Joint measurement and policy workshop on illicit financial flows

Methods to measure tax and commercial IFFs

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UN trade & development (UNCTAD)

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Overview

1. Conceptual framework
2. Methods overview
3. Measurement process

Conceptual framework

2030 Agenda for Sustainable Development

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Goal 16 – Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels

- **Target 16.4**: By 2030, significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime
- **Indicator 16.4.1:** Total value of inward and outward illicit financial flows (in current US Dollars)
- **UN Trade and Development (UNCTAD) and UNODC**, as co-custodians of indicator 16.4.1, are mandated to develop the statistical methodology

UNCTAD-UNODC progress

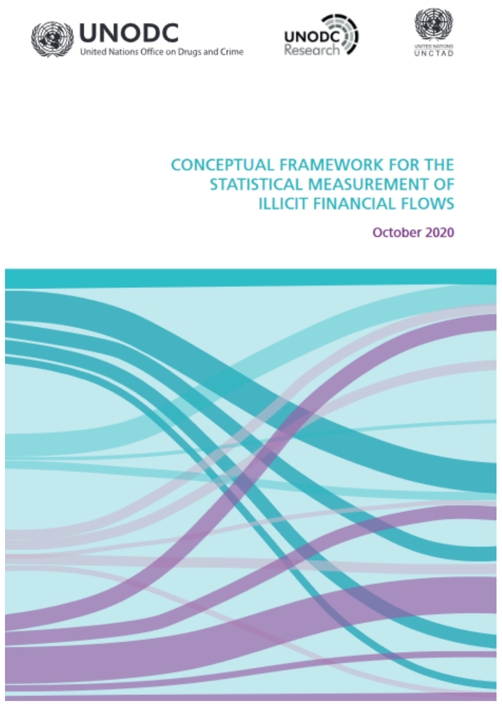
1 **From 2017**

Identify a definition and a measurement framework through:

- **Global expert consultations**
- **Task Force** on the statistical measurement of illicit financial flows

2 **October 2020**

Launch of the **<u>Conceptual Framework for the Statistical Measurement of IFFs</u>**



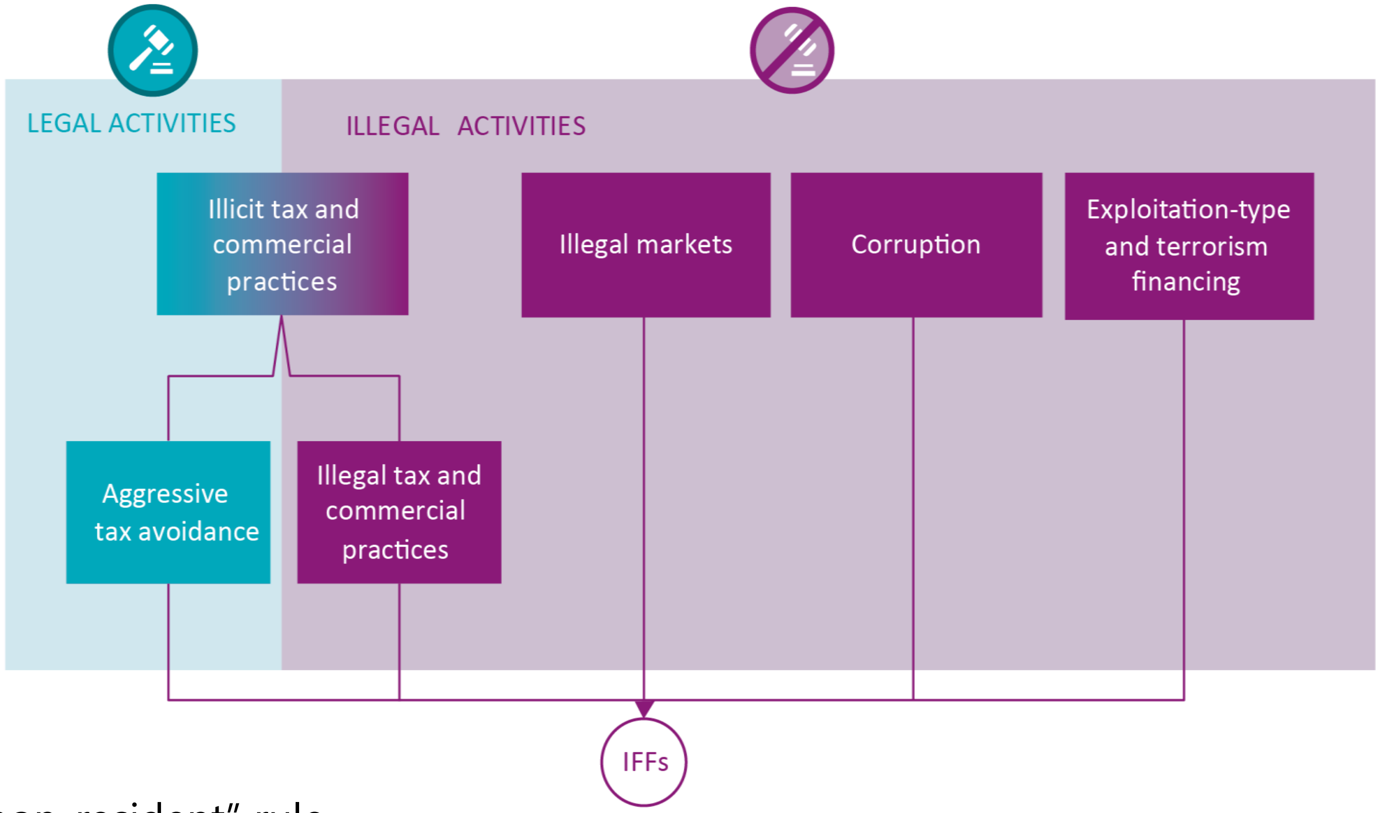
3 **March 2022**

Conceptual framework **endorsed** at the **53rd UN Statistical Commission**

Illicit financial flows

Definition for statistical purposes:

Illicit financial flows are "*Financial flows that are **illicit in origin, transfer or use**, that reflect an **exchange of value** and that **cross country borders**.*"

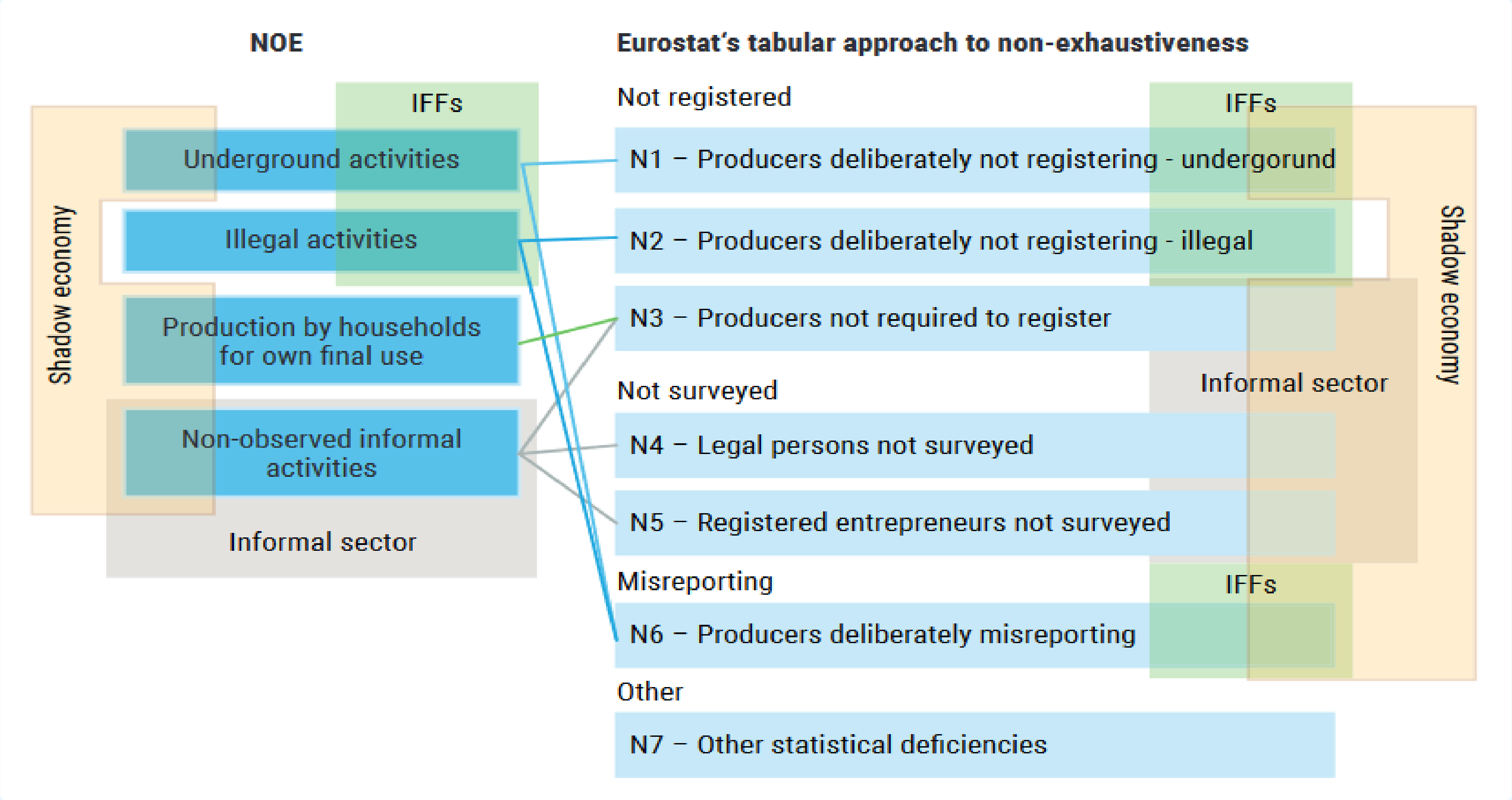


Core elements

- ✓ **Illicit ->** not only illegal
- ✓ **Cross-border** -> not domestic, "resident"/"non-resident" rule
- ✓ **Flows ->** no stock, no net flows
- ✓ **Exchange of value** -> not limited to financial assets. Any transaction form involving **any type of assets** (cash, precious metals, equities…)

Illicit financial flows and related concepts

Figure 14 Links of illicit financial flows to related concepts



Source: UNCTAD (2021)

Main conceptual framework features

Disaggregated: separate estimates for each IFF type
Bottom-up approach: starts from estimation of the value generated by illicit activities, to derive the amount of proceeds available for domestic and cross-border laundering (IFFs)
Comprehensive: encompasses all main types of illicit activities that cause IFFs
Country-Level: Allows to measure IFFs at the level of countries (in line with SDG indicator framework)
Compatible: Aligned to established concepts and standards from economics and accounting (system of national accounts and balance of payments)

Income generation / income management

Income generation

Set of cross-border transactions that are either performed in the context of the **production of illicit goods and services** or **generate illicit income for an actor during a non-productive illicit activity**.

- Linked to illicit markets and their functioning.
- Transnational supply and demand of illicit goods and services.

Income management

Set of cross-border transactions that **use illicit income to invest** in financial and non-financial assets **or to consume** goods and services

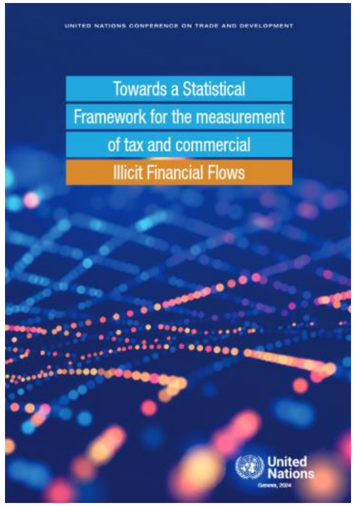
- IFFs to manage income generated from illicit activities.
- Linked to consumption and investment patterns.

Separate accounting of income generation and income management can help reduce risks of double counting and allow consistency with the SNA, BoP and other statistical frameworks.

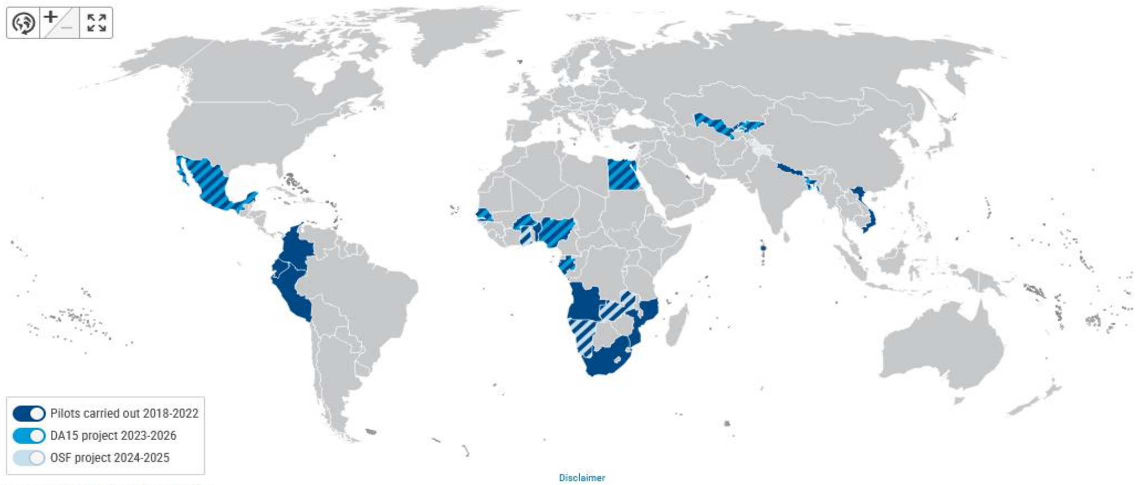
Ongoing and upcoming activities

- UNCTAD and UNODC developing methods to measure tax and commercial and crime-related IFFs respectively.

- Method testing pilots in 22 countries completed, further methodological refinement in 8 countries (2023-2026)



Map 1. 22 countries have studied the measurement of IFFs in 2018-2022 and twelve countries will do so between 2023 and 2026



Source: UNCTAD and UNODC
Note: Situation reflected on the map as of April 2024

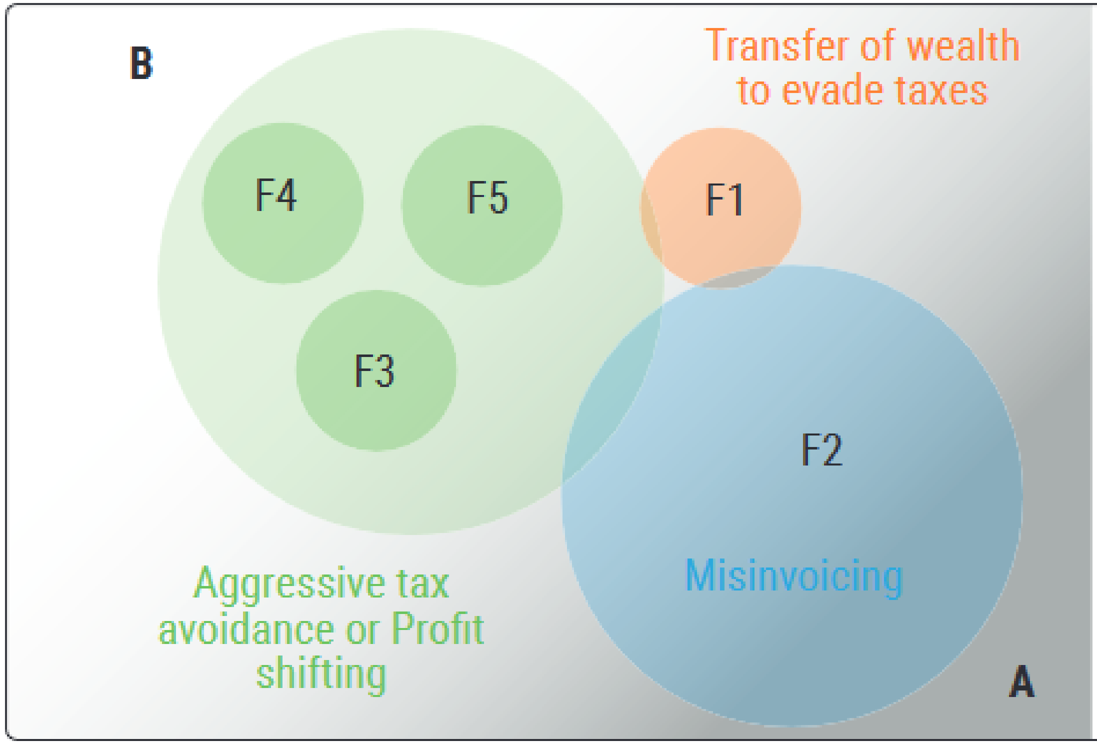
- IFF statistical framework expected for 2025-2026 - aggregating estimates tax/commercial and crime IFFs.

- Exploring opportunities to measure IFFs in Satellite/Thematic Accounts.

Tax and commercial IFFs - Methods overview

Tax and commercial IFFs

Figure 3 Main types of tax and commercial illicit financial flows



A Illegal commercial activities and tax evasion

F1 Transfer of wealth to evade taxes

F2 Misinvoicing

B Aggressive tax avoidance

F3 Transfer mispricing

F4 Debt shifting

F5 Assets and intellectual property shifting

Source: UNCTAD (2021)

Tax and commercial IFFs

Trade misinvoicing

- #1 Partner Country Method (PCM)+
- #2 Price Filter Method (PFM)+

Aggressive tax avoidance

- #3 Global distribution of MNEs profits and taxes
- #4 MNEs vs non-MNEs profit shifting

Tax evasion by individuals

- #5 Flows of undeclared offshore assets indicator
- #6 Flows of offshore financial wealth by country

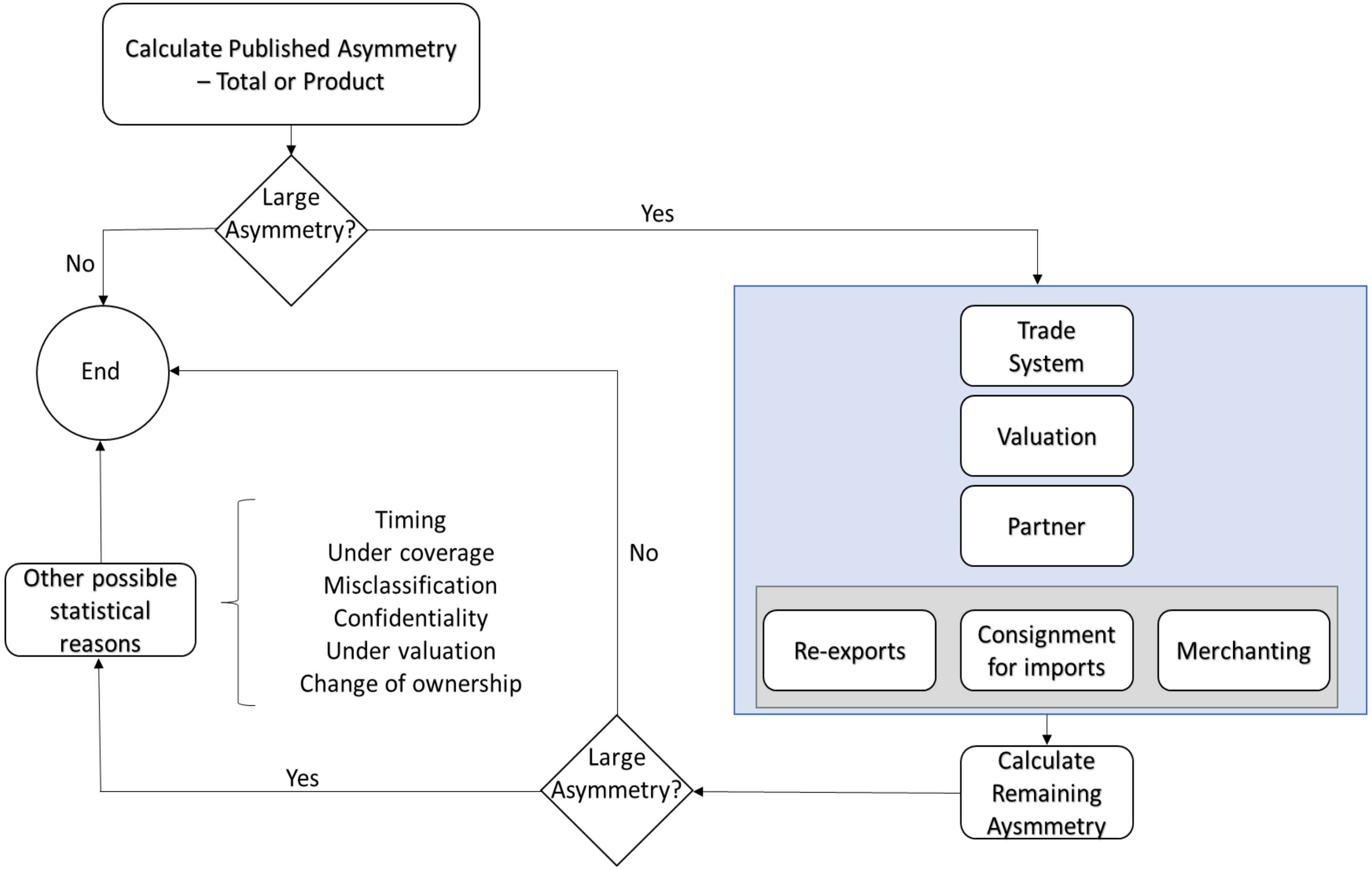
Trade misinvoicing – M#1

M#1: Partner Country Method **Plus**

Mirroring trade values by trading partners

Many factors for discrepancies -> [inspect!]

Discrepancy ≠ IFFs



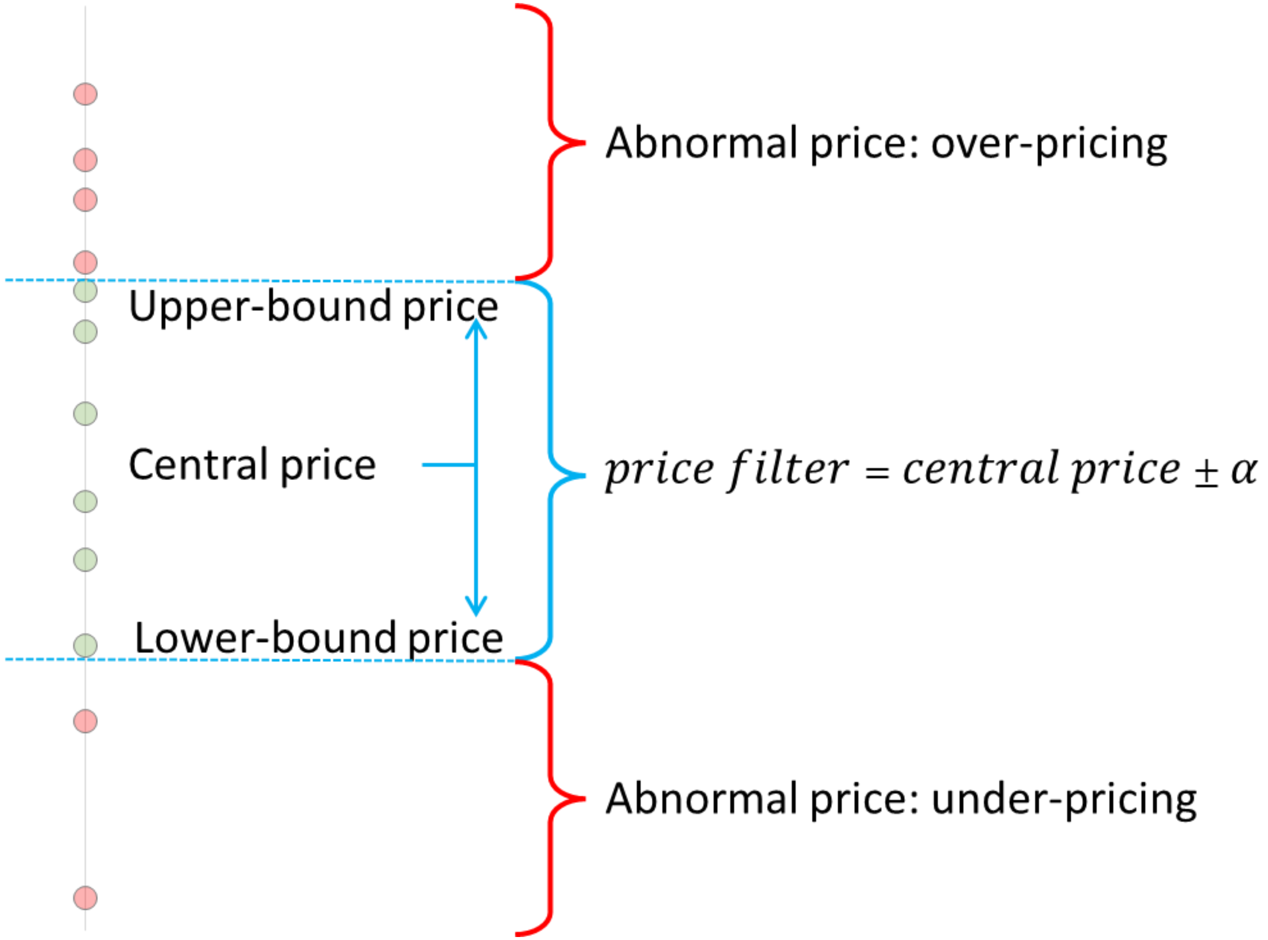
Trade misinvoicing – M#2

M#2: Price Filter Method Plus

Detect abnormal prices, deviating from arm's length

Central price? [statistical vs market price filter] [heterogeneity of products]

Variation? [consult experts]



Aggressive tax avoidance – M#3

M#3: Global distribution of profits

Tax semi-elasticity approach

Assuming shifting profits to lower-tax units

Any systematic deviation from predicted profitability is a sign of potential profit shifting -> caution in interpretation!

Data	[country-by-country reports, tax returns]
Tax rate	[effective tax rates, non-linear tax sensitivity]
Validate results	[location & economic activity of the unit]

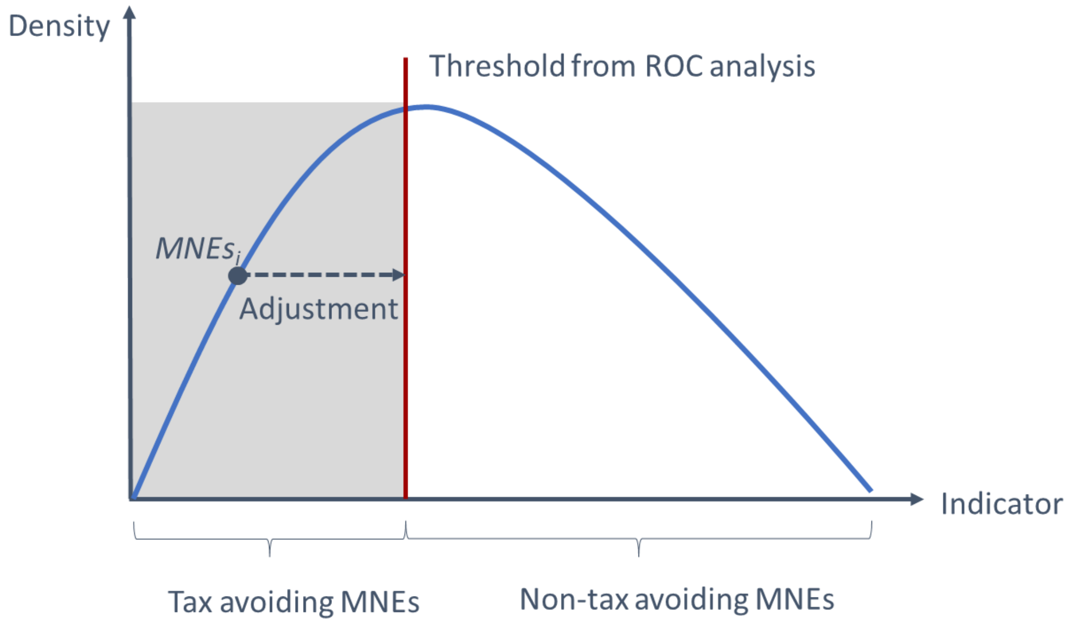
Aggressive tax avoidance – M#4

M#4: MNEs vs comparable non-MNEs

Hypothesis : Profit shifting detected by structural differences in business statistics

[deviation from normality]

- Step 1: Between (MNE vs non-MNE) + within (among MNEs) comparison
- Step 2: classification suspect – non suspect (ROC curve)



$$OutwardIFFs_i = \left(\tilde{x}_{h,i} - x_{j,i}\right) * Turnover_i$$

$x_{,i}$ … the declared value of EBIT to turnover ratio;

$\tilde{x}_{h,i}$ … the threshold value of the EBIT to turnover ratio in order to be classified as non-tax avoiding MNE.

Tax evasion by individuals – M#5

M#5: Undeclared offshore assets

Assets declared offshore by citizens of country A
vs
Assets of country A's citizens reported in other countries

Assumptions!

- Assumption:
  $\boxed{\text{internationally reported}} > \boxed{\text{reported to national authorities}}$

$$\phi_i = \sum_j \boxed{\beta_{j,i}} - \boxed{\alpha_i}$$

BIS LS
OECD CRS

National Tax
Authority

[Not distinguish between various categories of IFFs] -> double counting!

[Data requirements and availability]

[Citizenship vs residence]

[Stock vs flows]

Tax evasion by individuals – M#6

M#6: Offshore financial wealth

Unreported wealth held by individuals outside their countries

Validation and calibration of assumptions!

[Non-compliance rate]

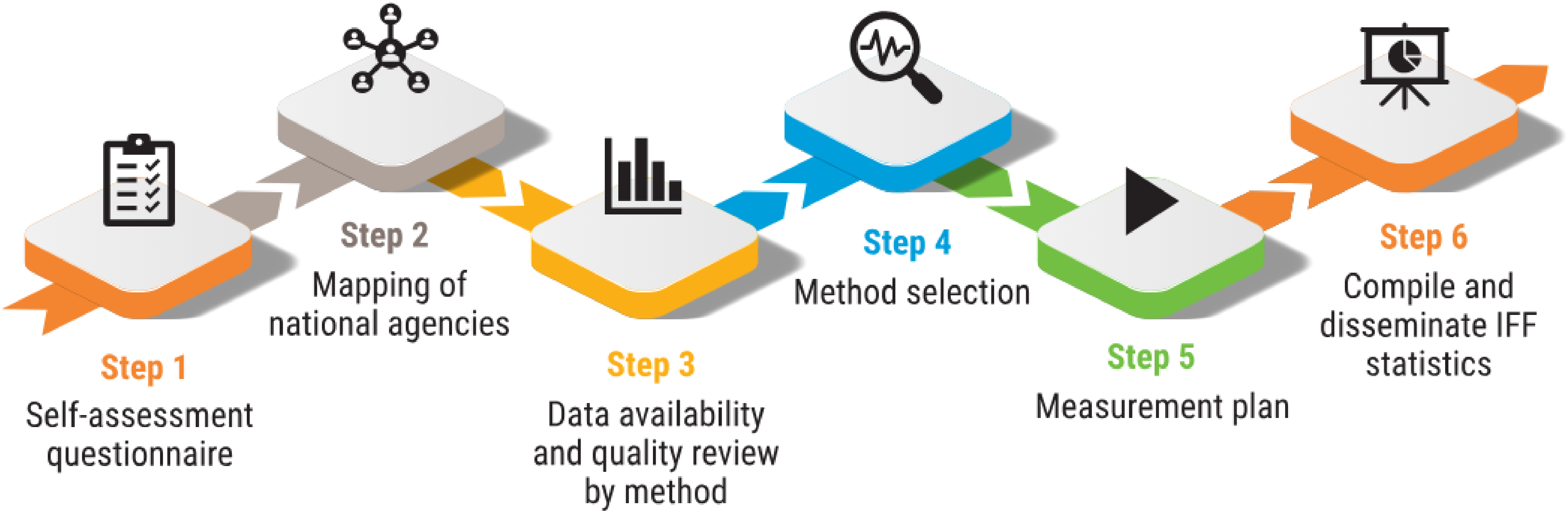
[Divide offshore wealth into deposits and portfolio investments]

[Capital gains, wealth consumption?]

Data exchange -> agreements, confidentiality

Measurement process

Measurement process



Mapping of national institutions

STATISTICS
- NSOs
- Statistical units of Customs, Central Bank

GOVERNMENT & POLICY
- Line ministries
- Financial intelligence units
- Government agencies

IFFs

ECONOMY & TRADE
- Chambers of commerce
- Trade unions

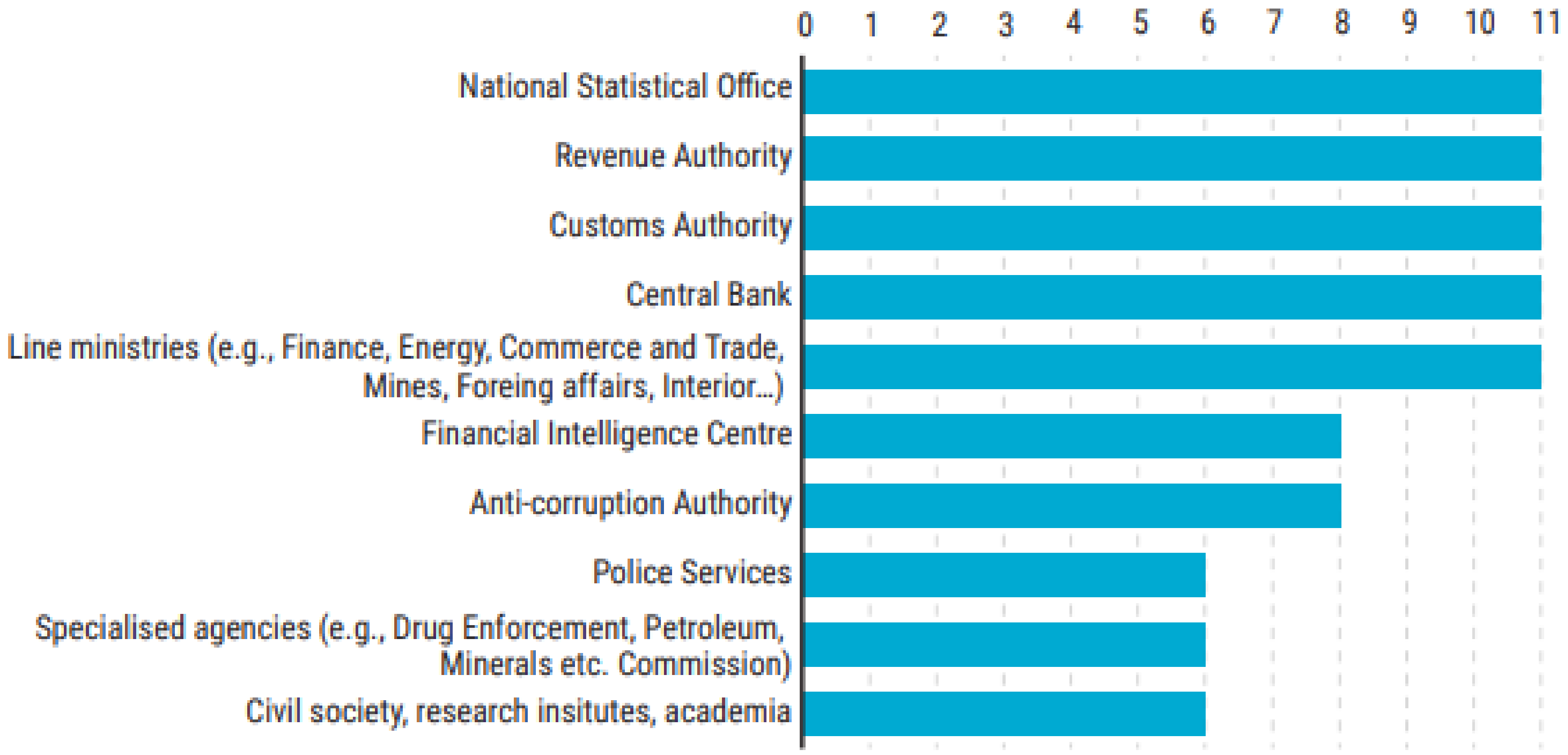
LAW ENFORCEMENT
- Police
- Customs/border control
- Criminal intelligence units

PRIVATE SECTOR
- Commercial banks
- Businesses

CIVIL SOCIETY
- NGOs
- CSOs
- Citizen science

Mapping of national institutions

Figure 11 The number of institutions involved in measuring tax and commercial IFFs in African countries



Key data sources

- International **trade** in goods and services statistics, **customs** data
- **Tax** data, transfer pricing disclosure forms, structural business statistics, statistical business registers
- Tax data, financial transactions data, tax audits, data from voluntary disclosure programmes, crime and criminal justice data
- Global data sources: UNCTAD, Comtrade, OECD, BIS ...

Data availability

- **Pool, share, access** data
- Data **availability review**

- **Variable/data needed**: listing the variable required for a particular method to measure IFFs.
- **Data source/agency**: listing which agency has the data and is considered a data source for this variable.
- **Frequency**: frequency of the reported variable.
- **Timeliness**: time lag of when data become available after the event.
- **Access**: how easily the data are accessible by an agency (group of agencies) compiling IFF statistics, including also legal setup.
- **Coverage**: what units and phenomena are measured by the variable selected, indicating whether there are potential gaps or overlaps in measurement.
- **Granularity**: what level of granularity for a variable is available.
- **Interoperability/format (linking)**: how is the variable integrated with other data, e.g., at which level and through which variable.
- **Alternative/proxy**: if variable is not available, what is the alternative variable and its source.
- **Fit for purpose**: is the variable in line with measurement requirements of IFFs?
- **Availability**: indicating whether variable/data with required quality are available or not.

Sustainability and uses

- Ensure **nationally-owned** sustained process
- **Action plan**
- Collaboration & capacity strengthening
- **Relevance** for analysis, policy, decision-making

Materials

- Conceptual Framework: https://unctad.org/publication/conceptual-framework-statistical-measurement-illicit-financial-flows
- Methodological Guidelines (draft): https://unctad.org/publication/methodological-guidelines-measure-tax-and-commercial-illicit-financial-flows-methods
- Towards a Statistical Framework to measure tax and commercial IFFs: https://unctad.org/publication/towards-statistical-framework-measurement-tax-and-commercial-illicit-financial-flows
- Statistical Measurement of Tax and Commercial Illicit Financial Flows: Pilot testing methodologies for SDG indicator 16.4.1: https://unctad.org/publication/statistical-measurement-tax-and-commercial-illicit-financial-flows
- Project website: https://unctad.org/project/measuring-and-curbing-illicit-financial-flows
- UNCTAD website: https://unctad.org/statistics/illicit-financial-flows

Thank you

https://unctad.org/statistics/illicit-financial-flows

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