

# **Illicit Financial Flows (IFF) and issues of global tax governance**

## **Concepts, Issues and Challenges**

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# Themes

- 1. Tax base and International taxing rights**
- 2. Double taxation; double non-taxation and “stateless income”**
- 3. Role of Secrecy Jurisdictions**
- 4. Base Erosion and Profit Shifting**
- 5. Illicit Financial Flows (IFF)**
- 6. International taxation reform- who does what**

## **1. Tax base and International taxing rights**

- **Taxing at source - means to tax where the taxable income is generated.**
- **Taxing on the basis of residence - where the person/entity who receives the income is based.**
- **Current rules and practices are residence-based model of taxation & favour capital exporting countries, because when one of their companies invests overseas they still get to tax the profits.**
- **Under such a system developing countries are predestined to lose out**
- **Bilateral tax treaties cement this model**

## **2. Double taxation; double non-taxation and “stateless income”**

- **Growing cross-border trade & investment made the then industrialising Northern countries to make rules and agreements to avoid “double taxation” (League of Nations)**
- **With further globalisation and of establishment of secrecy jurisdictions “double –no-taxation” emerged**
- **MNC took advantage of secrecy jurisdictions to set up complex structures and earn more and more “stateless income” – i.e. not paying taxes anywhere**

## **3. role of secrecy jurisdictions**

- tax haven – versus “secrecy jurisdiction” -
- Secrecy jurisdictions are not only the small islands with palm trees
- The UK with City of London & its Overseas Territories and Crown Dependencies - would be number 1; USA moving towards being NO 1; even Germany 9<sup>th</sup>. (Financial Secrecy Index )

### **Some illustrations**

- A building in Cayman Islands where 12,000 companies have registered officers
- An island (British Virgin Islands) inhabited by 34 times more firms than citizens;
- Although not a single banana tree grows there, Isle of Jersey was the major banana exporter to Europe
- – Where commercial fleet are registered: Panama number one; Liberia NO 2

## **4. Base Erosion and Profit Shifting (BEPS)**

**Profit = Sales – Costs**

- **In jurisdiction A - profit is taxed at 1 %**
- **In Jurisdiction B – Profit is taxed at 30%**
- **BEPS is a mechanism whereby MNC make sure that their profits appear in A & more costs in B**
- **Tax base eroded in B; Profit shifted to A**
- **Rampant use of trade mis-pricing – main mechanism**
  - a) **Import – Export misn- invoicing**
  - b) **Transfer mispricing in intra-company transactions**  
(60% of world trade between affiliated companies)
- **Thin capitalisation- (debt-equity proportion in investment;**
- **Shifting origin of profit from tangibles to intangibles**

## **5. Illicit Financial Flows (IFF)**

- 1. IFF - which come from illegal activities such as laundering the proceeds of crime, corruption and theft of state assets;**
- 2. IFF – which come from legally obtained income and become part of an illicit transaction when tax abuse by individuals or corporations.**
  - While there is consensus with regard to 1.; there is no total agreement re 2)**
  - All agree tax evasion is illegal; some claim tax avoidance is legal therefore should not be considered part of IFF!**
  - But why should what is demonstrably a legal fiction be considered legal**
  - Composition of IFF: 80 % business; 20 % crime etc.**

## 6. International taxation reform- who does what

Name	Approach	Key areas of Work
<b>OECD</b> 34 rich countries	<ul style="list-style-type: none"> <li>• Capacity-building; Technical assistance;</li> <li>• Research;</li> <li>• Developing international tax policy standards;</li> <li>• Forums for dialogue on international tax matters.</li> </ul>	<ul style="list-style-type: none"> <li>• Transparency and exchange of information</li> <li>• Base erosion and profit shifting</li> <li>• Tax and Development</li> <li>• Tax Inspectors without Borders</li> </ul>



# International taxation reform- who does what

Name	Approach	Key areas of Work
IMF	<ul style="list-style-type: none"> <li>• Technical assistance linked to macroeconomic issues (including fiscal policy);</li> <li>• Policy advice;</li> <li>• Research.</li> </ul>	<ul style="list-style-type: none"> <li>• Tax administration</li> <li>• All aspects of tax policy and tax legislation (including major role in introduction of VAT)</li> <li>• International taxation issues (e.g. spillover impacts and bilateral taxation treaties)</li> </ul>

<b>World Bank</b>	<ul style="list-style-type: none"> <li>• Technical assistance to revenue authorities;</li> <li>• Lending and grants to support tax administration and systems;</li> <li>• Policy advice; Research.</li> </ul>	<ul style="list-style-type: none"> <li>• Tax administration</li> <li>• Easing compliance burdens for business and SME taxation issues</li> <li>• Tax disputes and arbitration</li> <li>• Corporate taxation (including transfer pricing and tax incentives)</li> </ul>
UN Tax Committee (1 and half permanent staff!)	<ul style="list-style-type: none"> <li>• Development of guidelines, model treaties and manuals for use by developing countries;</li> <li>• Forums for dialogue on international tax matters;</li> <li>• Tax capacity-building.</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral taxation treaties (UN model treaty), ‘treaty shopping’ and treaty abuses</li> <li>• Transfer pricing (UN manual)</li> <li>• International cooperation in tax matters</li> </ul>