5
Bulgaria	worldwide	10%	5%	10%	0%-5%	0%	66
Burkina Faso	worldwide	6%	13%	6%-25%	13%	10%-30%	1
Cambodia	worldwide	14%	14%	14%	14%	levied	0
Cape Verde	territorial	20%	0%	20%	0%	20%	1
Central African Republic	worldwide	15%	15%	15%	15%	0%-50%	1
China,P.R.: Mainland	worldwide	0%-20%	20%	0%-10%	10%	no/yes	89
Colombia	worldwide	0%-33%	0%-33%	0%-33%	0%-33%	33%	4
Congo, Dem. Rep. of	territorial	0%-20%	0%-20%	0%-20%	0%-20%	N/A	0
Croatia	worldwide	0%-35%	0%	0%-15%	0%	0%	47
Dominican Republic	territorial	25%	25%	0%-10%-25%	25%	25%	1
Ecuador	worldwide	5%-25%	0%	0%-5%-25%	0%	0%-25%	14
Egypt	territorial	20%	0%	20%-32%	0%	none	53
El Salvador	territorial	20%	0%	0%-20%	0%-25%	25%	0
Estonia	worldwide	0%-21%	0%	0%-21%	21%	0%	42
Fiji	worldwide	10%	15%	10%	15%	levied	8
French Guyana	worldwide	18%	18%-25%	0%-18%	0%-25%	18%	120
Gabon	worldwide	10-20%	20%	10-20%	20%	20%	3
Georgia	territorial	7,5%	5%	0%-7.5%	5%	levied	25
Ghana	worldwide	8%	8%	8%	8%	5%	6
Guatemala	territorial	10%	0%-10%	0%-10%	0%-10%	N/A	0
Honduras	worldwide	5%	0%	5%-10%	0%	15%-30%	0
India	worldwide	11.33%-21.115%	0%	21%	0%	levied	78
Indonesia	worldwide	20%	20%	20%	20%	levied	56
Iran, Islamic Republic of	worldwide		0%		0%	N/A	25
Kazakhstan	worldwide	15%	15%	15%	0%-15%	0%	39
Kenya	territorial	15%-25%	10%	15%-25%	10%	N/A	8
Korea, Dem. Rep. (North)	worldwide	20%	20%	0%-20%	20%	levied	8
Kuwait	no income tax system	0%	0%	0%	0%	0%	37
Kyrgyz Republic	worldwide	0%	10%	10%	10%	levied	33
Lao People's Dem.Rep	no income tax system	10%	10%	10%	10%	levied	3
Lesotho	worldwide	25%	25%	15%-25%	25%	N/A	3
Libya	worldwide	5%	0%	0%	0%	N/A	10
Lithuania	worldwide	0%-15%	20%	0%-10%	0%-20%	none	46
Macedonia	worldwide	10%	10%	10%	10%	none	35
Madagascar	worldwide	24%	0%	24%	0%	24%	2
Malaysia	worldwide	15%	0%	15%	0%	none	70
Mali	worldwide	0%-18%	10%	0%-18%	10%	0%	4
Moldova	worldwide	0%-10%	15%	0%-10%	15%	10%	41
Morocco	worldwide	0%-10%	0%-10%	10%	0%-10%	15%-20%/ 0%-30%	38
Mozambique	worldwide	0%-10%-20%	20%	0%-20%	20%	10%-32%	4
Myanmar	worldwide	15%	0%	15%	0%	levied	5
Nepal	worldwide	5%-15%	5%	15%	5%	levied	7
Nicaragua	territorial	10%-15%	0%	10%-22.5%	0%	0%	0
Niger	territorial	0%-25%	0%-10%	0%-25%	0%-10%	N/A	2
Nigeria	worldwide	0%-10%	10%	10%	10%	0%-10%	10
Oman	territorial	0%	0%	0%	0%	0%	22
Pakistan	worldwide	0%-10%	10%	0%-10%	10%	0%	49
Papua New Guinea	worldwide	15%	17%	0%-15%	0%-17%	none	8
Paraguay	territorial	6%-15%	8%	6%-15%	15%	15%	0
Peru	worldwide	0%-30%	4%	0%-1%-5%	4%	0%	5
Philippines	worldwide	0%-25%	25%	20%	0%-30%	0%	38
Qatar	no income tax system	0%	0%	0%	0%	N/A	15
Romania	worldwide	0%-16%	16%	0%-10%-16%	0%-16%	1%-16%/0%-16%	85
Russia	worldwide	30%	15%	0%-9%-15%-20%	15%	yes/no	75
Rwanda	worldwide	15%	15%	15%	15%	0%-30%	1
Saudi Arabia	no income tax system	5%	5%	5%	5%	0%	8
South Africa	worldwide	0%	0%	0%	0%	25%	63
Sri Lanka	worldwide	10%	10%	10%	10%	none	37
Swaziland	territorial	10%	12.5%-15%	10%	15%	0%	4
Taiwan Province of China	territorial	20%	30%	20%	25%	levied	16
Tajikistan	worldwide	12%	12%	12%	12%	levied	11
Thailand	territorial	15%	10%	15%	10%	15%	53
Tonga	worldwide	15%	15%	15%	15%	levied	0
Trinidad and Tobago	worldwide	15%	15%	15%	5%-10%	levied	15
Tunisia	worldwide	0%-20%	0%	0%-20%	0%	0%	47
Uganda	worldwide	15%	15%	15%	15%	N/A	8
Ukraine	worldwide	15%	15%	0%-15%	15%	yes/no	66
United Arab Emirates	no income tax system	0%	0%	0%	0%	0%	33
Uruguay	territorial	3%-12%	7%	3%-12%	7%	12%	2
Uzbekistan	worldwide	10%	10%	10%	10%	levied	47
Venezuela, Rep. Bol.	worldwide	34%	0%	4.95%-34%	0%	1%-34%	27
Vietnam	worldwide	10%	0%	10%	0%	0%	38
Zambia	worldwide	15%	0%-15%	15%	0%-15%	0%	18

OECD countries	Worldwide or Territorial Taxation of individuals	Nonresident Individuals		Nonresident Corporations		Capital gains on sale of shares in resident	N. of Treaties in
		Interest	Dividend	Interest	Dividend		
Australia	worldwide	0%-10%	30%	10%	30%	none	44
Austria	worldwide	0%-20%-25%	25%	0%	0%-25%	0%	81
Belgium	worldwide	0%-15%-20%	15%-25%	0%-15%	0%-25%	0%	88
Canada	worldwide	0%-25%	25%	0%-25%	25%	levied	87
Chile	worldwide	4%-35%	35% (17% paid is creditable)	4%-35%	35% (17% paid is creditable)	0%	20
Czech Republic	worldwide	0%-15%	15%	0%-15%	0%-15%	levied	77
Denmark	worldwide	0%	15%-28%	0%	0%-15%-28%	none	75
Finland	worldwide	0%	0%-28%	0%	0%-28%	none	71
France	worldwide	18%	18%-25%	0%-18%	0%-25%	18%	120
Germany	worldwide	0%-25%	25%	0%-25%	0%-25%	levied	89
Greece	worldwide	0%-10%-20%	0%-10%	0%-10%-25%	0%-10%	5%-10%	47
Hungary	worldwide	20%	25%	0%	0%	none	66
Iceland	worldwide	15%	0%	15%	0%-10%	15%	37
Israel	worldwide	0%-15%	20%-25%	25%	20%-25%	25%	47
Italy	worldwide	0%-12.5%-27%	12.5%-27%	0%-12.5%-27%	0% - 1.35%-12.5%-27%	levied	84
Japan	worldwide	15%-20%	7%-20%	0%-15%-20%	7%-20%	15%	46
Korea, Rep.	worldwide	20%	20%	20%	20%	0%	69
Mexico	worldwide	4.9%-28%	0%	4.9%-28%	0%	25%-28%	37
Netherlands	worldwide	0-15%	15%	0-15%	0%-15%	0%-25%	88
New Zealand	worldwide	2%-15%	15-30%	2%-15%	15-30%	none	35
Norway	worldwide	0%	0%-25%	0%	0%-25%	levied	82
Poland	worldwide	0%-20%	19%	5%-20%	0%-19%	19%	79
Portugal	worldwide	0-20%	20%	0-20%	0%-20%	0%-10%/0%-25%	53
Slovak Republic	worldwide	19%	0%	19%	0%	19%	60
Slovenia	worldwide	0%-20%	20%	0%-15%	0%-15%	0%-20%/no	45
Spain	worldwide	0%-18%	18%	0%-18%	0%-18%	0%-18%	76
Sweden	worldwide	0%	30%	0%	0%-30%	none	80
Turkey	worldwide	0%-15%	15%	0%-15%	15%	0%	70
United Kingdom	worldwide	20%	0%	0%-20%	0%	18%/no	113
United States	worldwide	0%-30%	30%	0%-30%	30%	levied	66