

1. Introduction

Although there is no universally accepted definition, OECD (1998) provides a useful definition of a tax haven as a jurisdiction that imposes no or only nominal taxes itself and offers itself as a place to be used by non-residents to escape tax in their country of residence. A tax haven can offer this service because it has laws or administrative practices that prevent the effective exchange of information on taxpayers benefiting from the low-tax jurisdiction.¹ In this paper, we refer to the intent of such jurisdictions as being “parasitic” on the tax revenues of the non-haven countries. Our purpose is to develop a theory of tax havens and tax competition that explains why countries are, and should be, concerned about the detrimental effects of havens on their citizen’s welfare.

Policy actions by OECD countries reflect this concern. Before the 1998 OECD report, action against tax havens was predominantly unilateral, as exemplified by the introduction in 1962 of the U.S. Subpart F provisions that addressed so-called passive income earned in tax haven countries and not distributed to the United States.² Later many OECD countries enacted domestic tax rules designed to lessen the attractiveness of tax avoidance and evasion through tax havens.

The OECD report concludes that “governments cannot stand back while their tax bases are eroded through the actions of countries which offer taxpayers ways to exploit tax havens [and preferential regimes] to reduce the tax that would otherwise be payable to them.” (p. 37). It offers a long list of recommendations concerning domestic legislation, tax treaties, and international cooperation. In the last category is a recommendation to produce a list of tax-haven countries that would enable non-haven countries to coordinate their responses to the problems

¹ The OECD report distinguished tax havens from cases in which countries that raise significant revenues from the income tax but have preferential tax regimes for certain kinds of income, generally restricted to non-residents.

² This history is recounted in Eden and Kudrle (2005).