4

Tax Justice Toolkit

Glossary

STOP tax dodging

Abusive transfer pricing

See 'Transfer pricing abuse' below.

Arm's length principle

The establishment of prices in transactions of goods and services between related entities based on the prices charged in similar transactions between unrelated entities.

Arm's length price

A price set for a transfer of goods or services between related entities based on the prices charged in similar transactions between unrelated entities.

Assets

Assets are economic resources. Anything tangible or intangible that is capable of being owned or controlled to produce a value is considered an asset.

Automatic information exchange

A system by which relevant information about the wealth and income of a taxpayer – individual or company – is automatically passed by the country where the income is earned to the taxpayer's country of residence. As a result, the tax authority of a taxpayer's country of residence can check its tax records to verify that the taxpayer has accurately reported their foreign-source income.

Base erosion and profit shifting (BEPS)

This term is used by the OECD and others to describe the shifting of taxable income out of countries where the income was earned, usually to zero- or low-tax countries, which results in `erosion' of the tax base of the countries affected, and therefore reduces their tax revenues.

Beneficial ownership

A legal term used to describe anyone who has the benefit of ownership of an asset (for example, bank account, trust, property) and yet nominally does not own the asset because it is registered under another name. A mechanism is needed to provide tax authorities and citizens with information about 'who owns what where'. This should take the form of a public registry in every country – including every tax haven – of the real owners of all the trusts, foundations and companies established within its borders, which both governments and citizens can access.

Big Four

The world's four largest accountancy firms: Deloitte, Ernst & Young, KPMG, and Pricewaterhouse Coopers.

Capital flight

This refers to companies or individuals moving large amounts of money out of the country it was either earned, or otherwise made, instead of investing it locally. (See also 'Illicit capital flight' below.)

Consumption taxes

Taxes on spending on goods and services. They are usually indirect, often described as `value-added tax' (VAT).

Corporation tax

A tax that must be paid by a business based on the amount of profit generated. The amount of tax, and how it is calculated, varies depending upon the region or country where the company is located.

Country-by-country reporting

Country by country reporting would require multinational companies to provide a breakdown of profits earned and taxes paid in every country where they have subsidiaries, including tax havens. Ideally it would require disclosure of the following information by each multinational corporation in its annual financial statement:

Country-by-country reporting by multinationals should include the following information

- the name of each country in which it operates
- the names of all its companies trading in each country in which it operates
- the tax charge included in its accounts for the country in question
- details of the cost and net book value of its physical fixed assets located in each country
- details of its total gross and net assets for each country in which operates
- its financial performance in every country in which it operates, without exception, including:
  - its sales, both third-party and with other group companies
  - purchases, split between third parties and intra-group transactions
  - labour costs and employee numbers
  - financing costs split between those paid to third parties and those paid to other group members
  - its pre-tax profit.

Source: www.taxresearch.org.uk/Documents/CBC.pdf

Double tax avoidance agreements (DTAAs)/Double taxation treaties (DTTs)

These are bilateral agreements between two countries that are supposed to help eliminate the potential for double taxation on cross-border investments. Avoiding double taxation is a sensible aim, but DTAs can have outcomes that go beyond what was intended. Many investors seek to 'treaty shop' and channel funds through countries with especially favourable DTAs in order to avoid taxes. Developing countries have often agreed to DTAs that substantially reduce their scope to raise revenue.

Export processing zone

A ring-fenced area within a country/state in which export industries that have little interaction with domestic markets can operate with the benefit of relaxed or suspended regulations and laws, including tax laws (see also 'Tax incentives' below).

Facilitation payment

A bribe designed to quicken the pace at which an official performs a routine, non-discretionary action; sometimes referred to as a 'grease payment'. Facilitation payments contravene the OECD Anti-Bribery Convention.

False invoicing

Deals made between unrelated companies to manipulate prices to their mutual advantage so that they can reduce their taxable profits.

G8

The G8 is the group of eight of the world's largest economies (Canada, France, Germany, Italy, Japan, Russia, UK and US). Each year, the G8 holds a leaders' summit, when heads of government meet to discuss and attempt to resolve issues relating to the global economy and other matters of international importance. It also works throughout the year to tackle these issues. The G8 discusses and creates global policies; however, adherence to these policies is not obligatory, and other countries can decide whether or not to comply with them.

G20

The G20 is an informal grouping of developed and developing countries. The Group of Twenty (G20) finance ministers and central bank governors was established in 1999 to bring together important developed and developing economies to discuss key issues in the global economy. Given the G20's political clout, it provides a useful opportunity to bring together donors and multilateral agencies to support domestic resource mobilisation and address issues related to illicit capital flight.

Illicit capital flight

The illegal removal of large volumes of money from a country, including the removal of money in order to evade tax.

Illicit financial flows (IFFs)

The cross-border movement of funds that are illegally acquired, transferred or used. The sources of these cross-border transfers may be bribery, theft by government officials, the trafficking of drugs, arms and humans, smuggling, commercial tax evasion, trade mispricing or abusive transfer pricing.

International Accounting Standards Board (IASB)

The IASB is a self-appointed body that devises the rules covering how companies should produce their annual accounts. More than 100 governments worldwide, including those of the UK and all other member nations of the EU, tend to rubber stamp their findings into law. It is made up of accountants, a number of whom have worked for the Big Four accountancy firms. The IASB is partly funded by the Big Four.

Money laundering

The process of disguising the source of money gained from illicit activities to give the money the appearance of having originated from a legitimate source.

Multinational company

A company that operates in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralised head office where they coordinate global management.

Offshore financial centre

A tax haven. This is the term authorities in tax havens prefer to use.

Organisation for Economic Co-operation and Development (OECD)

An international organisation, based in Paris, and with a membership comprising 34 democratic, free-market countries. The OECD's mission is 'to promote policies that will improve the economic and social well-being of people around the world'. The OECD is an important and influential policy-maker on tax issues.

Progressive taxation

A progressive tax is one that places the biggest burden on those most able to pay. Most often applied in the form of income tax, a progressive tax is one where the tax rate rises as incomes increase, so that those who earn high incomes have a greater proportion of their incomes taken as tax.

Regressive taxation

A regressive tax, in contrast to a progressive tax, is one where everyone pays the same amount of tax, regardless of their income or their ability to pay. This results in the poor paying relatively more of their income on the tax than those with greater ability to pay.

Revenue authority

A government agency responsible for the intake of government revenue, including taxes. Depending on the jurisdiction, revenue authorities may be charged with tax collection, investigation of tax evasion, or carrying out audits.

Secrecy jurisdiction

Another term used to describe a tax haven – because of the high levels of secrecy they offer. Secrecy jurisdictions are those that intentionally or unintentionally enable individuals or corporations to escape regulation elsewhere, by concealing, either fully or partially, relevant information. The secrecy provisions offered by some jurisdictions can help individuals or corporations evade or avoid taxes. It can also help criminals and corrupt officials to hide their ill-gotten money from authorities elsewhere.

Special economic zone

See 'Export processing zone' above.

Subsidiary

A subsidiary is a company partly or completely owned by another company. Multinational companies generally have a large number of subsidiary companies in different countries. If a parent company owns a foreign subsidiary, the parent company must follow the laws of the country where the subsidiary operates. Meanwhile, the parent company incorporates the subsidiary's financial accounts into its consolidated accounts for the whole multinational company. For the purposes of taxation, subsidiaries are distinct legal entities.

Tax

A fee levied by a government or local or regional authority on income, transactions, products or activities in order to finance its expenditure,

Tax avoidance

The practice of seeking to minimise the tax one pays using methods that are legal. Tax avoidance seeks to reduce the payment of tax by arranging affairs in a way that fits within the letter of the law, (though not necessarily within the spirit of the law). As a result, tax avoidance might be legal, but it is not risk-free for the taxpayer. If unveiled by the tax authorities, tax avoidance strategies could lead to a sanction being imposed on the taxpayer. Therefore, tax avoidance implies accepting a level of risk when seeking to reduce tax payments. The term 'aggressive tax avoidance' describes the most extreme form of this practice, where the level of risk of legal sanctions is significantly higher.

Tax base/Taxable base

The sum of taxable activities and the value of property and assets subject to tax.

Tax breaks

A tax break is a type of tax incentive (see below). It relates to the practice of offering companies a reduction in the tax they have to pay or a break from paying any tax at all (see `Tax holiday' below).

Tax competition

The process by which countries compete with each other to attract investment from companies by lowering tax rates or providing special exceptions to tax rules (see 'Tax incentives' below).

Tax dodging

A popular term used by tax justice campaigners and the media to describe situations where it is not clear whether tax is being avoided or evaded, or a combination of both. It highlights the fact that many tax avoidance strategies are abusive while technically legal.

Tax evasion

Illegal or fraudulent non-payment or under-payment of tax.

Tax gap

The difference between the amount of taxes a government should be able to collect and the amount of taxes it actually collects. Or, to put it another way, the difference between the tax that is paid and the tax that governments believe should be paid in accordance with the spirit (as opposed to the letter) of the law of the law. Most of a country's tax gap is the result of individuals and businesses concealing or understating income and overstating deductions and exemptions (tax dodging).

Tax haven

Countries, states or territories that provide financial secrecy and generous tax rules that undermine the regulation of another country, state or territory for the primary benefit of, and use by, bodies (individuals, companies, organisations, etc) that are not resident there. The two distinct features of a tax haven are high levels of financial secrecy and very low or zero levels of tax for companies registered there. Note that there is no international agreement on the criteria by which to define a tax haven. For more detailed information see: www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf

Tax holiday

An agreement between a company and a government that specifies a period during which a company investing in a country does not have to pay tax.

Tax incentives

Special tax breaks – that is, reductions – offered by governments to encourage investment, usually foreign investment, by companies (see box overleaf).

Corporate tax incentives	Related financial and regulatory incentives
• tax holidays or reduced tax rates	• subsidised financing
• tax credits	• grants or loan guarantees
• investment allowances	• provision of infrastructure, training
• accelerated depreciation	• preferential access to government contracts
• reinvestment or expansion allowances	• protection from import competition
• exemption from or reduction of withholding taxes	• exemption from sales, wage-income or property taxes
• exemption from import tariffs	• reduction of social security contributions
• exemption from export duties	• subsidised delivery of goods and services.
• exemption from regulatory rules and standards.	

Source: IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006

Tax Information Exchange Agreements (TIEAs)

Bilateral agreements made between one country and another whereby the tax authorities in the two countries agree to exchange information with each other about individuals' and companies' assets in their country. In 2009 the OECD announced that it would blacklist any offshore tax jurisdictions (in other words, tax havens) that did not sign 12 TIEAs. The information exchanged through a TIEA is often not automatic – it is only `on request' – which means that a tax authority has to provide a detailed request for information on a specific individual or company suspected of tax evasion before any information will be given by the other tax authority. The amount of evidence required to make a request is so onerous that TIEAs are rarely used, even by developed countries. TIEAs have been made primarily between developed countries and tax havens. Developing countries have been excluded from TIEAs as they do not have the capacity to negotiate them. This is why tax justice campaigners are pushing for automatic and multilateral exchange of tax information – whereby all countries would exchange information with other countries automatically and not on request.

Some countries, like the Netherlands, have extensive networks of bilateral agreements, and are therefore used by corporations as conduits. Corporations engage in what is known as 'treaty shopping' and channel their payments through 'conduit havens' as a way to reduce their overall tax bill.

Tax planning

The designing and implementing of strategies, usually by accountants or lawyers, in order to assist a client in reducing, delaying or avoiding taxation. The practice is frequently legal.

Trade mispricing

The term used to describe both transfer pricing abuse (see below) between related parties, and false invoicing between unrelated parties (see page 2). Christian Aid estimates that developing countries lose $160bn a year through trade mispricing.[1]

Transfer price

Based on the arm's length principle, it is the establishment of prices in transactions of goods and services between related entities based on the prices charged in similar transactions between unrelated entities.

Transfer pricing abuse (also called 'transfer mispricing')

A practice in which two companies, subsidiaries of the same multinational company, buy and sell products and services to each other and artificially inflate or deflate prices so that nearly all profits are made where taxes are lower or even at zero level.

Unitary approach to taxation

Treating a multinational company – including all of its subsidiaries – as one single entity in relation to taxation (instead of treating each subsidiary as a separate company, as is the case with the present system based on the arm's length principle). This would require a multinational company to submit to the tax authorities in each country where it operates accounts of its operations globally but including a country-by-country breakdown. It would make it more difficult for multinationals to dodge tax by shifting their profits to tax havens.

VAT or Value-added tax

A tax on sales of goods and services which the consumer pays when purchasing these goods or services. Businesses are obliged to charge the customer the VAT and then pass on the VAT to the tax authority. This type of tax is relatively easy for governments to collect but is often regressive (see `Regressive tax' above).

Withholding tax

A tax collected at source on the dividends, interests and other payments made by individuals or corporations in a given jurisdiction when they send these dividends, interests and other payments to individuals or corporations that reside in other jurisdictions. For example, when a subsidiary in a developing country wants to send dividends to its parent company in the UK, the subsidiary could be required by the tax authorities in the developing country to pay a percentage of the dividends leaving the country as tax. Sometimes, bilateral agreements eliminate withholding taxes on these type of transactions.

Endnotes

1 The $160bn figure was Christian Aid's estimate of the amount of tax lost to developing countries globally every year which appeared in Death and Taxes: the true toll of tax dodging, Christian Aid 2008. Further detailed research on trade mispricing was conducted by Simon Pak in *False Profits: Robbing the Poor to keep the Rich Tax Free*, Christian Aid, 2009.

This publication has partly been funded by the European Union. The contents of this publication are the sole responsibility of Christian Aid and other member organisations of the STOP tax dodging campaign and can in no way be taken to reflect the views of the European Union.

14-770-J1727