BANKING SECRECY AND SLOVAKIA'S ASSESSMENT REPORT

WHAT THE OECD COUNCIL DISCUSSED IN THE TATRAS

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In the second half of September the Council of the Organisation for Economic Co-operation and Development for the first time held its meeting in Slovakia. The official statements of the highest OECD representatives gave a primarily positive evaluation of Slovakia and its ongoing reforms. Issues concerning the activity of the organisation and the issues, which it is currently dealing with, have been mentioned in the Slovak media less frequently. Yet, it was at its meeting in the High Tatras where the OECD Council approved two very important documents. One of them, very symbolically approved in Slovakia, was the final post-accession OECD report on Slovakia. The OECD evaluates in it very positively the successful process of financial liberalisation, restructuring and the revitalisation of the financial sector, the improvement in the investment environment and adherence to the timetable of fulfilling accession commitments[1]. The amendment to the Foreign Exchange Act valid as of 1 January 2003 completed the process of liberalising of the foreign exchange regime, which Slovakia undertook to do upon its entry to the OECD. The remaining restrictions on operations with foreign securities and financial derivatives were cancelled on 1 January 2003. On 1 January 2004 the requirement for SR residents to repatriate foreign incomes will be removed and the prohibition on opening deposit accounts and conducting operations with foreign currency abroad removed. Although the report's approval by the OECD Council went smoothly, the report itself was the result of a thorough review, which Slovakia underwent in the respective OECD committee. Besides this, the report's approval was accompanied by weeks of negotiations between delegations of the European Commission, the USA and Slovakia concerning the issue of evaluating the regulation of imports and the distribution of film works in the SR. The assessment of Slovakia's position concerning its commitment not to restrict the import of foreign films took place in the light of counterpoised interests of the USA and the EU. The export of American film productions to Europe is an important issue for the United States, as is the protection of the European film works for Europe. A positive result achieved is the fact that the approved OECD report evaluates the regime in the field of the import and distribution of audio-visual production as liberalised, where however it takes note of the fact that the SR Council for Radio and Television Broadcasting has the authority to ensure, where practicable and by appropriate means (a quotation of the respective European Directive), to require that the broadcaster reserve a majority of its broadcasting time for European works.

However, it was a different report on the agenda for negotiations at the Council's meeting in the Tatras that caught the attention of foreign journalists, as the Council was also deciding on an evaluation, for the OECD of the politically highly sensitive issue of banking secrecy and its role in tax evasion by dishonest tax payers from around the world. It was no wonder that impatient Swiss journalists were probing around from the very morning as to the state of the Council's negotiations. This is because Switzerland as a fortress of bank secrecy has for several years now been criticised not only by the OECD, but also the European Union. The relatively dramatic negotiations on the issue brought only a brief evaluation of the OECD work in what is, according to a statement by the OECD Council, an important field (see http://www.oecd.org/ document/ 35/0,2340,en_2649_37427_15091043_1_1_1_37427, 00.html). In it the OECD Council shortly states that the OECD has not reached a consensus in adopting a recommendation as to improving access to banking information for tax purposes and that only 26 of its members were willing by 31 December 2005 to create conditions enabling access to banking information. What however is hidden behind this laconic evaluation by the OECD Council?

Primarily the attempt to lift bank secrecy for tax purposes is a part of the wider efforts of the OECD aimed at improving the transparency of the world financial system. The motive is one of making financial flows transparent and to prevent the financing of terrorist groups, as well as the interest of states to protect their tax base. The OECD initiative however also has many critics, who claim that the rich OECD countries are concerned mainly with maintaining high taxes and

[1] The SR became the 30th member of the Organisation for Economic Cooperation and Development (OECD) on 14 December 2000.

a high involvement of the state in redistributing public wealth. However, losses on tax revenues are not limited only to the stated 26 OECD countries and the OECD initiative has received large support also from non-member economies, whose tax bases have been diminished also thanks to the harmful tax practices of other countries. Countries supporting the OECD's efforts include India, South Africa, Russia, Latin American countries and many others. There are many developing countries where corruption, embezzlement, financial fraud, machinations and tax evasion make it impossible for democratically elected governments to finance their needs. Banking secrecy on the one hand enables these negative manifestations, on the other it is an advantageous economic article, which has become a foundation stone to a huge financial industry of many countries.

The OECD initiative in the tax field, besides easing off banking secrecy for tax purposes, includes also an agreement with tax havens on the exchange of information and the elimination of harmful tax regimes in member as well as non-member states that focus on attracting especially some financial activities. For dealing with ever-more non-transparent global financial strategies, exploiting shortcomings in the legal regulations of individual jurisdictions and using illegal procedures, broad international cooperation is necessary. Any inconsistency, in terms of place or time, in the defence against global routes of spreading crime and tax evasion merely shifts them from one place to another counteracting thus the effects of the other procedures.

Through publishing a list of tax havens that had refused to co-operate with the OECD, the OECD in April 2002 opened up a path to cooperation with tax havens on the exchange of tax information. 31 countries identified as tax havens undertook to cooperate with the OECD, while 7 tax havens that refused to cooperate ended up on the OECD blacklist: The Marshall Islands, Nauru, Liberia and Vanuatu, which was removed from the list following an additional commitment to cooperate, and three European states Andorra, Lichtenstein, and Monaco. The tax havens should, according to the OECD and according to their voluntarily adopted commitments create by the end of 2005 the conditions for cooperation, leading to the effective exchange of information. The tax havens wishing to co-operate have undertaken to improve transparency, remove discriminatory practices and primarily become involved in the exchange of international tax information with OECD countries within the date set. Those tax havens that do not fulfil their written commitments made to the OECD expose themselves to the risk of coordinated defensive measures applied by member states, whereby the OECD threatens to use them against those jurisdictions that refuse to cooperate. This means that also member countries of the OECD that do not remove practices providing extensive tax advantages to selected geographically mobile financial activities, for example certain types of holding companies, mutual funds, or providing advantages through modification of the arm's length principle in transfer pricing, etc., should be affected in a similar way. A demonstration of the attractiveness of such tax preferences in practice are, for example, data on foreign investments. According to the recently published World Report on Investment 2003 Luxembourg was the largest recipient of foreign direct investment (FDI) in 2002 in absolute terms, and which USD 126 billion literally "flowed through". The massive inflow of FDI in Luxembourg is only somewhat lower than the total volume of FDI directed into the following three countries heading the FDI rankings – China, France and Germany. However, the truth is that in consequence of the pressure by the OECD, particularly in the recent period extensive changes to sophisticated tax regimes providing tax preferences have occurred in the OECD area. Out of the originally identified 47 potentially harmful tax regimes in 26 of the 30 OECD countries, the majority of them have already been re-evaluated, removed or modified. The remaining preferences applied now in the domestic tax regimes of only a few countries await the same fate at the end of 2003.

Along with the continuing OECD offensive the issue of equal conditions has become extraordinarily topical for tax havens and other regimes assisting tax avoidance. The possibility of "being forced out of the lucrative business of tax avoidance" and its shifting to the remaining other or new financial centres engenders fears among all those operating in the business, which only confirms that all forms of tax procedures harming other countries are closely related. None of the countries, which apply them, wants to free the field for other players and none wants to make the first move.

What, however, the OECD Council was trying to solve in the Tatras was enhancing the process of "improving access to banking information" for tax purposes in OECD member countries. Tax heavens fearing competition from OECD countries, asked several times OECD to co-operate as a whole. In other words they condition their co-operation by the participation of all member countries in all aspects of harmful tax practices, including in curbing bank secrecy. The OECD achieved the progress in many aspects of the access to banking information: in OECD countries anonymous deposit accounts have been removed, the obligation of financial institutions to identify their regular as well as occasional clients has been encoded in law, the requirement to prove domestic tax interests for the exchan-

ge of tax information between countries contractually bound concerning this exchange has been removed, access to banking information has been lifted for criminal tax purposes and the possibility has been created for improving co-operation in the field of the administrative and information systems. Nevertheless, the OECD among its members has not succeeded in achieving a common definition of tax fraud, since Switzerland and Luxembourg are not willing to accept a definition, which would go beyond the framework of domestic legislation. An even greater problem is the exchange of information for civil tax purposes, where four OECD countries: Austria, Belgium, Luxembourg and Switzerland are not willing to make any concessions. Detailed information can be found in the latest OECD report on improving access to bankinformation for tax purposes (http://www.oecd.org/dataoecd/5/0/14943184.pdf). Insufficient progress in both areas means a long-term dilemma for the OECD as regards how to proceed further. Representatives of the governments of OECD countries thus face serious difficulties. On 14-15 October the OECD Global Tax Forum met in Ottawa with tax haven representatives of (see also http://www.oecd.org/document/11/0,2340,en_2649_34897_16658827_1_1_1_37427,00.html), many of which sent representatives at the ministerial level to the meeting. The main interest of tax havens was to clarify with the OECD where does the level-playing field for tax havens and OECD member countries lie. The fate of the OECD's efforts over many years to improve the transparency of the world financial system and achieve the effective exchange of information has come into play more than ever before. The situation in the OECD, where four of its members with strictly regulated banking secrecy refuse to co-operate, has in practice provided an ideal opportunity for tax havens to withdraw from their unwanted cooperation with the OECD, as the tax havens in fact when committing themselves to co-operating with the OECD in exchange of information on taxable income, had done so despite their own applicable laws on banking secrecy. In what is politically a very difficult situation, the OECD has had to admit that no level-playing field in removing banking secrecy at present exists. It has been possible to maintain the prospect of cooperation with the condition that the issue of level-playing field should be dealt with later in certainly very complicated negotiations. However, St. Vincent has withdrawn its commitment and Antigua and Panama have their commitments temporarily suspended.

The possibilities of a global approach of the OECD to the circulation of non-transparent financial flows through bank and tax havens were made more complicated already in January this year when at the EU level a procedure concerning the exchange of information on interest on savings paid by banks to residents of other EU member states was agreed. The European directive adopted in June this year becomes a part of legislation of the member states on 1 January 2004, where its implementing legislation should be adopted over the course of the following year and on 1 January 2005 12 European countries will accede to the automatic exchange of information in this field. This European regulation allows as an alternative to the exchange of tax information the taxation of the interest paid via withholding tax in Belgium, Austria and Luxembourg. Since these economies, thanks to their banking secrecy, attract capital from other countries this exception significantly weakens the impact of this directive. As regards the performance of the automatic exchange of information these countries would be committed only in the case where the European Commission managed to conclude agreements on the exchange of information with Switzerland, Liechtenstein, San Marino, Monaco and Andorra (this would concern the exchange of information according to the OECD agreement on the exchange of information on tax matters upon request, which the OECD drafted for the purposes of the exchange of information with tax havens). Similarly, another condition is to also conclude a similar agreement with the United States on the exchange of information upon request, concerning interest payments on savings. The European directive would then become an important instrument for limiting the outflow of capital from the EU since it would be applied to payments of interest coming from outside the territory of the EU for EU residents. EU members with banking secrecy however justify their unwillingness to move towards the exchange of information in the framework of the time-table set in the OECD, i.e. from 1 January 2006, on the basis of the time-table agreed in the EU, including the last deadline, which is 2011. From this year an agreed withholding tax should begin to be applied in the full amount of 35%, 75% of which is transferred to the country of residence of the deposit account holder. In order to ensure the adoption of equivalent measures, the European Commission is conducting intensive negotiations, where the ministers of finance of the EU have already approved the agreement of January 2003 between the EU and Switzerland as the key country. Following ratification by the contracting parties this treaty will enter into force and come into effect on 1 January 2005, along with the directive. The procedure in the EU here counts also on the situation of administrative cooperation upon request in cases of tax fraud and similar acts , which however requires the concluding of bilateral tax treaties.

Strengthening transparency, the aim of which is not

only the integrity of the financial system, but also the effective prevention of criminal activities, is directly connected with the need to create an effective system for the exchange of information. International institutions such as the OECD, the EU, the FSF, and the FATF are endeavouring to achieve this, where given the complexity of negotiations of their parallel efforts they do not always create synergy. Cooperating tax havens, including those enjoying the interest of Slovak taxpayers, have accepted and so far have left unchanged their commitments to cooperate with the OECD countries. Such commitments includes also the obligation to undertake negotiations and sign an agreement on the exchange of tax information according to the OECD model agreement. Many OECD members have exploited this opportunity and started negotiations on bilateral treaties. The latest for example is an agreement signed on 21 November 2003 between the USA and Holland, enabling the exchange of information on tax matters between the USA and Aruba http://www.treas.gov/press/release/). The EU treaty with Switzerland similarly provides for the possibility to obtain information in criminal as well as civill cases of fraud and similar acts of taxpayers; on the basis of bilateral treaties between member states and Switzerland. Bilateral treaties based on the new OECD model agreement on the exchange of tax information, as well as the dates agreed in them may gradually reduce the significance of the different dates agreed by different international forums and contribute to "a levelling out of the conditions" for tax havens and countries with banking secrecy. Regardless of the popularity that withholding tax on interest on savings enjoys among the superpowers of bank secrecy, this is the more likely scenario for future development than one of a reversal, meaning the end of cooperation with the OECD on the part of tax havens.