: Global Governance Spotlight

2 | 2015

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# A milestone on the road to fairer global taxation?

## The 3rd International Conference on Financing for Development

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**For decades, development policy was shaped by the notion that the poor countries of the Global South needed money from the wealthy North in order to advance in their development. Since the 2008/9 financial crisis – and perhaps even before this – as various members of the OECD (Organisation for Economic Co-operation and Development) have found themselves facing national debt crises, this view of things has, it seems, begun to change. At the heart of the negotiations on the outcome document of the Third International Conference on Financing for Development, scheduled to take place from 13 to 17 July 2015 in Addis Ababa, lie two questions: How can 'developing countries' muster increased resources at home, in order to finance much-needed investment and expenditure on infrastructure and basic social-welfare provision? And how can both the size and effectiveness of international development aid be boosted? Neither of these problems – nor the precarious state of government coffers, including across the Global North – can be tackled without either increasing tax revenues or finding more effective and efficient ways of generating them.**

One major obstacle here is the tax avoidance and evasion practised by corporations and wealthy individuals – an issue that has come in for much greater public attention in recent years. The Washington-based research institute Global Financial Integrity, for example, estimates that illicit financial flows (IFFs) out of developing countries totalled US$6.6 trillion between 2003 and 2012, with the figure for 2012 standing at 991.2 billion. Although this includes monies deriving from straightforward criminal activity and corruption, the lion's share – 77.8 per cent – results from tax-avoidance practices (such as trade misinvoicing and trade mispricing) operated by transnational concerns. Africa alone loses at least US$50 billion a year in this way – this was the conclusion reached in an African Union report chaired by former South African president Thabo Mbeki. By way of comparison: the cumulative total of all official development assistance (ODA) for 2014, according to OECD criteria, was US$135.2 billion. Jesse Griffiths of Eurodad calculates that for every dollar the countries of the Global South take in (in the form of ODA, migrant transfers back home, investments and the like) they lose more than 2 dollars – 93 cents of this through IFFs.

### A global challenge

Losses due to tax avoidance and evasion have now also become a serious problem for the wealthy countries of the North – and not just those with high levels of national debt. The 'leaks' scandals of recent years, whether 'Offshore', 'Luxemburg' or 'Swiss', are eloquent testimony to this. They also flag up the weak points in the global taxation system. For one thing, there is still no effective inter-country cooperation between tax authorities, particularly when it comes to exchanging information about foreign nationals who make capital investments in the countries concerned. For another, the rules governing transfer pricing and invoicing are full of loopholes at the international level and are so complex that it is virtually impossible to monitor compliance effectively. A final factor is inter-country tax-competition, which continues to flourish, even within the European Union. The special terms which countries like Ireland and Luxemburg – and also the Netherlands – offer to transnational companies enables these enterprises to keep their tax-burden down at absurdly low levels.

In response to the public debate about these issues, but also because of the urgent need to boost public revenues, both national and international forums are currently working on a variety of possible solutions to the problem. These have two objectives:
1) they want to see greater transparency in regard to the financial transactions, assets and/or (beneficial) ownership status of corporations and individuals and they want whatever information is gathered to be shared between countries;
2) they want the tax regime for transnational corporations to be reformed, at least to the extent that the greatest loopholes are closed.

## Transparency and information-sharing

In recent years, movement on transparency and information-sharing has been due primarily to a US drive in this area. In 2010, prompted by cases of tax evasion involving banks in Liechtenstein and Switzerland, the US Congress passed the Foreign Account Tax Compliance Act (FATCA). This requires financial institutions across the world to pass information concerning accounts held by US citizens to the Internal Revenue Service (IRS). Institutions that contravene these regulations will have a 30 per cent penalty-tax imposed on profits in the US. Originally, banks had to report directly to the IRS, but a whole range of bilateral treaties have now been put in place which enable data to be transferred via government channels – and which also make it possible to obtain information from the US in return (albeit to a lesser extent).

A similar but more narrowly focused attempt to create greater transparency had already been made by the European Union with its Savings Tax Directive (EUSTD), which came into force in 2005. The Directive required that information about interest-payments made to persons not resident in the country in question be shared amongst the tax authorities of member-states. However, the Directive also provided for a substitute withholding tax, a provision applied by Luxemburg and Austria. In March 2014, an amendment was made to the EUSTD: information was now also to be exchanged about legal persons and the definition of ‘interest’ was broadened. In addition, in October 2014, the EU Directive on Administrative Cooperation in the Field of Taxation was renewed. This requires the automatic exchange of information between tax authorities for five types of income: salaries and wages; professional fees; proceeds of life insurance; pensions; and income from property.

In a further move, the new OECD Common Reporting Standard (CRS) is to be implemented, as stipulated in an agreement signed by 51 countries and jurisdictions in October 2014. The CRS is based largely on FATCA but takes a multilateral approach and differs from it on certain individual points (there are no arrangements for sanctions, for example). One criticism levelled by commentators is that the reporting standards are effectively geared solely to governments in industrial countries and that there are no provisions regarding implementation in countries of the Global South. Thus there is, at least currently, no option for one-way information-sharing, not even for transition periods, – a provision that would enable poor countries to benefit from information before they were in a position to supply some in return.

Other important steps towards greater transparency have been taken with the adoption of various regulations and guidelines relating to transnational companies from different sectors. By way of example: firms dealing in the extraction of minerals and fossil fuels are required by the Dodd-Frank Wall Street Reform and Consumer Protection Act and the EU Accounting and Transparency Directives to publish details of payments to governments on a country-by-country basis in their annual reports. The EU Capital Requirements Directive requires banks to disclose core data about their tax payments and business operations. Transparency requirements for other sectors are also in prospect at both EU and OECD/G20 level. Information disclosed by these means can be used by the media and by civil society to pick up irregularities at an early stage and to prevent corruption.

## Reform of company taxation

In November 2013, the G20 commissioned the OECD to design an action plan on base erosion and profit shifting (BEPS). The plan will suggest ways in which loopholes in company taxation might be closed. Interim proposals were approved by the G20 in November 2014. These covered 7 of the 15 points dealt with in the action plan: the transfer-pricing system for intangibles; harmful tax-practices; treaty abuse; hybrid mismatch arrangements; transfer pricing documentation; the digital economy; and the development of a multilateral tax-instrument. October 2015 is the projected deadline for processing the 8 remaining points: regulations on controlled foreign companies; interest-payment practices; involvement of non-OECD members; the ‘permanent establishment’ issue (in other words, the question of when a foreign subsidiary becomes liable for tax); transfer pricing for risks and capital; collection and analysis of data on BEPS; disclosure of aggressive tax-planning arrangements; and intergovernmental disputeresolution mechanisms. Because of the politically explosive nature of the topic, the BEPS project is advancing at a breathtaking pace compared with other measures being undertaken to refine international tax-regulations.

Although the overall thrust of the BEPS project has generally been welcomed, there have been several points of criticism. Some highlight the fact, for example, that certain negotiations and development-sessions (on harmful tax-preference regimes in specific countries, for instance) have been conducted behind closed doors; others criticise that work on the multilateral instrument – through which the individual BEPS measures will ultimately be enacted – has not involved civil society to a greater extent. Another major point is that the OECD is either unwilling or unable to fundamentally rethink its approach to transfer-pricing – the 'arm's length principle' (which aligns intra-company with market prices) – or to replace this with radically different methods such as a unitary tax.

## The involvement of the Global South

Other critics home in on the meagre benefits of the BEPS project to countries of the Global South – even though these are the very countries for whom the project's success would mean the most. Some of these countries derive the greater part of their corporate tax revenues from multinational concerns – in Rwanda, for example, the figure is 70 per cent, in Nigeria as much as 80 per cent. In a large-scale study carried out in 2014, the International Monetary Fund concluded that tax avoidance in these countries was particularly marked. All the signs are, however, that the measures mooted by the OECD will take only peripheral account of the interests of Southern countries. The OECD fraternity of industrialised countries is thus acting true to form – existing standards on international taxation are already geared to its membership.

The negotiations on the outcome document of the Third International Conference on Financing for Development in July 2015 will see the topic of taxation play an important role – notably in the section on the mobilisation of domestic resources. This creates a space in which to consider how global cooperation on tax might be radically reconfigured in ways that also benefit the Global South, particularly from a structural point of view.

At first sight, the initial draft of the outcome document (the 'zero draft') appears disappointing, in that it lists the main proposals on the current fair-taxation agenda (measures to combat IFFs, transparency initiatives such as country-by-country reporting requirements, establishment of public beneficial owner registries, and so on) but does not evolve its own approaches for solutions or reforms. It would, however, be scarcely realistic to expect a non-binding negotiating process that has lasted less than nine months to come up with any momentous advances on what are sometimes highly complex and technically involved issues.

Despite the absence of concrete proposals for reform, the text does provide a number of important political pointers. It proposes, for example, that the UN Committee of Experts on International Cooperation in Tax Matters, which has so far proved somewhat wan and ineffectual, should be upgraded to an intergovernmental committee. The co-chairs of the negotiations are here falling into line with demands and suggestions made by the G77 and the UN Secretary-General. Although strong opposition to the proposal is building up in the negotiations (particularly on the part of the EU and OECD, who consider their interests are already sufficiently well safeguarded), such an upgrading could fill an important gap in tax-related global governance. Including all countries on an equal footing would enhance the binding nature and legitimacy – and thus also the effectiveness – of any rules on global tax cooperation that emerged. Country cooperation on taxation-issues could then also be geared more closely than at present to the interests of small and, above all, poor countries. Where information-sharing was concerned, this would mean establishing transitional periods for achieving reciprocity in the flow of information and/or according these countries a right to support. Rather than running counter to the G20 and OECD attempts at reform, the work of such a committee would provide a useful complement to it – without putting global taxation policy into the hands of a regulatory body with an exclusive membership.

Non-governmental organisations have, similarly, already made concrete suggestions about the ultimate form a UN-based intergovernmental committee might take. Unlike the G77 governments, they do not call for an upgrade of the UN Committee of Experts but instead propose complementing it with a functional ECOSOC committee whose membership is open to all. In order to ensure its decisions are as binding as possible, this committee should, ideally, also be made the custodian of a framework-convention on international tax cooperation (along the lines of the Convention on Climate Change). Only in this way would it be possible to accommodate the principle of national fiscal sovereignty (also in force within the EU) and at the same time assure equal participation by the countries of the Global South.

## What remains to be done

These institutional reforms within the UN would also provide a locus for negotiations about projects and processes that have not yet made it onto the agenda.

These include, for example, a root-and-branch reform of the way in which transnational corporations are taxed. Here too, significant impetus is being generated by civil society. Various organisations (such as the Friedrich Ebert Foundation, Public Services International and the Global Alliance for Tax Justice) have, for example, set up an Independent Commission on the Reform of International Corporate Taxation. Involving prominent experts such as the economist Joseph Stiglitz, the former UN Under-Secretary-General for Economic and Social Affairs and Colombian Minister of Finance José Antonio Ocampo, and the MEP Eva Joly, the Commission elaborates proposals for reconfiguring the taxation regime for transnational corporations in ways that will render it more effective and more efficient. There will be a presentation of these proposals during the Addis Ababa meeting. This will, of course, come too late to influence results at that gathering, but it could already map out a path for the next stage of the work, once the BEPS project is concluded.

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**Imprint**

The Development and Peace Foundation was founded in 1986 on the initiative of Willy Brandt. As a cross-party and non-profit-making organisation, the sef: provides an international high-level forum for shared thinking on urgent peace and development issues.

Global Governance Spotlight is a policy-oriented series whose purpose is to critique international negotiation processes from a global governance perspective.

**Published by**
Development and Peace Foundation/
Stiftung Entwicklung und Frieden (sef:)
Dechenstr. 2 : 53115 Bonn : Germany
Phone +49 (0)228 959 25-0 : Fax -99
sef@sef-bonn.org : www.sef-bonn.org



**Editor**
Sabine Gerhardt

**Translation**
Margaret Clarke

**Design Basic Concept**
Pitch Black Graphic Design
Berlin/Rotterdam

**Layout**
Gerhard Süß-Jung