Illicit Financial Flows

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- The European Network on Debt and Development (Eurodad)
- 46 member groups in 19 countries
- Eurodad advocates for:
    - Policies that support pro-poor and democratically-defined sustainable development strategies
    - Development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.

What are IFFs?

<u>Illicit financial flows:</u>

In one word: **Politics…**

But the term is used to describe international flows stemming from:

- Proceeds of crime, incl. corruption
- Tax abuse (both tax evasion and avoidance)
- Market or regulatory abuse
- Theft of state funds, incl. illegitimate borrowing and lending, and other types of power abuse

“IFF” can cover flows that are illicitly earned, transferred or utilized

What are IFFs?

Illicit financial flows:

Illegal activities (trafficking, illegal arms trade, drugs, corruption, tax evasion, etc.)

Immoral and/or socially unacceptable activities (esp. corporate tax avoidance)

And activities that fall in the grey zone between the two…

What are IFFs?

<u>Illicit financial flows:</u>

Common traits:

- Use of financial secrecy (secrecy jurisdictions, tax havens, anonymous shell-companies, etc.)
- Loss of public resources

The politics of IFFs

- Illegal financial flows: At least on papr, all countries agree that this is unacceptable, but in particular the corruption agenda has historically been pushed hardest by OECD countries

- Legal or semi-legal financial flows: Much of this concerns the international rules for taxing multinational corporations. OECD countries don’t want the United Nations to get involved in this

- Consequently: Many OECD countries are advocating for a narrow definition of IFFs, whereas many developing countries want a broad definition (incl. legal flows)

Why are IFFs a hot topic?

- The loss of public resources amounts to hundreds of billions of dollars per year
- Addressing IFFs is now a part of the SDGs

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Sustainable Development Goal 16, 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

A few events that helped get us to SDG 16.4

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Offshore leaks (2013)

Luxleaks (2014)

Swiss Leaks (2014)

A few events that helped get us to SDG 16.4

- The report from the High-Level Panel on Illicit Financial Flows from Africa (“Mbeki Panel’s” report, 2014)

*“IFFs from Africa range from at least **$30 billion to $60 billion** a year… in reality Africa is a net creditor to the world rather than a net debtor, as is often assumed*

*“**large commercial corporations** are by far the biggest culprits of illicit outflows, followed by **organized crime**. We are also convinced that **corrupt practices** in Africa are facilitating these outflows*

*“It is somewhat contradictory for **developed countries** to continue to provide technical assistance and development aid (though at lower levels) to Africa while at the same time **maintaining tax rules that enable the bleeding** of the continent’s resources through illicit financial outflows”*


Illicit Financial Flows

Report of the High Level Panel on Illicit Financial Flows from Africa

Commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development

SDG target 16.4: IFF indicators

IFF indicator under SDG 16.4:
Total value of inward and outward illicit financial flows

- Illegal IFFs: Illegal activities are always difficult to measure.

- Legal IFFs: Could in theory be easier to measure, since transparency can be introduced by law. But especially among OECD countries, there is strong resistance towards, for example, letting developing countries and/or the public know what multinational corporations pay in taxes on a country by country basis

- Therefore, all IFF measurements are currently estimates.

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- An indicator for (legal or semi-legal) tax avoidance is still under discussion.
- Some estimates of revenue loss due to corporate income tax avoidance:
  - UNCTAD (2015): From developing countries - around US$70-120 billion per year
  - Cobham & Jansky (2017): Globally - around US$500 billion per year
  - Tørsløv, Wier & Zucman (2017) - Globally around €200 billion per year

What can be done?

Reducing illegal IFFs

Ownership transparency
Ending anonymous shell-companies, trusts and similar structures, which can be used to hide the true owner of assets.

- Public registers of ‘beneficial owners’ of companies was introduced in the EU in Spring 2018

What can be done?

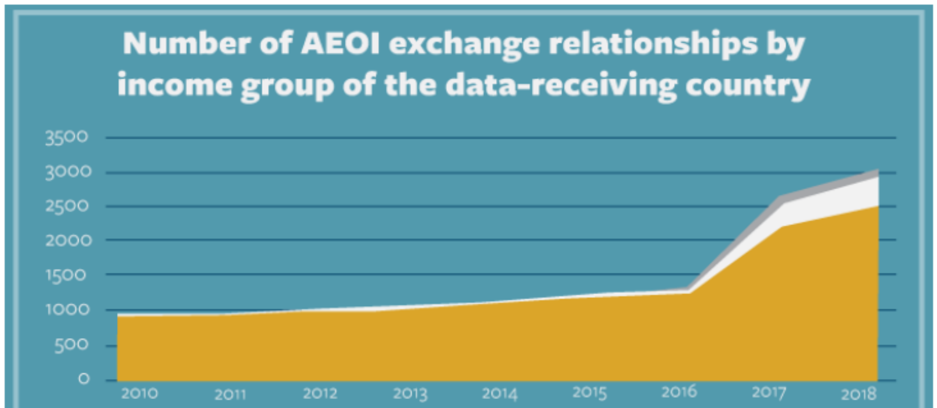
Reducing illegal IFFs

Exchange of banking information between governments: Identifying the real owners of bank accounts and sharing the information automatically with the tax authorities in the home country of the owner.

- International OECD/G20 agreement on automatic information exchange. NB! This agreement is based on a “dating system” where countries have to choose each other bilaterally before automatic information exchange will start. For example, Switzerland has chosen G20, Europe and ‘important economic and trade partners’, but not all countries.

What can be done?

Reducing illegal IFFs



	2010	2011	2012	2013	2014	2015	2016	2017	2018
RECEIVING PARTNER INCOME GROUP LMIC	0	0	0	0	0	0	2	55	59
RECEIVING PARTNER INCOME GROUP UMIC	58	58	64	66	68	75	80	362	436
RECEIVING PARTNER INCOME GROUP HIC	930	930	1008	1034	1106	1210	1259	2219	2543

LMIC: Low and Middle Income Countries UMIC: Upper and Middle Income Countries HIC: High Income Countries

FTC & Christian Aid, 2017

High-income countries have easier access to info. For example, Switzerland has chosen to exchange with G20, Europe and ‘important economic and trade partners’, but not all countries.

What can be done?

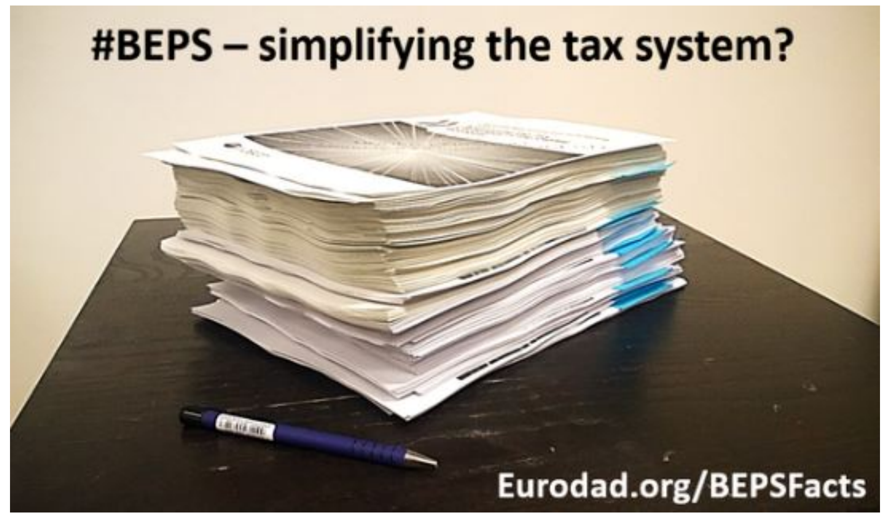
Reducing legal and semi-legal IFFs

Requires a review of the "global" rules on taxing multinational corporations

The ”global” tax system for multinational corporations

Mainly written by the OECD and G20 countries

- Tax system is highly complex, and based on the transfer pricing rules, incl. the “arm’s length principle”
- Citizens are not allowed to know how much tax multinationals pay in their countries



How multinationals are taxed today

Subsidiaries of multinational corporations are taxed as **independent companies**, based on the amount of profits they each have. However, through internal trading between subsidiaries, **profits can be shifted** between subsidiaries – from high-tax to low-tax jurisdictions. To shift profits, multinational corporations can manipulate the prices used when trading internally (**transfer mispricing**).

The transfer pricing rules are far from an exact science, and leave a lot of room for interpretation. The exact transfer pricing arrangements are often agreed bilaterally, in **secret agreements** between a corporation and a government.

How multinationals are taxed today

Tax Administrations can challenge transfer pricing decisions if they can find ‘**comparables**’, that show the multinational has not used market prices in their internal trades (i.e. that the ‘**arm’s length principle**’ has been violated).
However, it’s very difficult to find comparables for, for example, management advice, ‘knowhow’ or trademarks.

While countries are in most cases committed to taxing corporate profit made from business activity in their own country...
... many countries at the same time offer tax breaks on profits that are generated in other countries, but moved to their country for tax avoidance purposes. Often referred to as ‘***attracting business***’ through ‘***tax competition’***.

How multinationals are taxed today

- The Arm’s Length Principle is very unclear – a principle rather than a clear basis for taxation
- Citizens are not allowed to know that multinational corporations pay in tax in each country, and key interpretations of the law are issued as secret bilateral agreements with individual corporations
- Governments are competing instead of cooperating
- Many countries try to attract profits from other countries by offering ways for multinationals to avoid taxes
- The corporate tax system is extremely complicated

Whistleblowers, state aid cases and media investigations give us important insights

<u>Commission's estimate - Apple/Ireland state aid case</u>

Tax avoided:

€13 billion (2003-2014)

Effective corporate tax rate in 2014: **0.005%**

<u>LuxLeaks scandal (2014)</u>

Over 340 multinationals had secret deals with Luxembourg, resulting in billions of avoided tax. In some cases, the tax rate was less than 1%

Blacklisting of tax havens

Blacklisting of “tax havens” remains highly political

OECD: Trinidad and Tobago

EU: American Samoa, Guam, Namibia, Palau, Samoa, Trinidad and Tobago, the U.S. Virgin Islands

Other ”tax haven” lists

Secrecy jurisdictions

1. Switzerland
2. USA
3. Cayman Islands*
4. Hong Kong
5. Singapore
6. Luxembourg
7. Germany
8. Taiwan
9. United Arab Emirates (Dubai)
10. Guernsey*
11. Lebanon
12. Panama
13. Japan
14. Netherlands
15. Thailand

* British overseas territory or crown dependency. If Britain's network were assessed together, it would be at the top.

Source:
Financial Secrecy Index, Tax Justice Network 2018

Corporate “tax havens”

Offshore financial centres - top five	
Sinks	**Conduits**
Luxembourg	The Netherlands
Hong Kong	United Kingdom
British Virgin Islands	Switzerland
Bermuda	Ireland
Cyprus	Singapore

Source: Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network (Garcia-Bernardo et al., 2017)

What can be done to reduce legal and semi-legal IFFs

- Allowing citizens to see what multinational corporations pay in tax in their country

- Replacing the transfer pricing system & arm's length principle

- Protection of whistleblowers

International decision making on tax and transparency

International decision making

Rule-makers & Rule-takers

Shifting the global standard setting from the OECD and G20 to the United Nations would allow new alliances to emerge

Thank you for you attention

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