Tax Agreements with Tax Havens and Other Small Countries

By Marshall J. Langer

The current hostility of the major OECD countries towards the smaller international financial centers can be eliminated. The current lose-lose situation can be transferred into a win-win scenario by using simplified mini-agreements between developed countries and low-tax or no-tax countries that would provide tax benefits to bona fide resident individuals, but not to companies or other entities.

The world has changed considerably during the past half century; millions of wealthy individuals with trillions of euros and dollars now live in or have retired to small countries with benign tax systems. We should design a simplified mini-agreement that would enable a developed country to attract substantial new investment from wealthy individuals as well as tax information from their countries of residence in return for a reduction in excessive withholding taxes and an appropriate sharing of the withheld taxes between the source and residence countries.

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Most existing income tax treaties are suitable only when both the source country and the residence country impose tax on the worldwide income of all their residents. These treaties do not work well when some or all of the residents of either country pay no income tax at all or no tax on foreign income. Residents of no-tax or low-tax countries often suffer from a different form of double taxation – excessive source-country withholding taxes on their cross-border investment income. Many OECD countries have low "wholesale" withholding tax rates (15% or less) on dividends, interest and royalties paid to residents of treaty countries and a much higher "retail" rate (30% or more) when such income is paid to residents of non-treaty countries.

Let us look at how the current regime works when an OECD country imposes a high withholding tax on passive income paid to foreign individuals. The US, for example, still taxes corporate income twice. A US corporation pays about $400,000 in federal and state income taxes on each $1 million it earns. If the corporation distributes the remaining $600,000 as a dividend, US individuals and foreign individuals resident in most tax-treaty countries pay a further 15% US federal tax ($90,000 per $1 million), bringing the US tax liability to about 49% ($490,000 per $1 million). A foreign *high-net-worth individual (HNWI)* residing in a non-treaty country does much worse. He or

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she is supposed to pay a 30% US withholding tax on the dividend ($180,000 per $1 million); this would bring the US tax liability to about 58% ($580,000 per $1 million). The typical foreign HNWI reacts to this situation in one of three ways:

- he invests only in US companies that pay no dividends or very low dividends, primarily seeking capital gains since these are tax-free to foreign investors; or
- he invests in US shares through a company resident in a suitable third country (such *treaty shopping* used to be easy but it is gradually becoming more difficult and more expensive); or
- he invests elsewhere and limits his US equity investments to companies incorporated in other countries, many of which are foreign companies with substantial US business operations.

A foreign HNWI deriving interest income has an easier time with the US because it does not tax most interest paid to foreign persons. The US has never taxed foreign persons on US bank-deposit interest. Most other US-source interest income qualifies as tax-free "portfolio interest." The foreign non-treaty HNWI avoids investing in taxable US obligations because the combination of inflation and a 30% withholding tax would eat up over 100%

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of his taxable interest income.

An author or inventor with substantial US royalties or a retired investor with income from US pensions and annuities can move to one of several countries with a favorable US tax treaty and a comparatively benign local tax system for individual residents. Or, he can move to a country that does not tax his foreign income and he can use an intermediate company for *treaty shopping* and tax minimization.

Most, but not all, comprehensive income tax agreements are formal treaties that deal with different kinds of tax situations involving both individuals and businesses. There are several inherent problems with formal tax treaties:

- Each country must maintain an adequate supply of experienced negotiators.
- Tax treaties often take years to negotiate.
- They require time-consuming parliamentary scrutiny and approval.
- Some parliaments and treasury departments rarely look at tax treaties *after* they are ratified and enter into force.
- Subsequent treaty amendments require the same time-consuming parliamentary scrutiny and approval as the original treaty.
- Thus, treaties often remain in force unchanged long after they should

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have been amended to deal with changes in both countries' domestic tax laws.

The difficulty of ratifying and amending tax treaties has led treasury officials in some OECD countries to refrain from negotiating tax treaties with small developing countries, especially those countries with companies that they fear might be used for *treaty shopping.*

Treasury officials in OECD countries frequently say: "We don't do tax treaties with tax havens." The truth is that many OECD countries have always had tax treaties with some countries that are tax havens. Some of these treaties were acquired more by accident than by design. Others have been done intentionally on a very selective basis.

Those acquired by accident have sometimes resulted from extending tax treaties with other OECD countries to their colonies that supposedly had substantially similar tax systems. One example is that of the US treaty relationship with the Netherlands Antilles. The 1948 Netherlands-US income tax treaty was extended to the Netherlands Antilles in 1955. This and some other tax treaty extensions were used (or abused) for *treaty shopping*. The Netherlands Antilles adopted offshore legislation granting a 90% exemption on some passive income derived by qualified Netherlands Antilles companies.

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This reduced the normal 24% to 30% Netherlands Antilles tax rate on dividends, interest and royalties derived by these companies to only 2.4% to 3%. The statutory US withholding tax rate on dividends, interest, royalties and other passive income was then (and still is) 30%. The treaty provided for a 15% US withholding tax on most dividends and no US withholding tax on interest or royalties. This permitted Sanchez NV, an investment company owned by Juan Sanchez of Panazuela, to obtain US portfolio dividends with a total tax of only about 17%. The company also obtained US interest and royalties at a total tax of 3% or less. Despite some subsequent treaty modifications, the Netherlands Antilles-US treaty remained a treaty with the world for several decades. The extended treaty was substantially terminated in 1987. The Netherlands Antilles has since attempted without success to enter into a new tax treaty with the US.

Now, the US wants tax information from the Netherlands Antilles but it does not want the Netherlands Antilles (or any other country) to be used for treaty shopping into the US. The Netherlands Antilles and the US signed a *tax information exchange agreement (TIEA)* in 2002. The US treats the TIEA (and others like it) as an executive agreement that does not require the advice and consent of the US Senate to ratification. The TIEA still requires legislative

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approval in the Netherlands Antilles and is not yet in force. The proposed TIEA offers no tax benefits to the Netherlands Antilles other than reciprocal tax information which the Netherlands Antilles may not want or need. At the signing ceremony in April 2002, the US Treasury Secretary promised that the US would proceed with tax treaty negotiations within 12 months. There have been no subsequent reports of any such negotiations.

A few decades ago, the British Virgin Islands (BVI) and many other British colonies that theoretically imposed "taxes substantially similar in character" to those imposed by the UK had income tax treaties in force with Canada, Denmark, Japan, New Zealand, Norway, Sweden, Switzerland, the UK and the US. Most British colonies that became independent remained parties to these tax treaties. Virtually all of these extensions were eventually terminated and most have not been replaced. The UK alone has kept some of its tax arrangements with its current and former dependent territories.

The law of unintended consequences has not been repealed. Cancellation of their tax treaties led several Caribbean jurisdictions to suspend or repeal their previously acceptable income tax laws and to rely instead on other forms of revenue raisers. Some of these countries no longer impose income taxes on foreign-source income. Some have eliminated all

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income taxes. Others created new entities called *international business companies (IBCs)* that are tax exempt or pay only tiny amounts of tax. OECD countries have demanded that these tax havens sign TIEAs and furnish tax information concerning those who use their low-tax or tax-free facilities.

Third-country residents using tax treaty extensions to treaty shop into the US weren't the only ones playing games. The US Treasury has played games too. The US withholding tax rate on passive income paid to foreign persons was originally 12.5%. It was increased to 30% in 1942 as a "temporary wartime measure." This year, we celebrate the 63rd anniversary of that temporary wartime tax increase. The US Treasury discovered that its confiscatory 30% statutory withholding tax rate forced many prospective income tax treaty partners to negotiate with it so as to obtain reasonable withholding tax rates. The US freely offers most tax treaty partners withholding tax rates of 15% on dividends and zero on royalties and interest. [Bank deposit interest, "portfolio interest" and capital gains on stocks and bonds derived by foreign persons are all exempt even without a treaty].

Canada similarly imposes a 25% statutory withholding tax on passive income paid to foreign persons. It routinely reduces this rate to 15% or less for its tax treaty partners.

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As a practical matter, the US Treasury does not enter into tax treaties with some developing countries even if they are not tax havens because of the great difficulty Treasury has negotiating and concluding a tax treaty that will meet the approval of the US Senate. The Senate must give its advice and consent to ratification of every treaty, including every tax treaty. Treasury and the Senate both apparently prefer to confine that effort to tax treaties with significant US trading partners who are willing to accept all of the Senate's requirements. Thus, the US has a considerably smaller tax treaty network than many of its major trading partners. The only US tax treaty with a sub-Saharan African country is with South Africa. Its only tax treaties with Latin American countries are those with Mexico and Venezuela. The US also lacks tax treaties with significant Asian trading partners such as Hong Kong, Malaysia, Singapore and Taiwan.

While a normal income tax treaty requires ratification by both countries, other types of tax agreements such as TIEAs and transportation agreements do not. Occasionally, we also see a less-formal tax agreement such as the one between Australia and Taiwan. Since Australia does not recognize the Republic of China, there is an agreement between the Australian Commerce and Industry Office and the Taipei Economic and Cultural Office. Similar

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agreements have been signed with Taiwan by several other countries that do not recognize the Republic of China government. These agreements seem to accomplish the same purposes as a customary tax treaty.

A 1983 law authorizes the US Treasury to sign a TIEA as an executive agreement that does not require Senate consideration or approval. However, the other jurisdiction usually treats the TIEA as a treaty that requires legislative approval by its parliament. A TIEA is a less-formal tax agreement that generally has only one basic purpose, either reciprocal or unilateral exchange of tax information. Tax information from a small developing country may be valuable to an OECD country, but it is of little or no value to a country such as Panama which does not tax any foreign income. Most TIEAs with small developing countries are signed grudgingly solely because of pressure to do so by the developed country. Occasionally, the developed country adds some minimal tax benefits. Two of the three benefits granted by the US to some Caribbean Basin countries that have signed TIEAs have since been eliminated by Congress; the third is virtually worthless to countries that do not have significant tourist industries.

Despite intense pressure, developed countries have thus far enjoyed only limited success in obtaining TIEAs. The US started first and it now has

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both TIEAs *and* income tax treaties with Barbados, Bermuda, Jamaica, Mexico and Trinidad and Tobago. It has TIEAs in force with Antigua and Barbuda, Aruba, the Bahamas, Costa Rica, Dominica, the Dominican Republic, Grenada, Guyana, Honduras, the Marshall Islands, Peru and St. Lucia. However, TIEAs signed by the US some years ago with the BVI, the Cayman Islands, Colombia, Guernsey, the Isle of Man, Jersey and the Netherlands Antilles have not (yet) entered into force. Moreover, the US has not yet signed TIEAs with several other Caribbean jurisdictions previously covered by the terminated US-UK income tax treaty, namely Anguilla, Belize, Montserrat, St. Kitts and Nevis, and St. Vincent and the Grenadines; nor has it signed a TIEA with the Turks and Caicos Islands.

The EU has not fared much better with respect to its demand for TIEAs covering the EU Savings Tax Directive. Under pressure from the EU, the UK compelled its dependent territories and crown dependencies to sign savings income TIEAs and the Netherlands also compelled Aruba and the Netherlands Antilles to sign TIEAs. However, most former UK territories that are now independent countries have not signed such TIEAs and have little or no incentive to do so.

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Most countries exempt international transportation income even in the absence of an income tax treaty. US law exempts foreign persons from tax on income derived from the international operation of ships and aircraft provided the foreign person's country of residence grants an equivalent exemption. About 50 countries have accepted an open invitation from the US Treasury to confirm reciprocal exemptions by exchanging *diplomatic notes*. The notes confirm that both countries grant an equivalent exemption for qualified transportation income. The US has such diplomatic notes with many low-tax and no-tax countries, including the Bahamas, Bahrain, Hong Kong, the Isle of Man, Liberia, Malta, the Marshall Islands, Panama, Singapore, St. Vincent and the Grenadines, and the United Arab Emirates. The US also has such diplomatic notes with many other non-treaty countries, including Argentina, Chile, Colombia, El Salvador, Ethiopia, Fiji, Ghana, Jordan, Malaysia, Peru, Saudi Arabia and Taiwan. Some of these transportation agreements cover ships, some cover aircraft, most cover both.

The US also has *social security totalization agreements* in force with about 20 developed countries. Although these agreements are not ratified as treaties by the US Senate, each of them is reviewed by the US Congress before it enters into force.

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Treaty shopping is alive and well even after more than 25 years of serious efforts by some OECD countries to curtail its use. It just costs more than it used to. As one door is closed, another opens. For example, Malaysia's Labuan became a significant offshore financial center about 15 years ago. The US has no income tax treaty with Malaysia. Australia, the Netherlands, Switzerland and Sweden are among the few OECD countries whose income tax treaties with Malaysia now deny treaty benefits to low-tax companies established in Labuan. Many other OECD countries still permit Labuan companies to use their treaties with Malaysia.

It is fair to say that *all countries are equal but some are more equal than others.*

In spite of their protestations to the contrary, OECD countries do enter into tax treaties with tax havens and other small developing countries, but they do so on a selective basis.

- Australia has kept its long-standing treaty with Kiribati, formerly a part of the Gilbert and Ellice Islands.
- Austria has a new income tax treaty with Belize that entered into force in 2004.

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- Belgium recently entered into an income tax treaty with Hong Kong which is also seeking treaties with other OECD countries.
- Canada has a significant income tax treaty with Barbados that enables Canadian multinational companies to use low-tax Barbados IBCs to earn active foreign business income that can be brought back to its Canadian parent as tax-free *exempt surplus*.
- Denmark, Japan, Switzerland and many other OECD countries have tax treaties with Singapore which does not tax foreign income unless it is remitted to Singapore.
- France apparently likes to have tax treaties with French-speaking countries no matter how small they are.
- New Zealand and 14 other OECD countries have tax treaties with the United Arab Emirates (which includes Dubai);although the United Arab Emirates has no income tax, it has 43 income tax treaties in force designed to attract investment from its super-rich residents.
- Norway and Sweden both entered into new tax treaties with Barbados after cancelling their old treaty extensions with many Caribbean countries.

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- The UK tends to keep tax treaties with its current and former colonies; the UK recently announced that it is currently negotiating a tax treaty with the Cayman Islands which it plans to complete this year.
- The old US-USSR tax treaty is still in force between the US and nine CIS countries: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan, all of whose residents are entitled to zero-tax US royalties; the US also has a limited tax treaty with Bermuda covering only insurance enterprises.
- A further list of selected income tax treaties between OECD members and developing countries appears in Table A at the end of this paper.

Globalization affects wealthy individuals as well as multinational companies. Since the end of the Second World War millions of HNWIs have moved to countries with benign tax systems. An immense amount of wealth is owned by individuals who now reside in countries that tax them lightly or not at all. There is no shortage of suitable jurisdictions. Some are in the OECD, including Switzerland with its long-standing *forfait* (lump-sum tax) arrangements and the UK which has never taxed its non-domiciled residents on their foreign-source income unless it is remitted to the UK. Somehow, most of the hundreds of thousands of UK "non-doms" manage to survive on

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remittances of capital rather than income. Foreign income not remitted to the UK is not even reportable to a tax inspector.

Other OECD countries, including Canada, the Netherlands and New Zealand, refrain from taxing *new* residents on properly-structured foreign income for their first several years of residence. Full taxes don't apply unless these newcomers remain resident after their initial grace period.

Millions of individuals now have their primary residence in small developing countries with benign tax regimes of which there are several types:

- Some countries impose no taxes on income or capital gains. These include Andorra, Anguilla, the Bahamas, Bermuda, Cayman, the Seychelles, St. Kitts and Nevis, Turks and Caicos, the United Arab Emirates, Uruguay and Vanuatu. Add Monaco if you are not French.
- Other countries impose no tax on income or gains from foreign sources. These include Cape Verde, Costa Rica, Grenada, Hong Kong and Panama; some such as Cyprus, Jamaica, Mauritius and Singapore do the same if you are not domiciled.
- A third group of countries impose income taxes but permit qualified HNWIs to escape them. These include Belize, Gibraltar, Malta and the Netherlands Antilles.

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- A fourth group of countries tax worldwide income at low rates of 20% or less and do not tax capital gains. These include Guernsey, the Isle of Man and Jersey.
- Finally, Barbados and some other countries that tax residents don't treat you as resident unless you physically spend more than six months a year there. Many individuals "visit" these places for about five months a year and travel or visit other countries during the rest of the year.

The OECD continues to attack many no-tax and low-tax countries. OECD countries will not give meaningful tax benefits to no-tax or low-tax countries just to get them to sign TIEAs. Political realities make it clear that some OECD countries will not sign tax treaties with small developing countries, especially those perceived to be tax havens, unless these tax agreements meet the *WIIFM* test (What's in it for me?).

The answer is to create a new type of tax agreement that will increase investment in the relevant OECD country by wealthy individuals living in the tax haven and increase tax revenues in both the OECD country and the tax haven. If this is done correctly it will accomplish these results and will help to curtail treaty shopping that improperly benefits third countries to the detriment of both the source country and the residence country.

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Let's take an example using royalties. A best-selling author moves to the Bahamas where she pays no income tax since it has none. She earns millions of euros (and dollars) of royalties each year, most of which emanate from OECD countries that impose high withholding taxes. As a Bahamian resident she is not entitled to relief from these high taxes. Nevertheless, with proper planning, most of her US royalties do not pay the statutory 30% withholding tax. Her royalties from the US and other high-tax countries typically flow into a Dutch royalties company that pays zero US withholding tax, a small Dutch tax and professional fees, plus additional small taxes and fees to get the remaining income out of the Dutch royalties company through the Netherlands Antilles or some other accommodating jurisdiction to the author. Her total cost for all taxes and fees is probably less than 15%.

The US model income tax treaty exempts royalties paid to persons resident in treaty countries. Most existing US tax treaties exempt royalties or tax them at a 5% rate. A few tax them at 10% or more, usually only because the treaty partner wanted the higher rate.

Now let us suppose that the US decides to separate tax havens and other small countries into two groups – those that will cooperate with the US and those that won't. It decides that the Bahamas is cooperative even though

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it is a zero tax haven. The Bahamas has signed and ratified a TIEA with the US and is complying with its terms. It will give information to the US IRS sufficient to enable the IRS to confirm that the author's US royalties income really is hers and that she is a bona fide resident of the Bahamas and not also a US citizen or resident (and not a tax-motivated expatriate).

The US Congress could authorize Treasury to sign a mini-agreement that gives standardized tax benefits to another country in exchange for tax information and other assistance. The agreement could provide for an appropriate sharing of the withheld tax by the source and residence countries. Congress could authorize a standard mini-agreement to enter into force either without prior review by Congress (as it does with TIEAs) or only after review and approval (as it does with social security totalization agreements). In either case, standardization would minimize the need for extensive review.

The basic idea would be to follow a pattern that has already been approved by two-thirds of the 30 OECD members. Switzerland and 19 EU countries that are also OECD members are parties to the EU Savings Directive that entered into force on 1 July 2005. The EU Savings Directive permits Austria, Belgium, Luxembourg, Switzerland and some other jurisdictions to withhold tax at a specified rate on savings income paid to

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individual residents of other EU countries and requires them to pay 3/4 of that income to the taxpayer's country of residence in a lump sum once a year.

Suppose that the Bahamas and the US sign a mini-agreement that establishes a 10% withholding tax rate on US royalties income paid to a qualified Bahamian resident individual (or an LLC treated as a pass-through to such an individual). That rate is 10% more than the rate the US charges the Netherlands and its other preferred treaty partners. Suppose also that the mini-agreement provides for that withholding tax to be divided 50-50 between the source country (the US) and the residence country (the Bahamas). Each million dollars of US royalties income earned by the author would generate a $100,000 withholding tax of which $50,000 would be retained by the US and the other $50,000 would be sent by the US to the Bahamas at the end of the year. The US need not trust the Bahamas to collect its share of the tax.

Even though the Bahamas does not impose income tax, approval of a mini-agreement by the Bahamian parliament would authorize the imposition of a "pick-up" tax equal to its share of the withholding tax. The mini-agreement would prohibit the Bahamas from rebating any portion of the tax to the author. The tax revenue goes where it should. OECD commentaries on the passive income articles of its model income tax treaty consistently say that taxes on

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passive income should not all be kept by the source country and that it is not practical for all of it to go to the residence country.

The US Treasury might balk at having to negotiate individualized tax agreements with lots of small developing countries; the Senate would almost certainly object to having to make a detailed study of each one. The answer is to develop “cookie-cutter” tax sharing mini-agreements all of which are virtually the same. These would be pre-authorized executive agreements that would not require individual US Senate consent to ratification. In fact, that is how Treasury does TIEAs today.

Congress could pass a law authorizing Treasury to negotiate mini-agreements with cooperative jurisdictions. These mini-agreements would either be signed only with countries already having suitable TIEAs with the US or the mini-agreements would contain all of the usual TIEA provisions. They would authorize relatively standard withholding tax reductions from 30% to not less than 15% on dividends and from 30% to not less than 10% on royalties and on interest that is normally taxable (although much US interest is already exempt by law). The law would also authorize the standardized mini-agreements to provide for an appropriate split of the withholding tax revenues such as on a 50-50 basis. The standardized mini-agreements could also authorize similar reductions on income from pensions and annuities from 30% to not less than 10%. They would not deal with the taxation of companies other than pass-through entities owned by a bona fide individual resident. However, a country with a mini-agreement could request the start of negotiations for a more comprehensive tax treaty after the mini-agreement has been in force for at least two years.

Such a standardized mini-agreement would be appropriate for cooperative jurisdictions that impose no income tax or exempt all foreign income. A provision would be included requiring reciprocity or prompt renegotiation if the jurisdiction begins imposing taxes on US taxpayers. Uncooperative jurisdictions would remain subject to 30% withholding tax. I believe that many small countries with HNWIs investing abroad would promptly decide to become cooperative and would promptly sign and ratify TIEAs and tax sharing mini-agreements.

The mini-agreement proposal should be a win-win situation for everyone other than a country that now serves as a conduit for treaty shopping. There could now be a direct flow of royalties from the US to the Bahamas; each of these countries would receive $50,000 (per million) that they would never have received before. The author's after-tax cost would be less than before

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and she would eliminate the complexity and the fees she had to pay for treaty shopping. She would, of course, have to disclose her identity to the governments or to banks serving as acceptable intermediaries.

It has been suggested that the US Senate would never approve any tax agreement reducing the 30% withholding tax on payments to residents of a country that does not tax foreign-source income. That is not true. In 1981, the Senate consented to ratification of a proposed income tax treaty with Argentina which then had a territorial tax system. However, that treaty was approved subject to reservations and an understanding that were apparently unacceptable to Argentina so the treaty never entered into force. Nonetheless, the treaty *as approved by the Senate* would have reduced the US withholding tax on dividends and annuities from 30% to 20% and it would have exempted from US tax income from private pensions and certain types of interest income that is normally taxable. The Joint Committee on Taxation's explanation of that treaty clearly stated that Argentina did not then tax income from foreign sources.

The idea that it would cost the US Treasury money to reduce its 30% withholding tax on portfolio dividends and some other passive income paid to foreign individuals is a myth. To the contrary, selectively reducing withholding

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tax rates should actually increase US tax revenues if it is done properly.

- The statutory withholding tax rate on passive income should remain 30%.
- Treasury should be authorized to reduce the withholding tax by agreement with cooperative countries to a rate that is never less than the lowest rate available to foreign individuals under the US model income tax treaty. For years in which the rate for dividends paid to US individuals is 15%, the agreed withholding tax rate could be set at between 15% and 20%.
- Such a rate would discourage treaty shopping and would encourage foreign individuals to buy more dividend-paying US stocks.
- The withholding tax would be collected by the US but it would be shared on an appropriate basis between the US and the investor's residence country.
- The withholding tax rate and the basis for sharing the withholding tax revenues could be different for various types of income.

The time has also come for EU countries and other OECD members to try a *carrot* instead of a *stick*. Done properly, this will increase rather than lose revenue. OECD countries seeking cooperation from tax havens and other

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small developing countries should offer something of real value (a share of money) in return for tax information and increased investment. OECD countries that do so correctly will benefit themselves at least as much as they benefit the developing countries. Here are some suggestions as to how this could be done in a case involving a developed high-tax country (Taxland) and a developing country that either has no income tax or does not tax foreign income (Freeland). (Reciprocal provisions would, of course, be required if Freeland does tax income derived by Taxland resident individuals).

- Taxland and Freeland could sign a tax sharing mini-agreement that is not a full income tax treaty but is more than just a TIEA.
- Taxland could enact a law authorizing its Treasury to sign a standardized pre-approved mini-agreement with any cooperative country with which Taxland does not have an income tax treaty.
- The mini-agreement would contain information exchange provisions similar to those in the OECD model TIEA or those contained in Article 26 [Exchange of Information] of the current OECD model tax treaty.
- Withholding tax reductions would be given by Taxland only to individuals who are bona fide residents of Freeland and are not also residents of Taxland. This would eliminate the need for residence tie-

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breaker tests.

- Taxland’s withholding taxes on income paid to Freeland resident individuals would be reduced to reasonable rates the same or slightly higher than those offered by Taxland to most of its tax treaty partners.
- The mini-agreement would divide the tax withheld by Taxland between the two countries in a manner similar to that now being done by several countries under the EU Savings Tax Directive.
- Assume, for example, that Taxland now imposes a statutory 25% withholding tax on dividends, interest, royalties and some other passive income. Assume further that Taxland now reduces that tax under most of its income tax treaties to 15% on portfolio dividends and 5% on interest and royalties. The mini-agreement could provide for a withholding tax of 20% on dividends and 10% on interest and royalties paid to individual residents of Freeland.
- The EU Savings Tax Directive provides for 25% of the withheld tax to be retained by the source country and the other 75% of it to be paid in a lump sum to the residence country once a year. The mini-agreement could provide for such a 25-75 split or, in some cases, a 50-50 split.

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- The mini-agreement would not deal with the taxation of companies, trusts or other entities, nor would it cover permanent establishments or business profits.
- One advantage of a mini-agreement is that it would represent a start toward establishing (or reestablishing) a tax treaty relationship between the countries. The mini-agreement or accompanying notes could contain a commitment to begin negotiations for a possible full income tax treaty after a couple of years.
- The mini-agreement would provide Freeland with tax revenues and might encourage it to develop a tax system or revise its existing system.
- The fact that Freeland has no income tax or does not tax its residents' foreign income should not matter to Taxland since it makes sure that an appropriate tax has been paid. Moreover, half or 3/4 of the withheld tax would go to the residence country as it should under the OECD model income tax treaty commentaries.
- The need for individual parliamentary approval of each individual mini-agreement signed by Taxland could be eliminated by a law authorizing its Treasury to conclude mini-agreements with cooperative countries. The law could authorize Taxland withholding tax reductions to not less

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than 10% (or some other appropriate rate).

- The mini-agreement could require a bank approved by both countries to certify that the income recipient is a bona fide individual resident of Freeland and not also a resident of Taxland and that he or she is the beneficial owner of the income.

The mini-agreements would be used primarily to cover cross-border income payments that are now subject to high statutory withholding taxes, especially those that are currently much higher than the rates charged under most tax treaties signed by the source country. Thus, the UK and Australia would not cover dividends since these are not taxed under their domestic laws. Similarly, the US would not cover capital gains on securities.

A model mini-agreement suitable for both developed and small developing countries should be prepared by an organization such as STEP, with the assistance and approval of the Commonwealth Secretariat which can study and deal in an unbiased way with the problem of excessive taxation of individual residents of small developing countries by large developed countries. The Commonwealth Secretariat is an association of 53 countries with 1.8 billion citizens. Its members include both developed and developing countries. They include OECD members Australia, Canada, New Zealand and

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the UK. They also include some important countries not (yet) attacked by the OECD such as Bangladesh, Brunei, India, Malaysia, Pakistan, Singapore and South Africa. Its members also include 15 developing countries targeted by the OECD. Another dozen of the targeted jurisdictions are either UK dependent territories or countries associated with New Zealand. Thus, a significant number of Commonwealth Secretariat members would have a direct interest in this project.

If the US can have income tax treaties in force with countries such as Armenia, Azerbaijan, Barbados, Belarus, Bermuda, Cyprus, Estonia, Georgia, Iceland, Jamaica, Kazakstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Morocco, the Philippines, Romania, Slovenia, Sri Lanka, Tajikistan, Tunisia, Trinidad and Tobago, Turkmenistan and Uzbekistan, it can afford to have mini-agreements with the countries and territories whose tax treaties it previously unilaterally terminated and other countries willing to cooperate by exchanging information. So can other OECD countries which between them have existing tax treaties (as shown on Table A) with Antigua and Barbuda, Aruba, Bahrain, Belize, Brunei, Cape Verde, Chile, Cuba, the Dominican Republic, Ecuador, Fiji, Greenland, Grenada, Guernsey, Guyana, Hong Kong, the Isle of Man, Jamaica, Jersey, Kiribati, Kuwait, Macau, Malaysia, Mauritius,

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Montserrat, Myanmar, the Netherlands Antilles, Northern Cyprus, North Korea, Oman, Papua New Guinea, Qatar, St. Kitts and Nevis, Singapore, Taiwan, Tuvalu, the United Arab Emirates, Uruguay and Vietnam.

OECD countries no longer need to use excessive withholding taxes to induce other countries to sign tax treaties; most of them already have treaties with the other OECD members. The time has come for them to reduce excessive withholding taxes in a way designed to attract substantial new investment by those people who have the money. I am reminded of the statement made by Willie Sutton, a notorious American bank robber after he was finally arrested and was asked why he robbed banks. He said "I rob banks because that's where the money is."

A few OECD countries have finally taken steps to attract new investment by wealthy offshore individuals. While preparing this paper I was amazed to find that the United Arab Emirates, a country with zero income tax, has 43 income tax treaties in force 15 of which are with OECD countries. The reason is obvious – that's where the money is.

Let us look briefly at the tax treaty between New Zealand and the United Arab Emirates (UAE) that was signed in 2003 and entered into force in 2004. The treaty reduces New Zealand withholding taxes on dividends from 30% to

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15% and on interest and royalties from 15% to 10%; these reductions are similar to those given under other New Zealand treaties. Using standard OECD-type language, a New Zealand person is resident for purposes of the treaty if the person is resident in New Zealand for the purposes of New Zealand tax. However, a UAE individual is resident if he is considered a UAE resident under UAE laws by reason of his “domicile, residence or any other criterion of a similar nature.” There is no mention of tax.

Prior to ratification, the New Zealand House of Representatives Finance and Expenditure Committee examined the treaty in great detail. Here are a few of the findings in its report:

- the treaty is unusual because the UAE does not have a general income tax system, but the UAE has indicated that it may introduce one at some stage in the future;
- the main rationale for the treaty is to facilitate investment from the UAE into New Zealand;
- UAE investors will seek to receive the same after tax rate of return from New Zealand as they can earn elsewhere, including from countries that impose no tax on their investments;
- the UAE private sector is understood to have about US$600 billion

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available for investment;

- the UAE emphasized that a treaty was a basic prerequisite for investment from the UAE due to UAE investors' sensitivity to New Zealand tax;
- the main advantage for New Zealand is that the treaty opens up significant opportunities for foreign investment into New Zealand from the UAE;
- private sector investment from the UAE into New Zealand has the potential to increase significantly, given the reduction of withholding tax rates;
- the ability to exchange information with the UAE will also be an advantage for New Zealand, as this will assist in the detection and prevention of tax avoidance and evasion; and finally
- UAE investment in New Zealand is likely to be negligible in the absence of a treaty.

The reasons both countries wanted the treaty make it clear that their objectives could just as easily have been accomplished by a mini-agreement of the type suggested in this paper. The UAE is not the only country with wealthy individuals looking for safe places to invest but unwilling to be gouged

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by confiscatory taxes.

Those of us who travel regularly frequently see at least the outside of multi-million dollar homes owned and occupied by the thousands upon thousands of multi-millionaires who now reside in low-tax countries. Think Jersey, Guernsey, the Isle of Man, Gibraltar, Andorra, Monaco, Bermuda, the Bahamas, Cayman, the BVI, the Eastern Caribbean, Costa Rica, Panama, Dubai and the other UAE Emirates, Saudi Arabia, Bahrain, Brunei, Hong Kong, Singapore, and on and on. These multi-millionaires all have one thing in common – lots of money which they need to invest. Most OECD countries have done a lousy job of attracting this investment. They do get trillions of dollars and euros in bank deposits by exempting foreigners from tax on such deposits. Many OECD countries also attract some foreign investment in equities by exempting foreigners from tax on capital gains, but most super-wealthy investors are turned off by the prospect of being gouged by confiscatory withholding taxes on dividends and certain types of interest.

In conclusion, everyone can benefit from a mini-agreement between an OECD country and an international financial center that has many wealthy individual residents:

- a wealthy individual residing in the international financial center would

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be able to invest in the OECD country and pay a reasonable rate of tax on his investment income without resorting to treaty shopping;

- his country of residence will have a new source of income coming from its share of the withholding tax receipts; and
- the OECD country should attract substantial new investment by these wealthy individuals plus a bonus of full access to information.

This would indeed be a win-win situation.

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Table A

OECD Country	*Tax Treaties With Tax Havens and Some Other Small Countries*
Australia	**Kiribati, Papua New Guinea, Singapore, Taiwan**
Austria	**Armenia, Azerbaijan, Belarus, Belize, Kyrgyzstan, Malaysia, Moldova, Singapore, Uzbekistan**
Belgium	**Armenia, Belarus, Georgia, Hong Kong, Malaysia, United Arab Emirates, Uzbekistan**
Canada	**Barbados, Dominican Republic, Guyana, Jamaica, Kuwait, Kyrgyzstan, Malaysia, Moldova, Papua New Guinea, United Arab Emirates, Uzbekistan**
Czech Republic	**Belarus, Kuwait, Moldova, Singapore**
Denmark	**Malaysia, Singapore**
Finland	**Barbados, Kyrgyzstan, Malaysia, Singapore, United Arab Emirates, Uzbekistan**
France	**Armenia, Bahrain, Kuwait, Malaysia, Qatar, Singapore, United Arab Emirates, Uzbekistan**
Germany	**Azerbaijan, Singapore, Tajikistan, United Arab Emirates, Uruguay, Uzbekistan**
Greece	**Armenia, Georgia, Kuwait, Uzbekistan**
Hungary	**Belarus, Kuwait, Malaysia, Moldova, Singapore, Uruguay**
Iceland	**Greenland, Vietnam**
Ireland	**Malaysia**
Italy	**Georgia, Kuwait, Malaysia, Mauritius, Oman, Singapore, Uzbekistan**
Japan	**Singapore**
Korea	**Belarus, Fiji, North Korea, Kuwait, Myanmar, Singapore, United Arab Emirates, Uzbekistan**
Luxembourg	**Malaysia, Mauritius, Singapore, Uzbekistan**
Mexico	**Chile, Ecuador, Singapore**
Netherlands	**Aruba, Belarus, Kuwait, Moldova, Netherlands Antilles, Singapore, Taiwan, Uzbekistan**

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New Zealand	**Chile, Fiji, Malaysia, Singapore, Taiwan, United Arab Emirates**
Norway	**Azerbaijan, Barbados, Netherlands Antilles, Singapore**
Poland	**Armenia, Belarus, Kuwait, Kyrgyzstan, Malaysia, Moldova, Singapore, Tajikistan, United Arab Emirates, Uzbekistan**
Portugal	**Cape Verde, Cuba, Macau, Singapore**
Slovak Republic	**Belarus, Turkmenistan, Uzbekistan**
Spain	**Cuba**
Sweden	**Barbados, Belarus, Mauritius, Singapore, Taiwan**
Switzerland	**Barbados, Belarus, Kuwait, Kyrgyzstan, Moldova, Singapore, Uzbekistan**
Turkey	**Azerbaijan, Belarus, Kuwait, Kyrgyzstan, Malaysia, Moldova, Northern Cyprus, Singapore, Tajikistan, Turkmenistan, United Arab Emirates, Uzbekistan**
United Kingdom	**Antigua & Barbuda, Azerbaijan, Barbados, Belize, Brunei, Grenada, Guernsey, Isle of Man, Jersey, Kiribati, Kuwait, Mauritius, Montserrat, Oman, St. Kitts & Nevis, Singapore, Taiwan, Tuvalu, Uzbekistan**
United States	**Barbados, Bermuda, Jamaica, Morocco, the Philippines, Sri Lanka, Trinidad & Tobago, Tunisia, + 9 former USSR states**

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