

# **Global Alliance for Tax Justice**

**Position Paper and Recommendations for  
The Third UN Conference on Financing for Development**

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## Introduction

The substantial problem of illicit financial flows (IFFs) and the large amounts of resources leaving developing countries untaxed is now well recognised. While estimates are difficult, it is fully accepted that illicit outflows are larger than inflows from aid and that a large proportion is driven by tax abuse. For example, the 2015 Report of the High-Level Panel on Illicit Financial Flows in Africa estimates that well over US\$50 billion of illicit money is flowing out of Africa every year – greater than the money that is flowing in through official development assistance (ODA) from donor countries and organisations. Consequently, national and international tax issues are inextricably linked and are both fundamentally important in the United Nations Financing for Development (FfD) debates.

2015 will be a landmark year for the global fight against poverty and for equitable and sustainable development, with three crucial summits happening within just six months. The United Nations Third International Conference on Financing for Development in Addis Ababa in July will be followed by the UN Summit for the adoption of the Post-2015 development agenda in September in New York, and by the 21st Conference of Parties to the UN Framework Convention on Climate Change in December in Paris. Due to the strong political ties between these three processes, one summit will not be successful unless all of them are. Central issues for all three summits are the insufficient mobilization of funding for development and environmental protection, as well as the failure of governments to fulfil old funding commitments.

The FfD negotiations include proposals for reforms of international financial and trade systems to ensure that these systems fully support and do not undermine the right to development of all countries and peoples. The issues tackled in previous meetings in Monterrey and Doha continue to be of central importance, and the conference in Addis Ababa must ensure that old commitments to address systemic and structural issues are turned into concrete and ambitious action, and are to be supplemented by new and stronger commitments to provide a solid finance framework for the future.

This paper provides a summary of key recommendations related to tax, transparency and illicit financial flows, which should be incorporated in the FfD negotiating text and ultimately in the final outcome document of the Third Conference on Financing for Development.

## Taxation is key for domestic resource mobilisation

Tax is the most sustainable and reliable source of financing for all states. It enhances both the accountability of governments to citizens<sup>1</sup> and of businesses to society. It is also a key lever to reduce income inequality in society. While official development assistance (ODA) will still play an important role - especially for the poorest countries - the importance of a well-functioning system of taxation cannot be overstated.

Currently, domestic resource mobilization is hampered by inadequate global tax standards, race-to-the-bottom tax competition, the lack of financial transparency including the existence of secrecy jurisdictions, and a proliferation of other harmful tax policies and practices. For example, developing countries are often not benefitting from the extraction and use of their natural resources in large part because of lack of transparency, regulation and fair and effective taxation. These problems also contribute to environmental degradation and abuse.

Therefore, global cooperation is urgently needed to establish the basis for fair, effective and progressive tax systems that provide a sustainable source of income and reduce inequality.

## The role of tax in delivering human rights

In her 2014 report on taxation and human rights, the United Nations Special Rapporteur on extreme poverty and human rights described tax as a critical tool for both realizing human rights and tackling inequality. The Rapporteur emphasized that taxes are not the only source of government revenue, but they are arguably the most important because they combine three critical functions: the generation of revenue for the realization of rights; achieving equality and tackling discrimination; and strengthening governance and accountability. Taxation is critical to finance for development and can be a powerful tool for stimulating poverty reduction. Higher and more stable revenues result in increased sustainable investment in public services, infrastructure and other development needs, and improve competitiveness of economies over the long term.

A second tax and human rights connection relates to the spillover effects of fiscal policies. States should take steps to prevent violations of human rights outside of their territories as a result of the activities of business enterprises that are incorporated under their laws or that have their main seat or place of business under their jurisdiction.<sup>2</sup> For example, states should take measures to ensure that business enterprises that the state is in a position to regulate, including legal, accounting and other specialized firms that may assist in tax abuse, do not participate in or facilitate tax abuse or illicit financial flows, given that they have a detrimental impact on the realization of economic, social and cultural rights.<sup>3</sup>

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<sup>1</sup> Prichard et.al. 2014, ICTD Working Paper: <http://www.ictd.ac/en/publications/taxation-non-tax-revenue-and-democracy-new-evidence-using-new-cross-country-data>

<sup>2</sup> See CRC/C/KOR/CO/3-4, E/C.12/DEU/CO/5 and CCPR/C/DEU/CO/6.

<sup>3</sup> Maastricht Principles on Extraterritorial Obligations of States in the area of Economic, Social and Cultural Rights Principles, principles 24 and 25.

## International cooperation for global solutions

In a globalized economy, no country can tackle tax evasion and avoidance on its own. Since the loopholes and secrecy provided by one country can undermine the tax bases of all other countries, these problems are fundamentally cross-boundary in nature and will require global solutions. Through international cooperation, countries can also share resources and exchange information to ensure that even countries with low capacity will be able to protect and benefit from their own tax base.

However, the ongoing tax related processes are far from being globally representative. More than 130 developing countries are currently not included in the OECD and G20 processes. This lack of participation is clearly reflected in several of the outcomes of the OECD/G20-led tax processes, including the process of Automatic Information Exchange and on Base Erosion and Profit Shifting (BEPS) of corporates. Under the new regime for automatic information exchange, many developing countries will not be able to access the information they need to collect taxes due to lack of international cooperation and “reciprocity-requirements” which they do not have the capacity to fulfil. The OECD BEPS process builds on the new regime for automatic information exchange (e.g. as a tool for exchanging country-by-country reporting about corporate tax payments); developing countries will therefore also have difficulties benefiting from the OECD BEPS outcomes. The OECD template on country-by-country reporting is also highly problematic in that it will not encompass all activities of large multinationals and reports will not be made public. Furthermore, it also builds on instruments such as the OECD’s Model Tax Convention, which also gives preferential treatment to “residence countries” (mainly OECD member states) at the expense of developing countries (so called “source countries”). Transfer pricing relies on the “illusionary” approach of treating parts of global operating corporations as if they were independent units. Thus, as long as OECD and G20 are the decision making bodies on global tax standards, the unfair playing field will be maintained and the specific interest and challenges for developing countries will be given less priority. For example, taxation of the extractive sector and rationalisation of tax incentives are among issues that are not being addressed.

Eventually, international cooperation on tax matters will need a legally binding agreement – an international UN tax convention – to ensure a solid framework for the work, including a clear definition of principles as well as implementation of agreements reached.

But as a first and vital step, it must be ensured that the Addis Ababa conference includes a Ministerial Roundtable on tax matters in the official FfD agenda in order for high-level participants to commit to establish a truly global, inclusive and intergovernmental body on tax matters under the auspices of the UN. Such a body is vital to ensuring that the tax related policy decisions from the Addis Ababa conference can be carried forward and turned into concrete instruments and standards, while at the same time ensuring that all countries – including the least developed countries – are able to participate on an equal footing. This body must have sufficient resources and a strong mandate to ensure that it is able to tackle the problems related to tax, transparency and illicit financial flows.

While the current UN Committee of Experts on International Cooperation in Tax Matters has provided – and continues to provide – very important useful outputs, it is by nature an expert committee with a very limited number of members who act in their personal capacity and not as government negotiators. This committee can therefore not serve as the basis of an intergovernmental process. Therefore, a new intergovernmental UN body on tax matters is needed.

### **Recommendations**

- ◆ Organise a Ministerial Roundtable on tax cooperation as part of the official FfD agenda in Addis Ababa to ensure high-level engagement in the tax negotiations.
- ◆ Establish an inclusive intergovernmental body on tax matters under the auspices of the UN, which could also initiate and lead negotiations on a new UN framework convention on international cooperation in tax matters as a first step in the reform of international tax rules.

## Progressive tax policies to tackle inequality within countries

There is also a clear need to address the much broader aspects of taxation and development related to strengthening national tax systems – and most critically ensuring tax systems are pro-poor, gender responsive and progressive in nature. Despite a clear commitment made in Doha to undertake efforts to enhance tax revenues “with an overarching view to make tax systems more pro-poor”<sup>4</sup> tax equity issues have still not been tackled, and therefore this area needs much more attention this year.

Regressive tax policies are drivers of inequality and undermine sustainable development. Tax codes and tax structures also drive gender inequality. Negotiations about Domestic Public Resource Mobilisation must therefore emphasize the importance of progressive taxation (versus regressive consumption taxes that the poor proportionally pay more of) and the need for gender-sensitive policies. The loss of tax revenues due to tax evasion and avoidance significantly reduces the funds available to finance policies aimed at fulfilling the human rights of women and girls. Women in most societies are over represented in the lowest quintiles of income distribution and bear the brunt of regressive taxation.

Tax incentives provided to multinational corporations are further reducing tax revenues and thus equality and the generation of financing for development. The underlying drivers of regressive taxation should also be addressed, including tax related conditions linked to various forms of financing.

Increasing the tax base in a progressive way would mean shifting the burden of taxes away from people living in poverty – the majority of whom are women and other marginalized groups at the bottom of the income distribution – and towards highly profitable sectors and wealthy individuals. Caution should be exercised if commitments to raise tax/GDP ratios are being considered. Such a commitment cannot stand alone and must be linked explicitly to tax equity, ensuring countries focus on the direct taxation of wealth, income and assets, the removal of tax incentives and exemptions benefiting large corporate actors and on efforts to eliminate loopholes and improve enforcement.

Finally, a fair distribution of revenues and expenditures will also demand strong and functioning labour market regulations (specifically, minimum wages) and institutions of social dialogue, as well as transparent and democratically accountable institutions.

### **Recommendations**

- ◆ Increase domestic resource mobilisation and reduce inequality by adopting a full range of progressive taxation measures. Tax policy design and implementation must actively seek to reduce income and gender inequality.
- ◆ Make it the highest priority commitment to invest tax funds in the vital human development related public services and public infrastructure (e.g., health, education, water, housing, sanitation, transportation), social protection floors and to reverse climate change.
- ◆ Provide the means for citizens to make their voices heard and hold governments accountable on their tax policy and how revenue raised is spent.
- ◆ Ensure fiscal policies are gender sensitive. This should include assessing and tracking the impact of regressive taxes, such as VAT, and the tax burden, and measures to shift the burden away from poor women and men.
- ◆ Ensure tax incentives are transparent and in line with sustainable development and in compliance with gender equality and human rights obligations, e.g. require a cost-benefit analysis of tax incentives.

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<sup>4</sup> United Nation, *Doha Declaration on Financing for Development*, International Conference on Financing for Development, 2008

## Fair international tax rules

Double taxation agreements have been identified as a major source of revenue loss in developing countries, including through the IMF study on spillovers in international taxation. In particular, the balance between source and residence countries' taxation needs to better take into account the needs of developing countries.

The harmful tax practices of many developed countries matter greatly. It is now well established that negative spillover effects on corporate tax bases are “especially marked and important for developing countries” and “the sums at stake in international tax issues are large relative to their overall revenue”.<sup>5</sup> To enable progress, countries should be able to sanction jurisdictions which are persistently secretive, as well as seeking practical ways to work towards a ‘good neighbour’ model of global tax cooperation.

### Recommendations

- ◆ Countries must immediately undertake spillover analysis of their national tax policies to assess negative impacts (e.g. tax base erosion), particularly on developing countries, and take action to remove policies that cause harm.
- ◆ Ensure the review of Double Taxation Agreements to ensure that these are fully in line with and do not undermine sustainable development and financing for development needs.
- ◆ Support developing countries, particularly smaller low-income countries, which decide to apply sanctions against non-collaborative jurisdictions that purposefully “trade in secrecy” to attract proceeds of tax dodging and illicit financial flows.
- ◆ Ensure a transparent and accountable tax treaty negotiating process in which, at the very least, a national parliament ratifies treaties and relevant stakeholders (beyond those who represent business interests) are consulted during the negotiating process.
- ◆ Work towards a UN convention.

## Private finance is no silver bullet

It is already clear that foreign direct investment (FDI) flows to the least developed countries are very low. Furthermore, the quality of FDI and the benefits that developing countries ultimately derive have been repeatedly called into question. Many developing countries are unable to ensure linkages with local firms, dynamic accumulation of capital, technology transfer, high quality job creation and skills transfer. FDI flows are often accompanied by significant outflows of resources, and of course the profit-seeking nature of FDI means this form of financing does not flow to – and is not suited for – many important sectors of public service provision.

These limitations are often not adequately addressed in the international development cooperation discourse. At the same time, one of the greatest benefits of FDI – the tax revenues it can yield – often fails to materialize because of tax evasion and avoidance.

Another argument repeatedly raised is that governments should attempt to close funding gaps for important public services by incentivizing the private sector to invest or provide charitable services. These approaches are labeled under the concepts of “blending” public and private finance, “leveraging” private funds for investments or as “public-private partnerships.” All of these instruments are supposed to generate billions in funding and are based on lean governance structures and voluntarism.

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<sup>5</sup> IMF, *Spillovers in International Corporate Taxation*, IMF Policy Paper, 9 May 2014

However, governments are bound to their duty to protect and fulfill everybody's human rights, specifically people's economic, social and cultural human rights. This means that governments have to ensure that they retain the financial ability to fulfill these duties. Relying on the goodwill of rich individuals and corporations for the necessary means will not suffice. Such an approach rests the fulfillment of basic human rights on the motives of corporate decision makers, who are accountable to their shareholders, not the public at large. It will mean losing democratic space, increase the influence of the already powerful and elevate profit-seeking over human rights.

Instead of falling into the trap of problematic financing experiments, governments must compel multinational corporations to pay their share of taxes, and create responsible guidelines for DFI funds.

### **Recommendations**

- ◆ Create a responsible financing charter for private investors to ensure private finance contributes to and does not undermine sustainable development.
- ◆ Require that funds from Development Finance Institutions not be allowed to flow through offshore tax havens or low tax jurisdictions.

## **Make multinationals pay their share**

The FfD process should ensure that multinationals pay their share of taxes where their economic activities take place and value is created. The fiscal losses for all countries are crucial, given the shortcomings in current global tax rules and the ease with which MNCs are able to enormously reduce the taxes they pay.<sup>6</sup> Research has shown that poorer countries generally suffer the greatest shrinkage of their tax base as a result of corporate profit shifting; the multinationals' tax base of some lower income countries could even be doubled from their current size.<sup>7</sup> This is the most obvious area where a global effort to make things fairer would result in direct and large revenue raising opportunities for developing countries. Ensuring MNCs pay their share of taxes should be considered one of the most important means of mobilising resources to enable developing countries to implement their development goals.

### **Recommendations**

- ◆ Develop solid alternatives to the dysfunctional Arm's Length Principle.
- ◆ Remove policies and treaties that erode the tax base of other countries.

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<sup>6</sup> The OECD has found that some multinationals use strategies that allow them to pay as little as 5% in corporate taxes while smaller businesses are paying up to 30%. See: OECD, *Addressing Base Erosion and Profit Shifting*, A study commissioned for the G20, 2013.

<sup>7</sup> Note that current data does not capture the global nature of profit shifting, particularly in relation to developing countries. See: Cobham, A. and Loretz, S., *International Distribution of the Corporate Tax Base: Implications of Different Apportionment Factors under Unitary Taxation*, International Centre for Tax and Development, Working Paper 27, 2014.

## The need for transparency

Bank secrecy in intermediate jurisdictions, anonymous shell-companies and lack of transparency in the reporting of multinational companies are key enablers of illicit financial flows.

All countries have a common responsibility to reduce illicit financial flows and combat tax evasion and avoidance. However, given that developed countries largely control the international financial system, dictate global tax rules, host headquarters, regulate most multinational enterprises - and have a higher capacity, it should be clear that developed countries have different responsibilities.

Automatic exchange of tax information is an example where the different levels of responsibility comes into play. While all countries should eventually exchange information automatically, developing countries with low capacity should be allowed to receive information, even if they do not yet have the capacity to send the same information back (reciprocity). Allowing developing countries to participate in automatic information exchange will provide them with information that is vital for them to collect taxes, and thus be a key step towards building their capacity.

Public country-by-country reporting will provide the information needed to assess whether multinational corporations are paying taxes where the economic activity takes place and value is created. Therefore, it is a key tool in the fight against tax avoidance. Country-by-country reporting information should be part of company annual reports so that they are audited. All country-by-country reports must be fully and easily available to the public in order to enable greater accountability of companies, tax authorities and governments to their citizens.

Public beneficial ownership registries of companies, trusts and other similar legal structures will provide transparency around the use of shell-companies, and thereby support the fight against tax evasion, illicit financial flows and money laundering.

### **Recommendations**

- ◆ Adopt a common UN standard of multilateral, automatic exchange of tax information with the option of non-reciprocal information exchange for countries with low capacity
- ◆ Eliminate secrecy of beneficial ownership worldwide through public registers of beneficial owners.
- ◆ Ensure financial transparency by implementing annual public country-by-country reporting by multinational corporations.
- ◆ International financial institutions or systemic institutions such as the Bank for International Settlements (BIS) should focus on monitoring illicit flows and make their data accessible to governments and the public.



## **Accountability, monitoring, evaluation and capacity building**

Accountability, monitoring and evaluation measures should include tracking the creation of beneficial ownership registers, the extent of automatic information exchange and the number of multinationals reporting publicly on a country-by-country basis.

While a global framework for cooperation is essential, immediate action at national level would directly enhance resource mobilisation in developing countries.

Capacity building of tax administrations in developing countries will also be a vital key to success. However, such capacity building must always be receiver country driven, transparent, and free from any kind of political steering of developing countries' tax policies and choice of development pathway.

### **Recommendations**

- ◆ Gather data on financial flows and assets held in non-transparent jurisdictions as well as financial transparency measures systematically at the global level.
- ◆ Enhance national statistical capabilities to monitor and evaluate the performance of all tax types, the size of the tax gap and how the tax burden is being shared.
- ◆ Track economic inequality trends before and after tax in all countries.
- ◆ Mobilize new and additional funding for capacity building of tax administrations in developing countries and ensure that all capacity building is receiver country driven, transparent and free from any kind of political steering of developing countries' tax policies and choice of development pathway.

**The Global Alliance for Tax Justice encourages our members and allies to engage their national leaders and UN negotiators and mobilise public support to ensure these recommendations are included in the final United Nations Financing for Development 2015 outcome document.**

**Together we must transform the current economic system that privileges corporations and the wealthy, drives inequality and hurts our environment. Our vision promotes progressive redistributive taxation policies to fund the vital public services that will end inequality and poverty and lead to sustainable development.**

For more information: [www.GlobalTaxJustice.org](http://www.GlobalTaxJustice.org)