Harmful Tax Practices and the Role of Civil Society

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SADC BIG Conference

April 25, 26 2013

Johanesburg

Overview of Presentation

- The Global Context for Harmful Tax Practices
- Harmful Tax Practices
- The Tax Gap
- Evaluating a tax system and tax practices
- Conclusions

The global context of harmful tax practices

The inherent tension between economic globalisation and domestic taxation:

- Increased cross-border flows of goods and finance
- ICT advances
- Excessive financialisation of the gobal economy
- Dominance of MNEs

Some ‘inherent’ challenges

- Determination of fair ‘arm’s length’ prices for intra-enterprise trade
- Coherent source vs resident principles in the absence of a supra-national tax authority
- Distinguishing between fair and unfair tax competition

But also…

Serious failure of global tax governance: tax evasion and tax avoidance associated espcially with the opportunities available to MNEs as they interact with a range of enabling entities, especially tax havens

Scope of problem

GFI has led work on civil society estimations of illicit financial flows:

- For 2010, their estimate of illicit outflows (ócapital flightô) from developing countries ranges from $ 1.1 trillion to $ 783 billion.
- For Africa, in 2010, they estimate illicit outflows of from $ 86 billion to $ 42 billion.
- Africa, then, is not the main victim (Asia is) in absolute terms, of capital flight.
- However, as a share of Africaôs modest Gross Continental Product these numbers are highly significant
- They also dwarf aid inflows by about 10 to 1
- GFI estimates that about 30-35% is the criminal component, and 60-65% results from the mispricing of exports and imports

Harmful Tax Practices

We need to distinguish between:

- Tax evasion
- Permissible tax avoidance
- Impermissible tax avoidance

How to spot a tax haven

- Zero or very low profits on income and wealth
- Legislated secrecy
- Advertises itself as such
- Different treatment of residents and non-residents

GFI's Secrecy Index 2011

1. Switzerland
2. Cayman Islands
3. Luxembourg
4. Hong Kong
5. USA
6. Singapore
7. Jersey
8. Japan
9. Germany
10. Bahrain
11. British Virgin Islands
12. Bermuda
13. United Kingdom
14. Panama
15. Belgium
16. Marshall Islands
17. Austria
18. UAE
19. Bahamas
20. Cyprus

Some tricks of the trade

- Transfer pricing
- Financial mispricing
- Thin capitalisation
- Round tripping
- Trusts and shell companies

The tax gap

- Very difficult to estimate: a range of contestable assumptions are required
- Innovative approaches such as TJNôs ôexpectations gapô are possible
- SA tax gap estimates range from R 10 billion to R 30 billion
- For 2013/14, R 30 billion wouldôve meant a budget deficit of 3.8% rather than 4.6% of GDP
- R 30 billion would make a R 300 per month BIG available to 8.3 million people

Towards civil society work in evaluating a tax system and tax practices

Consider the following 7 focus areas in assessing the tax evasion/avoidance órisk profileô of country as a way to prioritise tax advocacy efforts.

Tax and economic history of country

For SA, for example, these are some of the factors that would contribute to the risk of widespread harmful tax practices:

- A history of capital flight by individuals and businesses from the 1970s onwards as concern over the viability of the apartheid state mounted
- The use of secrecy jurisdictions by the apartheid state to evade economic and financial sanctions, often in collusion with developed country governments
- Consistent liberalisation of exchange controls since 1997 and the delisting of large SA companies
- Growing ôfinancialisationö of the SA economy
- High and persistent inequality

Transparency

1) Public availability and quality of information about tax policy and legislation

2) Public availability of tax-*relevant* information, such as tax incentive agreements with foreign and domestic firms

3) Interpretive notes which provide clarity on how the revenue authority intends to interpret an apply the tax law

4) Availability of credible tax statistics for past tax years, which includes attempts to assess tax collected against estimates of tax due (i.e. the tax gap)

Institutional performance of the revenue authority

5) Adequacy of Funding of the revenue authority and the ratio of such funding to tax collected

6) Perceived integrity and insulation from political and business interference of the authority

7) Coherent and effective compliance approach (e.g risk profiles and random scanning based on credible industry and individual tax payer data)

A GAAR that covers:

8) Transfer pricing

9) Incorporation and effective management

10) óTainted elementsô

11) CFC legislation

12) Tax havens

13) Thin capitalisation legislation

14) Deferred taxation

Tax treaties and agreements

15) Tax treaties aligned with international norms regarding source and resident principles

16) Information sharing and mutual assistance agreements with other tax authorities

Tax culture

17) Extent of evasion and avoidance ócultureô by MNEs and country-elites, including the perceived values of tax practitioners

Harmful tax practices of own country

18) Different treatment of residents and non-residents

19) Agreements with known tax havens and emerging tax havens

20) Quality of reporting of own corporations

Conclusion: Some general emerging areas for civil society work on tax

- Developing our understanding of unitary taxation and formula apportionment as an alternative to country by country profit taxation of an MNE
- Requiring MNEs, within the current approach, to publish country by country balance sheets rather than at the global level only
- Deepening the call for routine information exchange between tax authorities
- Harsher measures against tax havens, led by developed countries (who implicitly underwrite most of these havens), especially in relation to secrecy provisions
- A conceptual shift in corporate culture from seeing tax as a cost item to seeing it as a social dividend payout