Introduction
Illicit Financial Flows
Data
Empirical Strategy
Pilot study
Implications for Policy
Proposed Policy Interventions
INTRODUCTION

- Multinational corporations exploit existing tax arbitrage opportunities.
- The overall scale of profit shifting and the resulting tax revenue losses - economically significant.
- It has an important negative effect on economic growth.
- Undermines countries’ capacity to mobilize its revenue resources.
- Which countries are likely to be affected more?
$427 billion in tax is lost every year

$245 billion lost to global corporate tax abuse by multinational corporations

$182 billion lost to global private tax evasion by wealthy individuals
• Considering all of a country’s external economic relationships, **where** is the highest risk for illicit financial flows?

• Geographic risk: Which partner countries are relevant?
  ○ E.g. Cayman Islands are the largest global contributor to financial secrecy, but how important are they for North Macedonia?

• What data sources exist to answer these questions?
• Illicit Financial Flows are enabled by legislative opportunities:
  ○ Secrecy → Provides anonymity. Typically involves an offshore corporate structure.
  ○ Lax legislation → Provides motivation and opportunities for corporations and individuals to escape tax or other regulation.
Vulnerability to IFFs

Vulnerability score: Average of Secrecy Scores of partners, weighted by the value of the flow

(= how harmful is the secrecy provided by a country’s partners)
TJN’s IFF vulnerability tracker

http://iff.taxjustice.net/
Inward direct investment to North Macedonia

- Austria: $716.3 M
- Switzerland: $204.2 M
- Serbia: $98.7 M
- LIE
- JFY
- RUS
- LUX
- MLT
- BHS
- VCT
- USA
- FRA
- EST
- ALB
- Bermuda: $116.3 M
- British Virgin Islands: $95.1 M
- Croatia: $84.2 M
- Belgium: $126.6 M
- Turkey: $296.3 M
- Bulgaria: $174.4 M
- Cyprus: $157.6 M
- Netherlands: $461.4 M
- Slovenia: $435.4 M
- Germany: $318.8 M
- United Kingdom: $677.4 M
- Greece: $538.7 M

South Africa: $2.6 B
## DATA – MACRO VS MICRO

<table>
<thead>
<tr>
<th></th>
<th>MACRO</th>
<th>MICRO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level</td>
<td>Country level</td>
<td>Firm level</td>
</tr>
<tr>
<td>Channels</td>
<td>Economic aggregated (Trade/FDI/Bank/Portfolio)</td>
<td>Transfer pricing transactions</td>
</tr>
<tr>
<td>Intensity</td>
<td>Compared with GDP</td>
<td>Compared with Revenue or Gross Profit</td>
</tr>
<tr>
<td>Goal</td>
<td>Understand vulnerabilities, target policy</td>
<td>Red-flag transactions or companies for audit</td>
</tr>
</tbody>
</table>
Use a new source of administrative data: Transfer Pricing Disclosure Forms (TPDFs).

To estimate the relative importance of five transaction categories: (i) tangible goods, (ii) services and fees, (iii) royalties, (iv) interest, and (v) reimbursements.
Our empirical strategy to using transaction-level data to estimate the relative importance of individual profit shifting channels consist of two steps. First step;

\[ T_{i,x} = \sum_{x,c} \tau_{x,c} \cdot X_{i,x,c} \]

We calculate the hypothetical total tax paid on the transaction’s value, \( T_{i,x} \), defined as the sum across \( x \) and \( c \) of the products of the applicable tax rate, \( \tau_{x,c} \), and the value of the transaction category, \( X_{i,x,c} \).
Second step, we move from transaction-level data to the company-level.

\[
\log (\pi_i) = \beta_0 + \beta_x \cdot \log (T_{i,x}) + \gamma_x \cdot \log (V_{i,x}) + \delta_x \cdot \chi_i + \epsilon,
\]

- Use hypothetical taxes in a variation approach pioneered by Hines and Rice (1994)
- \(T_{i,x}\) is a vector of hypothetical taxes applicable to transaction \(x\);
- \(V_{i,x}\) is the value of transaction \(x\);
- \(\chi_i\) is a vector of controls containing the company \(i\)'s financial information available in the TPDFs
- \(\epsilon\) is the error term
Figure 1: Average Haven Score of partner countries for Nigerian MNCs’ intra-group transactions, by type of transaction

Figure 2: Destinations of outgoing transactions classified as Interest
In Nigeria, we analyzed a sample of 87 companies. Risk profiles were created for each company based on the value of the transactions and the location of the subsidiary.

Six companies were selected to be audited: three using the old methodology, three using vulnerability analysis.

The audits are underway and are expected to be completed soon.
Proposed policy intervention in two phases;

• Phase one - identify companies with the high risk of profit shifting.

• Phase two - send letters to a randomly chosen subgroup of companies.

Assess the treated companies’ change in behavior by analyzing TPDFs in the year following the intervention.
CONCLUSION

- We use administrative data and we are happy to help you do that too.

- To identify transactions that are most often used by multinationals to shift profits out of developing countries, or by the wealthy to hide their assets and evade tax and other regulation.

- Interest payments to affiliates in low-tax countries emerge as the likely most important channel of profit shifting for our sample of Nigerian companies.