International regulation and transparency to support Domestic Budget Revenues

This issue brief summarizes the key propositions put forward in the recently released SDSN Working Paper Financing Sustainable Development, regarding the improvement of international rules on taxation, transfer pricing and transparency to support the mobilization of domestic resources for the post-2015 agenda. References and additional supportive evidence are provided in the Working Paper. Citations of this Issues Brief should refer to the Working Paper.

International tax and secrecy havens, massive tax evasion, abusive transfer pricing, harmful tax competition, and corrupt natural resource deals significantly depress countries’ ability to mobilize domestic resources. ONE estimates that developing countries lose some $1 trillion per year through illicit financial flows. Losses of similar magnitude are estimated by other sources cited by the World Bank. Developing countries typically suffer the biggest impact on Domestic Budget Revenues (DBR), as documented by the IMF in the case of corporate tax competition or trade mis-invoicing. There can be no doubt that an Financing for Development (FFD) framework for achieving the SDGs and meeting the international climate objectives must address international rules on taxation, transfer pricing, and transparency.

Of particular importance for the poorest countries are widespread malpractices in the natural resource sector. Anonymous shell companies, trusts, and other investment vehicles in offshore locations often hide beneficial owners, opening the door to corruption and fraud. Opaque contract terms invite corruption and allow natural resource companies to abuse the better information and legal advice they have access to in comparison with host governments in poor countries.
Reforming the underlying rules is complex, but many international processes are already underway, such as the OECD’s Action Plan on Base Erosion and Profit Shifting (BEPS) mandated by the G20. Yet, these processes are not sufficient to address the full set of reforms required to stop the race to the bottom on tax revenues from multinational corporations and wealthy individuals. In particular, the BEPS process does not involve developing countries as equal negotiation partners and therefore does not address many of the issues most pertinent to poor countries. Given the quasi-global scope of its rule-setting and its recent endorsement under the G20, the BEPS framework and process should be strengthened further, but its governance must be expanded to give equal voice to developing countries that are not members of the G20. While FfD will not substitute for any of these processes, it can and should adopt some core global norms. We highlight the key reforms in the sections below.

**Transparent Beneficial Ownership of Companies, Trusts, and Other Investment Vehicles in All Countries**

There is no serious, legitimate reason for hiding the true ownership of companies, trusts, or similar legal structures from tax authorities, provided that essential safeguards on accessing confidential information are in place. Yet the practice is widespread, not only in offshore tax and secrecy havens but also in other developed and developing countries. Corporate structures and trusts whose ownership is unclear are often at the heart of murky natural resource deals, abusive transfer pricing, and corruption in both developed and developing countries. As part of an FfD framework, countries must resolve that all countries, including their sovereign territories, should require that the beneficial ownership of all companies, trusts, and similar legal structures be transparent and publicly available in open data format. Failure by individual countries to comply with this basic standard should no longer be tolerated.

**Reform of International Tax Governance**

Two thirds of all cross-border business transactions take place between companies belonging to the same group. By artificially overpricing imports and underpricing exports, multinational companies can shift profits to countries with low or zero corporate taxes even if the source of the profits lies elsewhere. As a result, multinational companies pay as little as 5 percent in corporate tax, while smaller local companies pay as much as 30 percent. These practices may be legal, but they undermine public resource mobilization in rich and poor countries alike and tilt the playing field against smaller companies. FfD should recognize this problem as critical for mobilizing public revenues and call on all countries to implement specific measures, such as:
• **Full and equal participation of developing countries in the OECD/G20 BEPS process** or the establishment of new multilateral processes in which developing countries can participate adequately.

• **Mandatory country-by-country reports by multinational companies** that detail the number of their employees, physical assets, sales, profits, and taxes (due and paid).

• **Provisions allowing developing countries to withhold corporate taxes from companies operating in their jurisdiction** – just like governments withhold individuals’ income taxes.

• **Increased technical support on international taxation and tax audits to developing countries**, including through the Tax Inspectors Without Borders toolkit launched by the OECD.

**Exchange of Information Among Tax Authorities and Taxation of Offshore Assets**

Significant progress has been made in requiring tax havens to share information on assets and taxes paid by non-resident or multi-national companies, as well as by individuals. As a result, the OECD Committee on Fiscal Affairs has discontinued its list of uncooperative tax havens. This work is now continued under the Global Forum on Transparency and Exchange of Information for Tax Purposes. The ‘Global Tax Forum’ has an interesting ‘UN-style’ governance structure: membership is open to all countries that commit to implementing the international standards on transparency and exchange of information and participate in the peer review process. Though hosted at the OECD, all 126 member jurisdictions have an equal vote. The forum is currently chaired by South Africa with vice-chairs from Barbados, China, and Germany.

Since its launch as a global initiative in 2009, the Global Forum has seen a sharp improvement in the ‘supply side’ of international tax cooperation, with more jurisdictions responding to requests for exchange of information and response times falling rapidly. The ‘demand side’ has also improved, with many countries sharply increasing the number of exchange of information (EOI) requests. Through its peer review mechanisms, the Global Tax Forum monitors implementation of exchange of information standards. A small number of members (British Virgin Islands, Cyprus, Luxemburg, Seychelles) continue to be ‘non-compliant,’ with a substantially larger number of countries rated ‘partially compliant’. FfD could request all countries to participate actively in the Global Tax Forum and to become fully compliant in the near future.
On 29 October 2014, over 50 countries signed an agreement to automatically exchange information on bank accounts among tax authorities. This agreement will make a critical contribution towards combating tax evasion and fraud. In addition, tax havens increasingly levy taxes on assets held in their jurisdiction, transferring parts of the revenue raised back to the governments where the individuals and companies concerned reside.

Yet, there is an important snag: developing countries often lack the capacity to participate in EOI agreements. For this reason, the Global Tax Forum has launched an Africa Initiative to engage with African countries on tax transparency and exchange of information. The FfD process should explore opportunities for strengthening countries’ capacity to participate in exchange of information programs, in order to combat tax evasion and fraud.

**Publish what you pay**

All large companies operating in developing countries, particularly in the extractives and natural resource sectors, should be required to publish contracts as well as all payments to government officials in every country they operate in. Several such standards are available, including for natural resource companies, and have been adopted by Canada, the EU, Norway, and the US. Other countries, including China, have indicated that they may be willing to comply. Companies often require governments’ approval to publish contracts and payments, so ‘publish what you pay’ should be included in the FfD process.

**Open government data**

Transparent and open government data on budgets, procurement, public expenditure, social service delivery, and SDG outcomes is the flipside of ‘publish what you pay’ for corporations. FfD should anchor open government data and mandatory disclosure laws as critical components of a resource mobilization strategy and the ‘data revolution’ called for by the High-Level Panel on the Post-2015 Development Agenda.

**Periodic review of key international rules and standards for consistency with achieving the SDGs**

International rules on taxation, business accounting, banking and insurance regulation, and the exchange of information between governments are complex and will evolve in coming years. Moreover, some are governed by private entities that may not respond directly to governments. It will be neither possible nor
desirable for FfD to monitor each process or to provide detailed technical guidance on how rules need to evolve to support financing for sustainable development. For this reason, we propose that FfD request that standard-setting bodies periodically report on whether their rules are consistent with achieving the SDGs and international climate objectives. These reports should be made public and submitted for review and approval to each organization’s governing bodies. If issues are found, the organization should recommend measures to be taken by its governing bodies to address the issues. Such ‘consistency checks’ could, for example, be requested from the IMF on financial standards, the Bank for International Settlement (BIS) on global standards for banking and insurance regulation, the International Accounting Standards Board on accounting practices, particularly in relation to transfer pricing, and so on.

**IMPROVED ENFORCEMENT**

Some of these changes may be resisted by a small number of countries and companies that currently benefit from opaque rules at the expense of others. As early as 1998, the OECD proposed that member countries terminate their tax conventions with uncooperative tax havens, but this proposal has since been dropped from official OECD reports. Given the detrimental impact of tax havens on financing for sustainable development, the FfD process might reconsider the original OECD recommendation as a standard that should apply in the 21st century. Without credible enforcement of minimal global standards, countries rich and poor will find it increasingly hard to mobilize the public resources they need to pursue sustainable development.