

# Combating illicit financial flows

## *Definition, measurement and policy response*

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G-24 TECHNICAL GROUP MEETING  
LIMA, PERU

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## 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

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- The emergence of the IFF agenda
- Definitional questions: Avoiding avoidance?
- Policy agenda

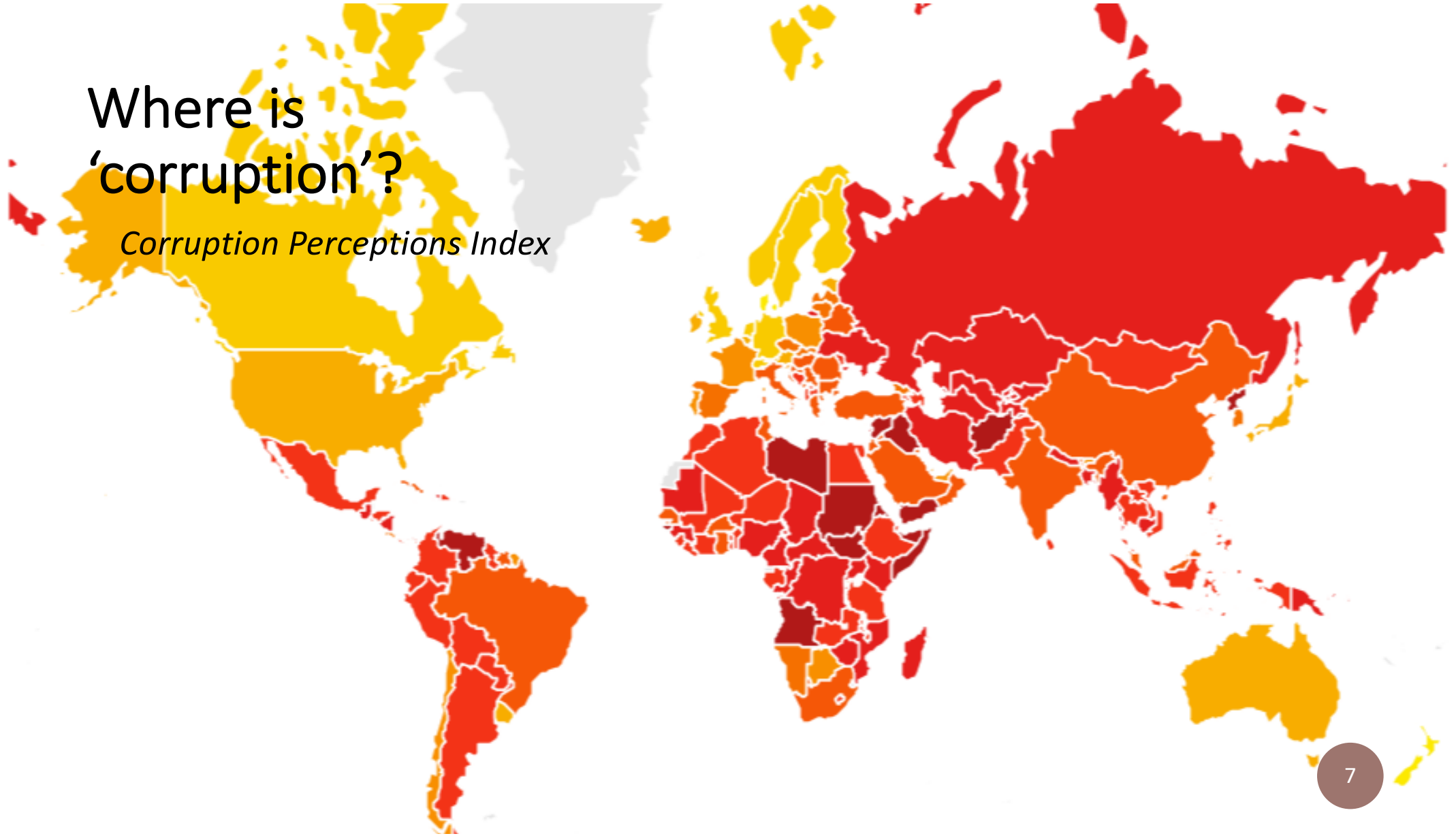
# 1. Emergence of IFF agenda

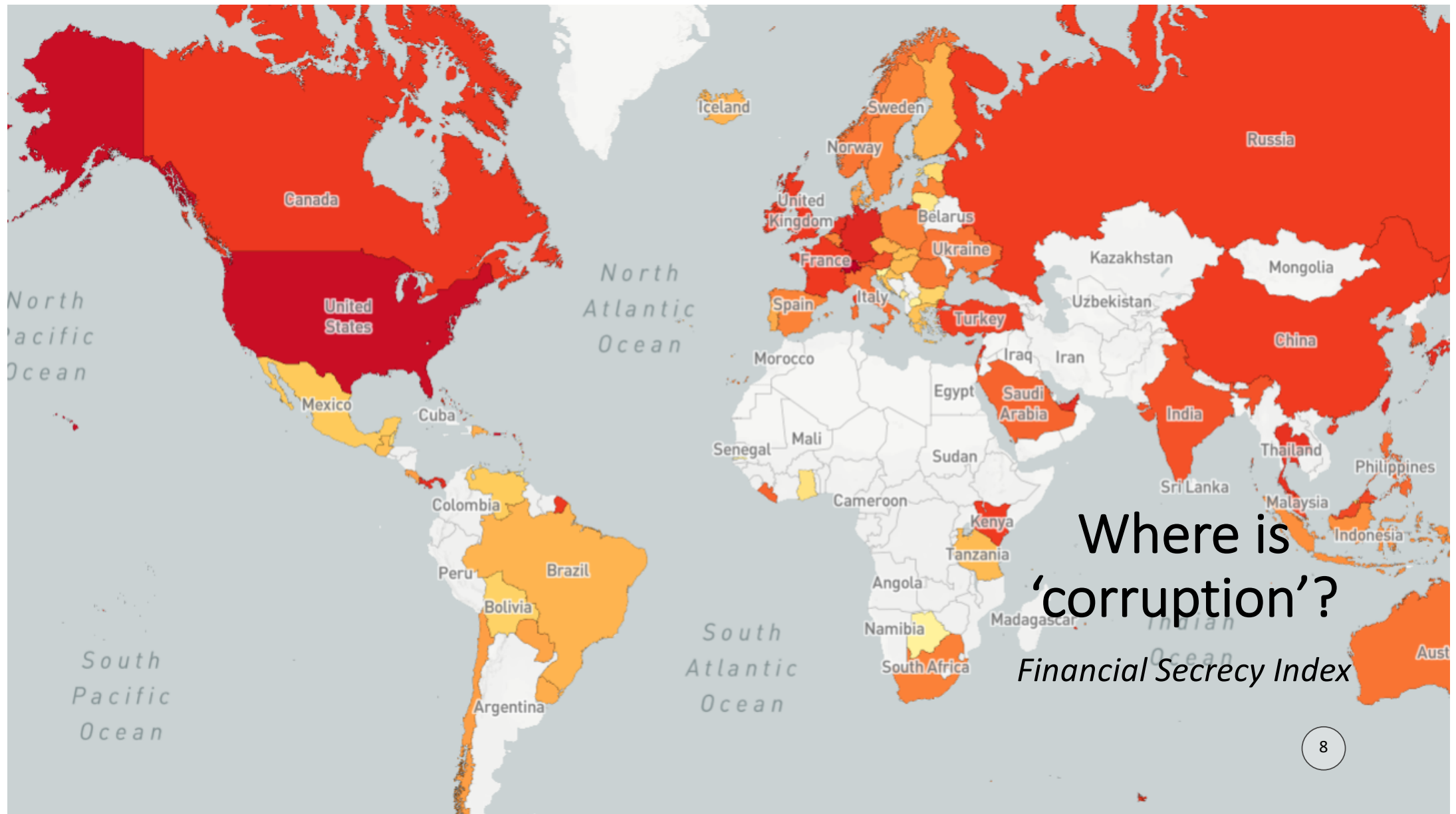
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# Where is 'corruption'?

*Corruption Perceptions Index*





Where is  
'corruption'?  
Financial Secrecy Index

# FSI 2018: Secrecy Scores

Ownership Registration		Legal Entity Transparency		Integrity of tax and financial regulation		International Standards and Cooperation	
1	Banking secrecy	6	Public Company Ownership	11	Tax Administration Capacity	17	Anti-Money Laundering
	IDs 89, 157, 158, 352, 353 and 360		IDs 470 – 475, 485 and 486		IDs 317 and 400 to 406		ID 335
2	Trusts and Foundations Register	7	Public Company Accounts	12	Consistent Personal Income Tax	18	Automatic Information Exchange
	IDs 204, 206, 214, 234, 236 - 240, 244, 355, 384, 393, 395 and 396		IDs 188, 189 and 201		IDs 374, 435 and 489		IDs 150, 371 - 374, 376 and 377
3	Recorded Company Ownership	8	Country by Country Reporting	13	Avoids Promoting Tax Evasion	19	Bilateral Treaties
	IDs 388, 470 - 473, 485 and 486		ID 318		Cf. Tax Details section of the country database reports		IDs 301 and 143
4	Other Wealth ownership	9	Corporate Tax Disclosure	14	Tax Court Secrecy	20	International Legal Cooperation
	IDs 416, 418, 437, 439 and 487		IDs 363, 419 and 421		IDs 407 to 410		IDs 33, 35, 36, 309 - 314 and 469
5	Limited Partnership Transparency	10	Legal Entity Identifier	15	Harmful Structures	16	Public Statistics
	IDs 269, 272, 273, 274, 476, 477 and 479 to 484		IDs 414, 415 and 420		IDs 172, 184, 224 and 488		IDs 425 to 434

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

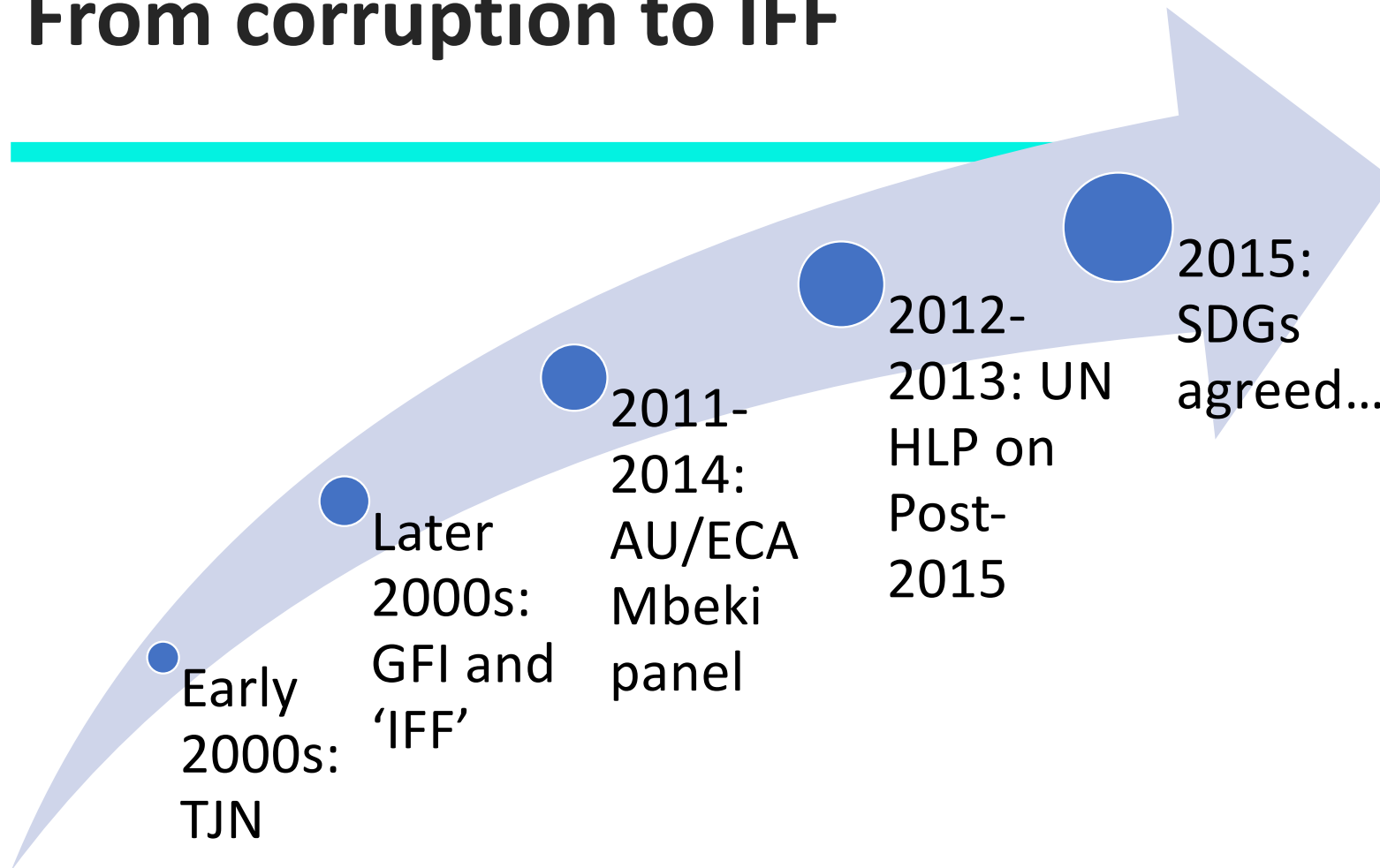
- Arithmetic average of 20 Key Financial Secrecy Indicators (0-1), 4 areas, driven by 115 variables (“IDs”), 0-100
- Fully referenced to source, verifiable
- More demanding than IOs/standards
- All data downloadable
- Used by financial intelligence units, public prosecutors, risk rating agencies, tax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

■ <https://www.financialsecrecyindex.com/>

**Weakest Link Principle**



# From corruption to IFF



...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

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Definitional questions

Typology and impacts

Not avoiding avoidance



# Types of illicit financial flows



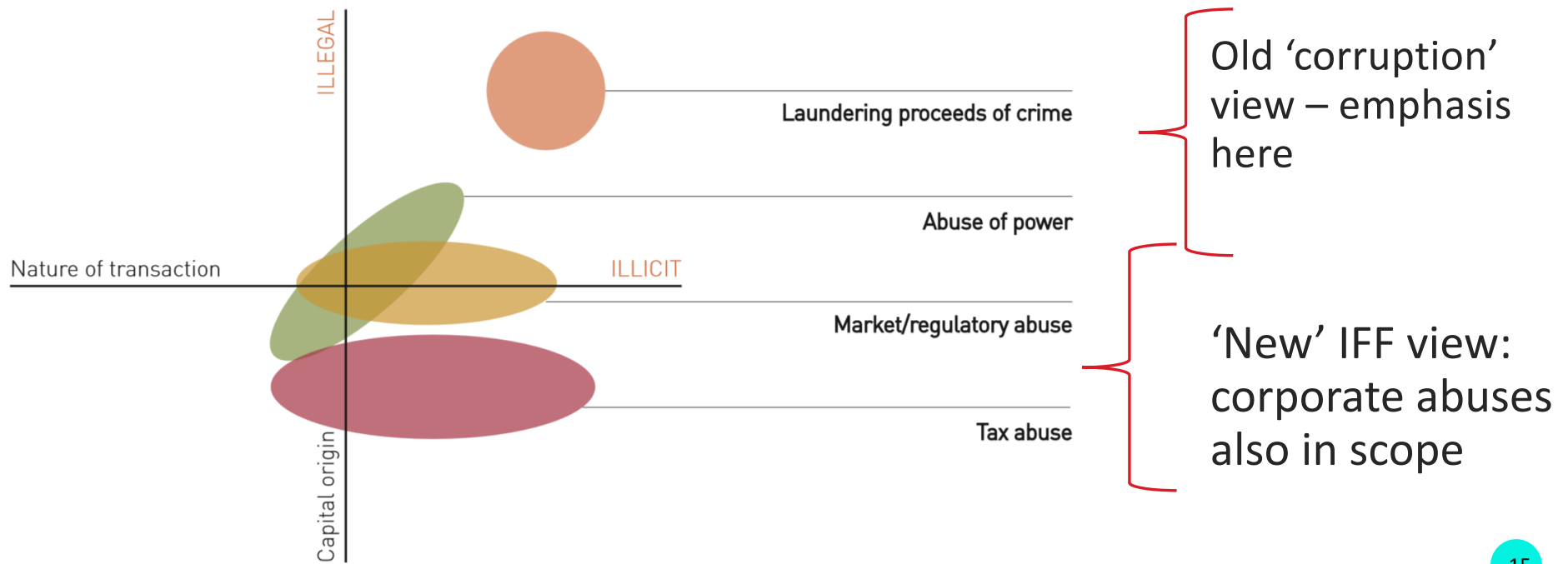
1. Laundering of proceeds of crime
2. Abuse of power, including theft of state funds and assets
3. Market/regulatory abuse
4. Tax abuse

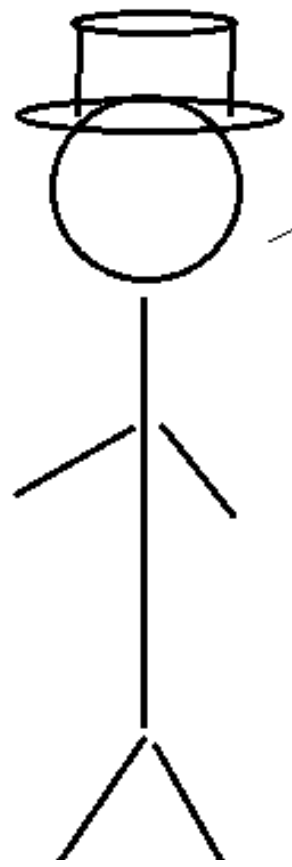
Each can be situated in terms of

- capital legality; and
- transaction licitness

# IFF by capital and transaction type

Figure 2.1  
Origins of illicit financial flows

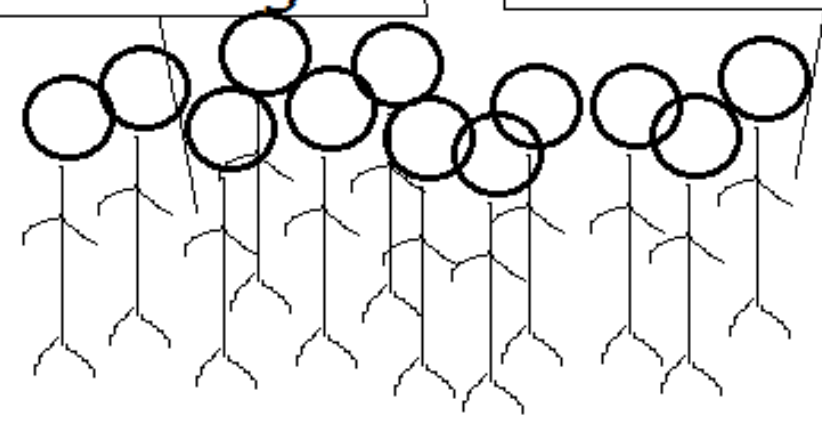




Settle down. Listen to me. You have agreed the wrong target. The problem is not multinationals. The problem is corruption. Our tax dodging is not corrupt. Poor countries are corrupt. Poor people are corrupt. You are corrupt. Target yourselves.

Stop the bleeding!

*Multinationals  
Pay your share!*



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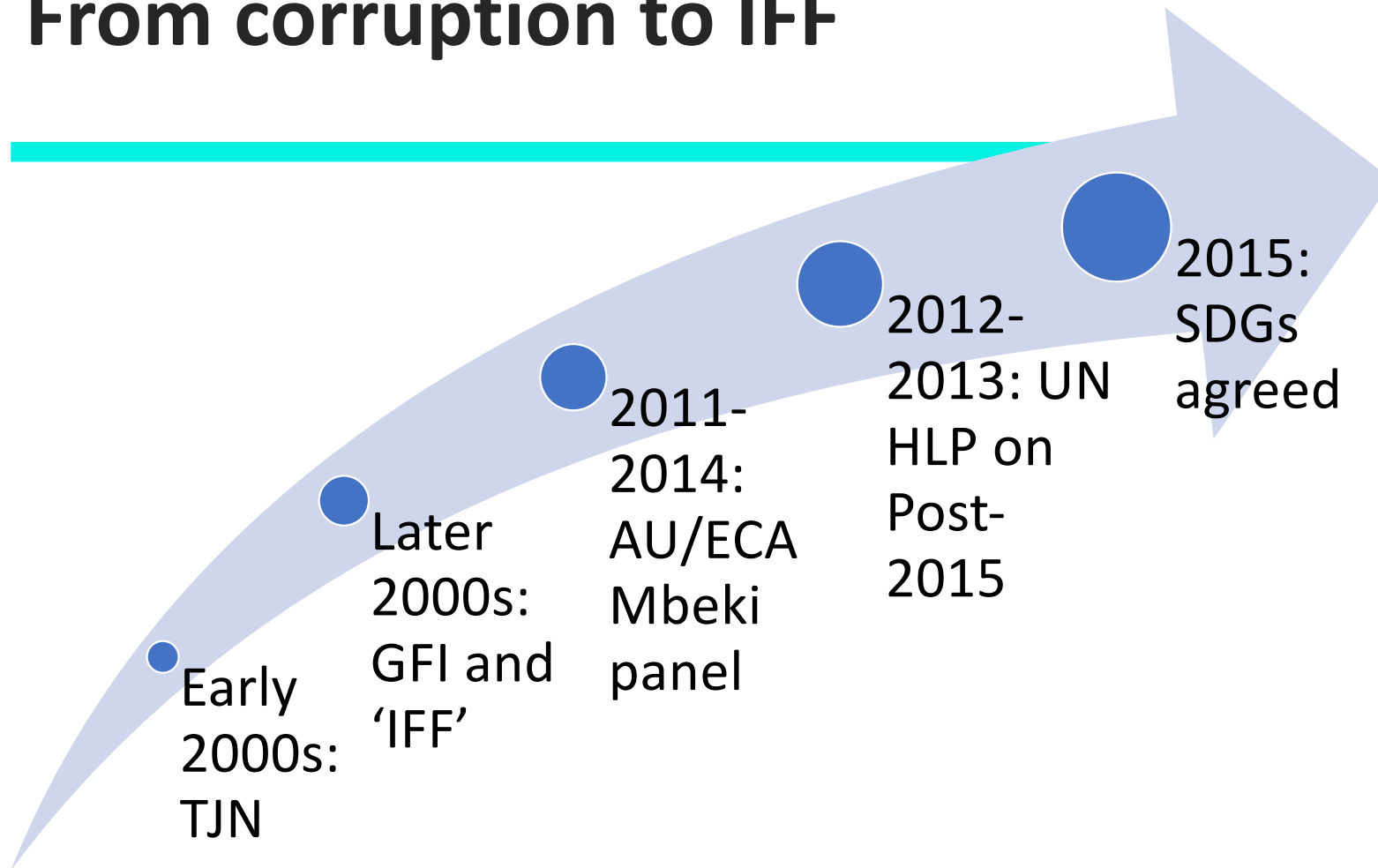
# Three reasons to retain MNE avoidance



1. Substance: inclusion is what was agreed in SDGs



# From corruption to IFF



# Foundations of SDG inclusion

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- 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

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- 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

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## ■ 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

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- 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

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- 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):

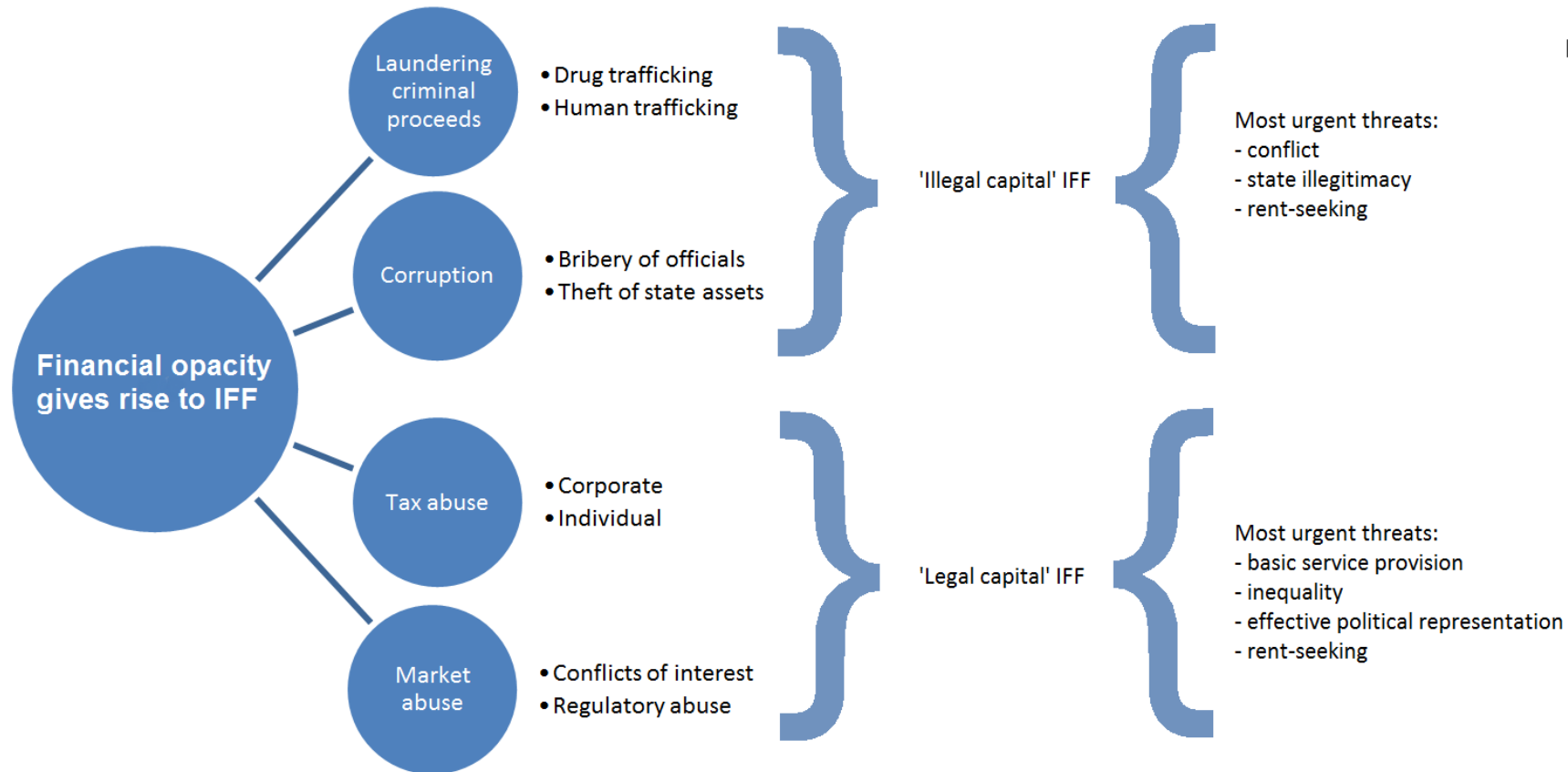
*The business of global tax evasion takes many other forms as well. As the economist Vito Tanzi says, “Tax evasion prospers when society condones it.” A popular technique in recent years is transferring copyrights, logos, trademarks, patents, and other such intangibles to offshore subsidiaries in tax 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

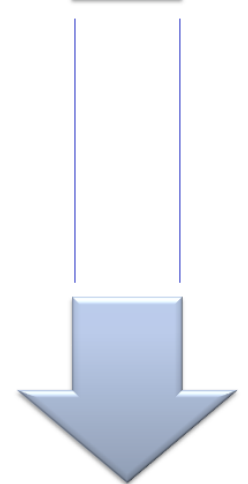
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- Illicit = illegal **Largest component: 'commercial tax evasion'**
  - “Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another. GFI classifies this movement as an illicit flow when the funds are illegally 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



Risk to negative security



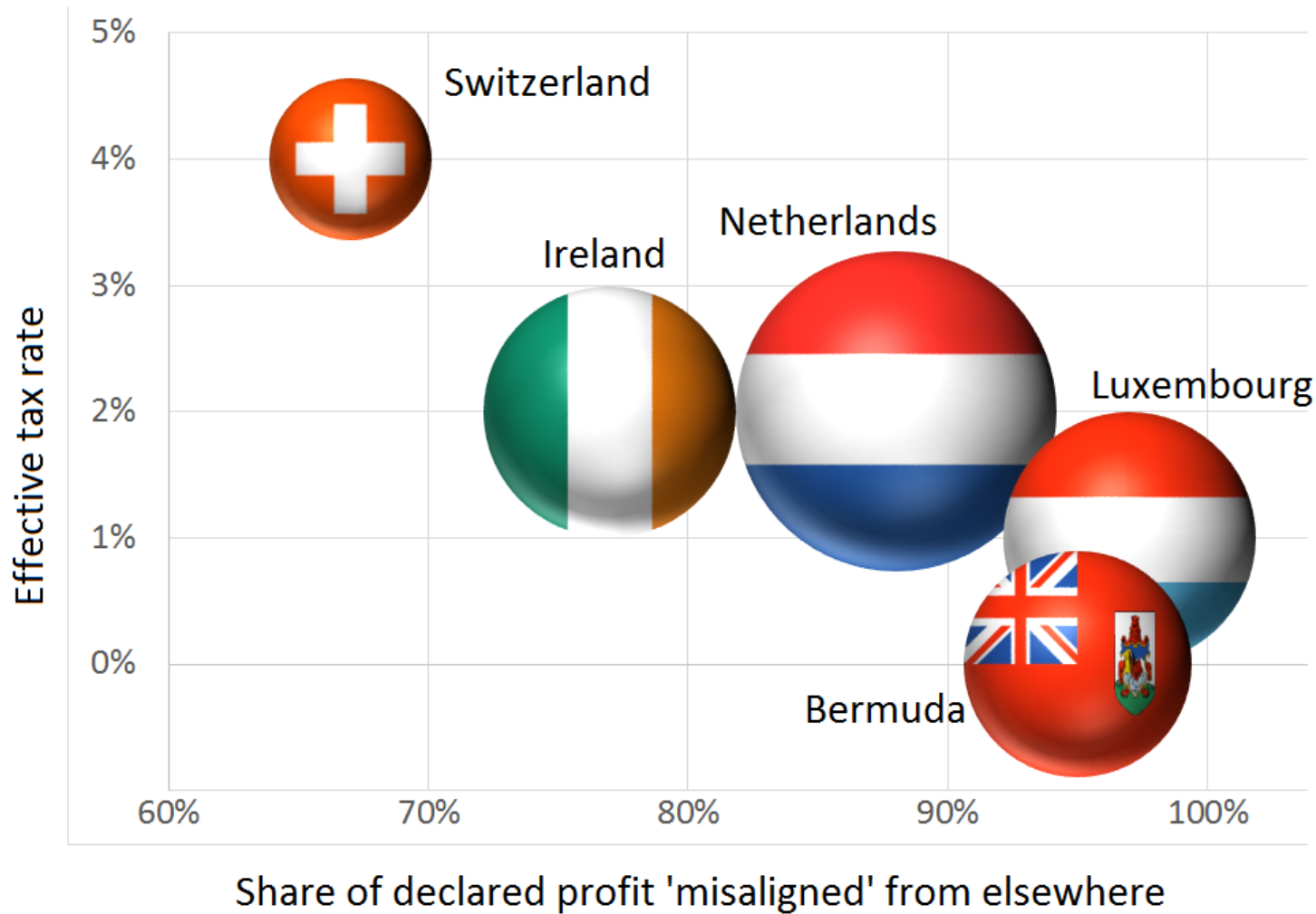
Risk to positive security

# Three reasons to retain MNE avoidance



1. Substance: inclusion is what was agreed in SDGs
2. Definition: illicit  $\neq$  illegal
3. Scale and robustness of estimates

# Profit 'misalignment'



# 3. Policy agenda

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SDG indicators

Convention on  
financial  
transparency

International  
tax reform



# 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

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- 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

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