Combating illicit financial flows

*Definition, measurement and policy response*

Alex Cobham

@alexcobham

Tax Justice Network

G-24 TECHNICAL GROUP MEETING

LIMA, PERU

14 March 2019
On the Tax Justice Network:

“TJN has done more than any other organisation to put fiscal justice at the center of the policy agenda.

Tax issues should not be left to those who want to escape taxes!

Changes will come when more and more citizens of the world take ownership of these matters. TJN is a powerful force acting in this direction.”

Thomas Piketty
On the Tax Justice Network:

“TJN has been instrumental over the past 10 years in making people understand that paying taxes is key to building a civilised society, that tax evasion and tax avoidance must be addressed without complacency.

They have significantly contributed to trigger the political support necessary to fight bank and fiduciary secrecy and address the distortions of the international tax system.”

*Pascal Saint-Amans*
*head of tax, OECD*
Overview

- The emergence of the IFF agenda
- Definitional questions: Avoiding avoidance?
- Policy agenda
1. Emergence of IFF agenda
Where is ‘corruption’?

Corruption Perceptions Index
Where is ‘corruption’?

Financial Secrecy Index
FSI 2018: Secrecy Scores

<table>
<thead>
<tr>
<th>Ownership Registration</th>
<th>Legal Entity Transparency</th>
<th>Integrity of tax and financial regulation</th>
<th>International Standards and Cooperation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Banking secrecy</td>
<td>6 Public Company Ownership</td>
<td>11 Tax Administration Capacity</td>
<td>17 Anti-Money Laundering</td>
</tr>
<tr>
<td>Ids 89, 157, 352,</td>
<td>Ids 470 – 475, 485</td>
<td>Ids 317 and 400 to 406</td>
<td>Id 335</td>
</tr>
<tr>
<td>353 and 360</td>
<td>and 486</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Trusts and Foundations Register</td>
<td>7 Public Company Accounts</td>
<td>12 Consistent Personal Income Tax</td>
<td>18 Automatic Information Exchange</td>
</tr>
<tr>
<td>Ids 201, 206, 214, 234,</td>
<td>Ids 188, 189 and 201</td>
<td>Ids 374, 435 and 489</td>
<td>Ids 150, 271 - 374, 376 and 377</td>
</tr>
<tr>
<td>236 - 240, 244, 385,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>384, 393, 395 and 396</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Recorded Company Ownership</td>
<td>8 Country by Country Reporting</td>
<td>13 Avoids Promoting Tax Evasion</td>
<td>19 Bilateral Treaties</td>
</tr>
<tr>
<td>Ids 388, 470 - 473, 485</td>
<td>Id 318</td>
<td>Cf. Tax Details section of the country</td>
<td>Ids 301 and 143</td>
</tr>
<tr>
<td>and 486</td>
<td></td>
<td>database reports</td>
<td></td>
</tr>
<tr>
<td>4 Other Wealth ownership</td>
<td>9 Corporate Tax Disclosure</td>
<td>14 Tax Court Secrecy</td>
<td>20 International Legal Cooperation</td>
</tr>
<tr>
<td>Ids 416, 418, 437, 439</td>
<td>Ids 363, 419 and 421</td>
<td>Ids 407 to 410</td>
<td>Ids 33, 35, 36, 309 - 314 and 409</td>
</tr>
<tr>
<td>and 487</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Limited Partnership Transparency</td>
<td>10 Legal Entity identifier</td>
<td>15 Harmful Structures</td>
<td></td>
</tr>
<tr>
<td>Ids 269, 272, 273, 274,</td>
<td>Ids 414, 415 and 420</td>
<td>Ids 172, 184, 224 and 488</td>
<td></td>
</tr>
<tr>
<td>476, 477 and 479 to 484</td>
<td></td>
<td>Public Statistics</td>
<td></td>
</tr>
<tr>
<td>16 Public Statistics</td>
<td>Ids 425 to 434</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Arithmetic average of 20 Key Financial Secrecy Indicators (0-1), 4 areas, driven by 115 variables (“IDs”), 0-100
- Fully referenced to source, verifiable
- More demanding than IOs/standards
- All data downloadable
- Used by financial intelligence units, public prosecutors, risk rating agencies, tax administrations, central banks, etc.

Weakest Link Principle

Source: TJN 2018 (FSI-Methodology), page 12

https://www.financialsecrecyindex.com/
From corruption to IFF

Early 2000s: TJN

Later 2000s: GFI and ‘IFF’

2011-2014: AU/ECA Mbeki panel

2012-2013: UN HLP on Post-2015

2015: SDGs agreed...

...Pushback begins
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.
Pros and cons of the IFF target

- Pros
  - Important reflection of the genuine shift in policy concerns
  - Consensus between the old and new corruption views

- Cons
  - So comprehensive it may not support specific policy analysis and/or response
  - So broad it may not support national accountabilities
  - Consensus may (!) not persist
2. Definitional questions

Definitional questions
Typology and impacts
Not avoiding avoidance
Types of illicit financial flows

1. Laundering of proceeds of crime
2. Abuse of power, including theft of state funds and assets
3. Market/regulatory abuse
4. Tax abuse

Each can be situated in terms of
- capital legality; and
- transaction licitness
IFF by capital and transaction type

Figure 2.1
Origins of illicit financial flows

Old ‘corruption’ view – emphasis here

‘New’ IFF view: corporate abuses also in scope
Settle down. Listen to me. You have agreed the wrong target. The problem is not multinationals. The problem is corruption. Our tax dodging is not corrupt. Poor countries are corrupt. Poor people are corrupt. You are corrupt. Target yourselves.
Three reasons to retain MNE avoidance

1. Substance: inclusion is what was agreed in SDGs
From corruption to IFF

Early 2000s: TJN
Later 2000s: GFI and ‘IFF’
2011-2014: AU/ECA Mbeki panel
2012-2013: UN HLP on Post-2015
2015: SDGs agreed
Foundations of SDG inclusion

- African Union/UNECA High Level Panel
  - We placed emphasis on illegality across any stages of such outflows to show that a legal act in one geographical location does not nullify the intent and purpose of such outflows, which is to hide money even if legitimately earned.
  - We also felt that the term “illicit” is a fair description of activities that, while not strictly illegal in all cases, go against established rules and norms, including avoiding legal obligations to pay tax.
Foundations of SDG inclusion

- African Union/UNECA High Level Panel
  - IFFs originating from commercial activities have several purposes, including hiding wealth, evading or aggressively avoiding tax, and dodging customs duties and domestic levies. Some of these activities, especially those linked to taxation, are described from a more technical perspective as “base erosion and profit shifting” especially within the ambit of the OECD.
Foundations of SDG inclusion

High Level Panel on Post-2015

- Developed countries could also pay more attention to exchanging information with developing countries to combat tax evasion. Together, they can also crack down on tax avoidance by multinational companies through the abuse of transfer pricing to artificially shift their profits across international borders to low-tax havens.

- Developed countries... have special responsibilities in ensuring that there can be no safe haven for illicit capital and the proceeds of corruption, and that multinational companies pay taxes fairly in the countries in which they operate.
Three reasons to retain MNE avoidance

1. Substance: inclusion is what was agreed in SDGs

2. Definition: illicit ≠ illegal
Definitional questions: two views

- **Illicit = illegal**
  - “Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another. GFI classifies this movement as an illicit flow when the funds are illegally earned, transferred, and/or utilized.”

- But, context: GFI was set up to promote Raymond Baker’s important work – which put the entire focus on ‘commercial tax evasion’
Definitional questions: two views

- Illicit = illegal? Baker (p.24):

Reading the newspapers today might lead you to believe that conveying illicit funds from country to country is a highly complex and specialized process. Not so. Here’s a starter kit that provides and illustrates most of the basics... With these techniques you can shift all types of **criminal, corrupt, and commercial dirty money** like a pro—like a Mexican drug cartel or the Saddam Hussein family or Al Qaeda or a **corporate CEO**.
Definitional questions: two views

Illicit = illegal? Baker (pp.32-33):

False pricing in deals between related or unrelated parties tie the shift of tainted money to legitimate transactions, whether the proceeds are commercially tax evading or corrupt or criminal in origin. The cover provided by the partially legal aspects of the business is a great advantage. But there is another reason why it is the most popular means of moving illicit funds. Falsifying prices of international transactions is the only mechanism for shifting money out of a country where no one else in the country needs to know about it.
Definitional questions: two views

- Illicit = illegal? Baker (pp.135-136):

  The business of global tax evasion takes many other forms as well. As the economist Vito Tanzi says, “Tax evasion prospers when society condones it.” A popular technique in recent years is transferring copyrights, logos, trademarks, patents, and other such intangibles to offshore subsidiaries in tax havens. Revenues derived from licensing or selling these corporate assets to other subsidiaries and affiliates can accumulate in the haven tax free...
Definitional questions: two views

Illicit = illegal  Largest component: ‘commercial tax evasion’
  “Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another. GFI classifies this movement as an illicit flow when the funds are illegally earned, transferred, and/or utilized.”

Illicit ≠ illegal  Core component: ‘corporate tax avoidance’
  Illicit: “forbidden by law, rules or custom” (OED)
  Illicit > illegal (e.g. tax); illicit < illegal (e.g. Blankenburg & Khan)
  But in all cases, for legal or social reasons, illicit = HIDDEN
IFF impacts

Financial opacity gives rise to IFF

- Laundering criminal proceeds
  - Drug trafficking
  - Human trafficking
- Corruption
  - Bribery of officials
  - Theft of state assets
- Tax abuse
  - Corporate
  - Individual
  - Conflicts of interest
  - Regulatory abuse
- Market abuse

'Illegal capital' IFF

Most urgent threats:
- Conflict
- State illegitimacy
- Rent-seeking

'Legal capital' IFF

Most urgent threats:
- Basic service provision
- Inequality
- Effective political representation
- Rent-seeking

Risk to negative security

Risk to positive security
Three reasons to retain MNE avoidance

1. Substance: inclusion is what was agreed in SDGs

2. Definition: illicit ≠ illegal

3. Scale and robustness of estimates
Profit ‘misalignment’

- Switzerland
- Ireland
- Netherlands
- Luxembourg
- Bermuda

Share of declared profit 'misaligned' from elsewhere
3. Policy agenda

SDG indicators

Convention on financial transparency

International tax reform

tax justice network
SDG indicators

16.4.1
- Total value of inward and outward illicit financial flows (in current United States dollars)

Issues:
- Uncertainty of estimates (IFF hidden by definition; data weakness)
- Complexity of alternatives (e.g. risk-based)
- Combines all IFF despite important channel, motivation differences

Response:
- Construct measures of relevant variables, instead of uncertain estimates of all IFF
SDG indicators

- An indicator of misaligned profits, based on OECD country-by-country reporting data:

  The value of profits reported by multinationals in countries, for which there is no proportionate economic activity

- An indicator of undeclared offshore assets, based on OECD CRS:

  The value of citizens’ assets held by other jurisdictions, for which there is no declaration by citizens to their tax authorities
Convention on financial transparency

RAISING THE STANDARD FOR ALL: THE ABC

- Automatic exchange of financial information (multilateral)
- Beneficial ownership transparency (public registers for companies, trusts and foundations)
- Country-by-country reporting, publicly by all multinationals (GRI standard>OECD)
International tax reform

- Reform at OECD Inclusive Framework to achieve a redistribution of global taxing rights
- Unitary taxation with formulary apportionment, with a balanced formula: sales and employment
- Full transparency of double (non-)taxation: public country-by-country reporting as well as aggregate statistics
  - IMF, World Bank support to countries to achieve this
Combating illicit financial flows

*Definition, measurement and policy response*

Alex Cobham
@alexcobham
Tax Justice Network

G-24 TECHNICAL GROUP MEETING
LIMA, PERU

14 March 2019