

University of Antwerp: Debating Development
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Illicit Financial Flows
The Role of Tax Avoidance Merchants in Fixing the System

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The Offshore Tax Haven and Financial Secrecy System

■ Origins

1920s: capital flight and tax evasion

International Chamber of Commerce: problem of 'double taxation'

League of Nations Reports: Economic Experts & Technical Experts

1928 Conventions: 1 & 2: Prevention of Double Taxation (portfolio investment)

Residence: returns (interest, dividends, fees) from investment (passive income)

Source: profits (active income) of foreign-owned affiliate/ Permanent Establishment

1928 Conventions 3 & 4: Assistance in Assessment & Collection

■ Allocation of Income of TNCs (Corporate Groups)

"In a business of this nature you cannot say how much is made in one country and how much is made in another. You kill an animal and the product of that animal is sold in 50 different countries. You cannot say how much is made in England and how much is made abroad"

(Sir William Vestey 1920).

Carroll report 1932-3: **separate accounting**: 'arm's length principle'

MC article 9: **power to adjust**: profits comparable to similar independent business

■ TNCs & wealthy exploit the independent entity principle

Vesteys: 1921 transfer global assets to family trust (France), leased to UK company exploits concepts of residence & source

tax haven = convenient country for fictitious location of assets/legal persons

TNCs & Offshore Finance 1950s-1980s

- **Bretton Woods System**

- fixed/adjustable exchange rates, national monetary management
 - gradual & partial liberalisation of trade & payments

- **Expansion of TNCs**

- reinvest retained earnings

- 'leads and lags' in transfer payments, undermines fixed exchange rates

- 'Eurodollar' market

- **'Offshore' Finance**

- exploiting regulatory differences & ambiguity

- interest rates & capital requirements

- **International Tax Rules**

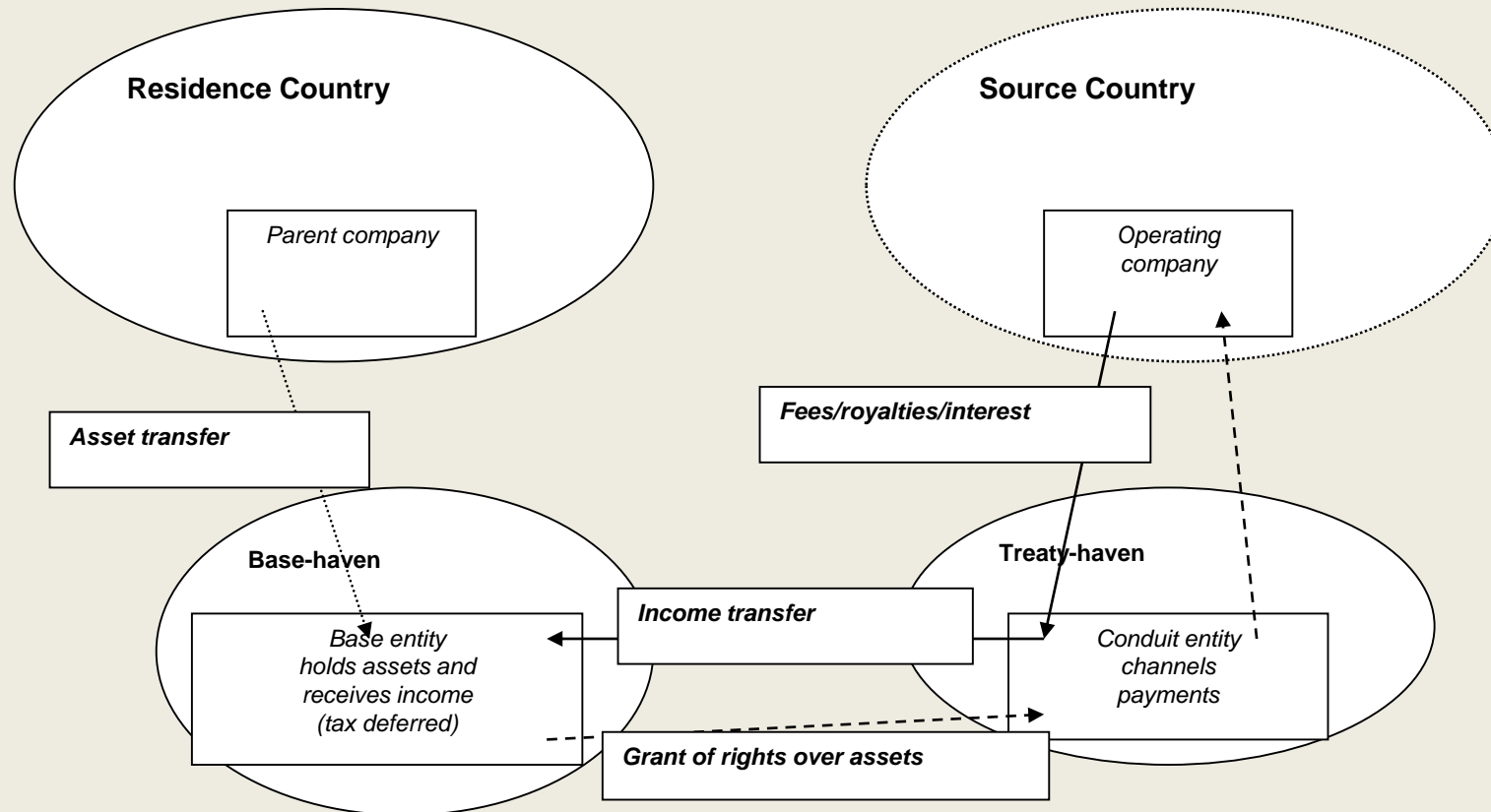
- tax treaties 1945-: aim to prevent double taxation; minimal provision for cooperation

- 'double non-taxation': low-tax on earnings retained offshore funds expansion of TNCs

- **Financial Liberalisation 1979-**

- 'offshoring' ubiquitous & systematised

Basic Stepping-Stone Structure



The Emergence of Rules on ‘Transfer Pricing’

■ US Attempts at Reform

Kennedy administration, Stanley S. Surrey

US Treasury refers ‘treaty abuse’ via ‘base companies’ to OECD, report 1962

US proposals on Controlled Foreign Corporations (CFCs)

full inclusion of worldwide income would eliminate all internal transfers

Subpart F rules enacted 1962 include only “passive” income in low-tax countries

Pressure to treat financial services etc as ‘active’ legitimises ‘offshore’

■ US Transfer Pricing Regulations 1968

New focus on transactions: even for shared functions (capital, R&D, central services)

Need to search for comparable *transaction prices*

rejected by OECD report 1967: general rules impossible, would be ad hoc

No change to art.9 Commentary, but art. 9(2) added 1997

■ Contradictory Convergence

US Regs criticised & found unworkable (Treasury 1973, GAO 1981, IRS 1984)

political concerns about MNE transfer pricing 1970s

Congress urges formulary apportionment – hostility from other OECD members

Political concern about power of TNCs > UN Group of Experts

OECD report on Transfer Pricing 1979 – adopts US approach

US Tax Reform Act 1986, White Paper 1988 – Comparable Profits Method

Conflicts in OECD 1988-1992

Transfer Pricing Guidelines 1995 accept “transactional” profits methods

OECD Transfer Pricing Guidelines 1995

■ Legal Status

Global soft law: Guidelines for MNEs and Tax Administrations

MC Commentary: TPGs “guidelines”, Art.9 is authoritative statement

UN Commentary: “should be followed” 2001, omitted 2013 - Manual

State Practice variations:

- (i) no reference to TPGs, domestic law “complies” (US, France)
- (ii) domestic law based on ALP, implies use of TPGs (many countries)
- (iii) TPGs can explicitly be used to “interpret” treaties (UK, Commonwealth)

■ Canonical Standing

Widely adopted: OECD etc, 1996- , almost universal 2009-

Cognitive community of specialists, institutionalised through OECD

Pressures to conform: capacity building, peer-review (Mexico 2003)

Brazil 1998 based on OECD but fixed margins, simplified: review by OECD 2018-9

■ Global Regulation and National Sovereignty

ad hoc methodology & complexity allows national flexibility

depoliticises issue: allocation of MNE profits becomes “technical” question

‘expert’ community – dominated by private practitioners (revolving door)

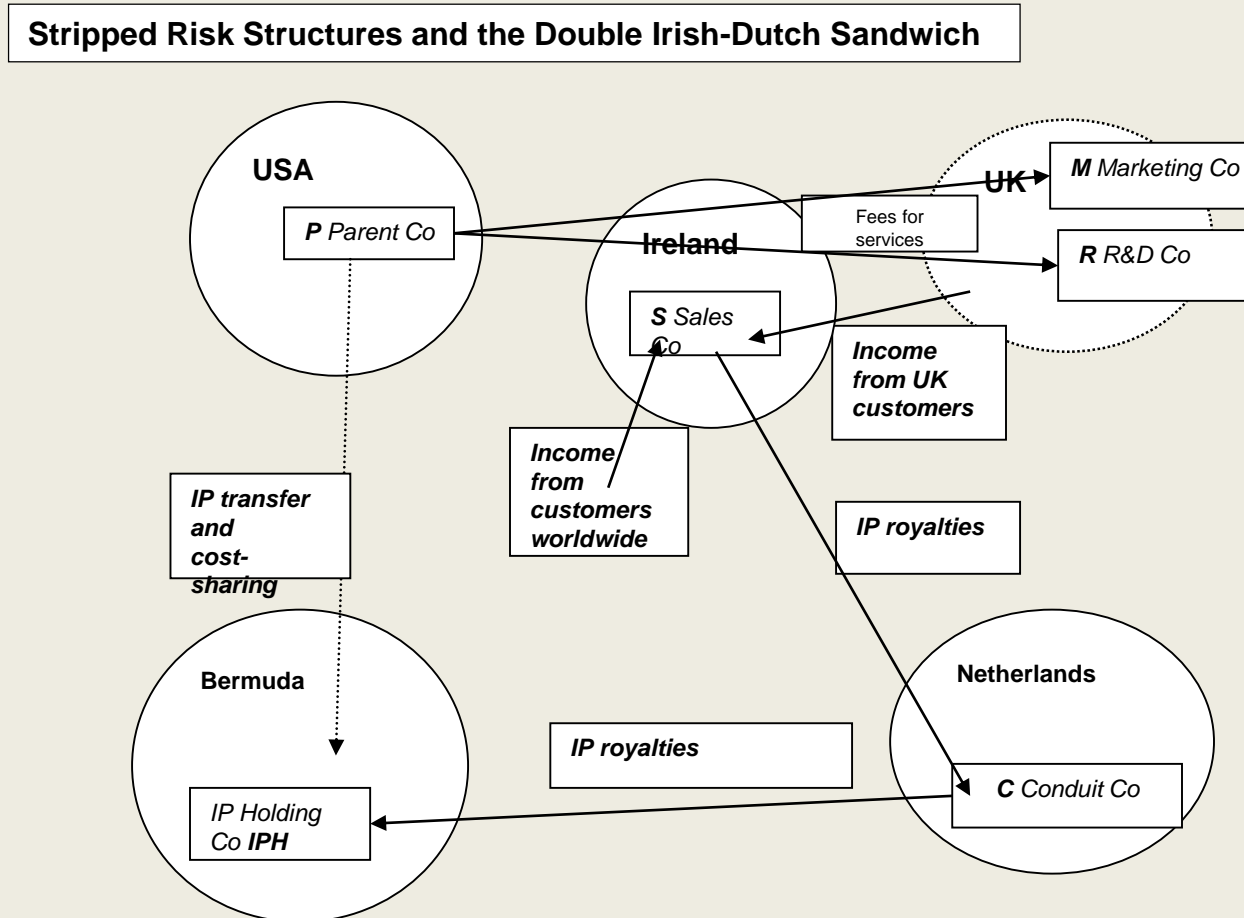
need for international consensus, yet continual rise of conflicts & disputes

MAP & Arbitration -- but totally secret

Problems with the ALP

- **Subjective and Ad Hoc Rules**
Five approved methods: CUP, Cost+, Resale-, TNMM, Profit Split
Requires analysis of “facts & circumstances” to identify functions, + search for ‘comparables’
Need for expert knowledge of business: asymmetry between Revenue & Taxpayer
- **Basic conceptual flaws**
Separate entity concept illusory: whole is more than sum of parts, profits from synergy
Key functions centrally managed: Finance, R&D, Risk - major problems for ALP
- **Spread of National Provisions based on TPGs**
Especially 1995>> (UK 1998), most developing countries since 2010
Statutory power to adjust to “arm’s length” profits + Specific Regulations based on OECD TPGs
Brazil 1998 Fixed Margin Method, compatible with art. 9 but not TPGs – reviewed by OECD 2019
- **Perverse Incentives of the Independent Entity Principle**
Design of ‘tax efficient supply chains’ & ‘stripped risk’ structures (e.g. PWC-Caterpillar 1999)
Countries offer low-tax regimes for ‘high-value’ functions (Belgium, Lux, NL, Switzerland)
- **‘Harmful Tax Competition’ Initiatives**
OECD Report 1998, EU Code of Conduct 1999: curb on incentives to attract ‘mobile activities’?
Largely ineffective – no test of ‘substance’
- **Dematerialisation of the Economy**
Shift to ‘services’ 1980s+: taxed in residence of provider – can easily choose low-tax country
Digitalisation: OECD ‘E-Commerce’ project 1999-2003 decides no changes needed

Elaboration of Avoidance Structures



The Role of Professionals

- **Mediating the Market**

 - between the state and the economy

 - professional techniques – intellectual capital (Bourdieu):

 - lawyers: translation & interpretation:

 - language of law indeterminate: contextual, abstract, normative

 - accountants: interface for corporate regulation

 - transnationalisation

 - economic diplomacy

 - regulatory arbitrage

- **From ‘gentlemen practitioners’ to systemic ideologists**

 - 1880-1940: construction of the ‘code of capital’ (Pistor 2019, Picciotto 2011)

 - separate accounting & independent entity principle

 - 1950-1990: systematisation & transnationalisation

 - construction of ‘offshore’

 - ‘transfer pricing’: from group accounting method to tool for tax-driven TNC structures

 - 1990-2009: phase of ‘global governance’

 - TPGs become globalised, arm’s length principle canonised

 - 2009-2019: GFC & aftermath:

 - popular distrust of expertise, political demagoguery

Politicisation of International Tax Evasion/Avoidance

■ Period of 'Globalisation' 1990- 2009

G7 1996 negative effects of globalisation on tax:

> OECD *Harmful Tax Competition* 1998

OECD Global Forum on Taxation 2001-

Tax Information Exchange Agreements (TIEAs) – bilateral

Asian financial crisis 1997-8 > Financial Stability Forum 1999 (2009 > Board)

Oxfam report 2000, foundation of Tax Justice Network 2003

■ GFC & after: Transparency

G20 April 2009: 'the era of bank secrecy is over'

2010 US-FATCA: KYC obligations on all banks with US presence

2010: Tax Administrative Assistance Convention (1988) revised & open to all

2013 G8 Lough Erne Declaration: Automatic EoI in Tax, G20 request to OECD

2014: OECD publishes Common Reporting Standard, CRS-MCAA signed

94 countries exchanging by end-2018

■ Illicit Financial Flows

Mbeki report & Addis Ababa Action Agenda 2015

SDGs & tax evasion – is avoidance also 'illicit', or 'legal'?

International Corporate Taxation

- **‘Base Erosion & Profit Shifting’ - BEPS**
G20 supports OECD BEPS project 2012-13:
 - tax TNCs ‘where activities occur and value is created’
 - technical work: professional lobbying, some civil society
 - Reports 2015, patch-up of existing rules
 - Revised TPGs 2017: start from contracts, but analyse “real deal”
 - ‘far more complex’ (Andrus & Collier 2017)
 - achievement: country-by-country reporting (CbCR) – game changer
- **Unilateral Measures**
 - India equalisation levy 2016, UK Diverted Profits Tax 2015-6
 - US reforms 2017: ‘territorial’, but with anti-BEPS – GILTI & BEAT
 - EU Commission 2018: long-term: CCCTB + Profit-Split
 - Short-term: proposed Digital Services Tax, blocked by minority of MSs
 - Unilateral adoption: France, Spain, Italy etc (US retaliation?)
- **BEPS 2.0: tax consequences of digitalisation**
 - Action 1 reports 2015, 2018:
 - affects whole economy, so need for comprehensive solution
 - exacerbates problems: (i) taxable presence (ii) criteria for allocation of income
 - Proposals Jan. 2019, Work Plan June, proposals October: Pillars 1 and 2
 - Solution by 2020?
- **Is a paradigm shift possible?**

Thank You
Merci
Dank Je

for more details see
<https://www.bepsmonitoringgroup.org/>
International Centre for Tax and Development: <http://www.ictd.ac/>