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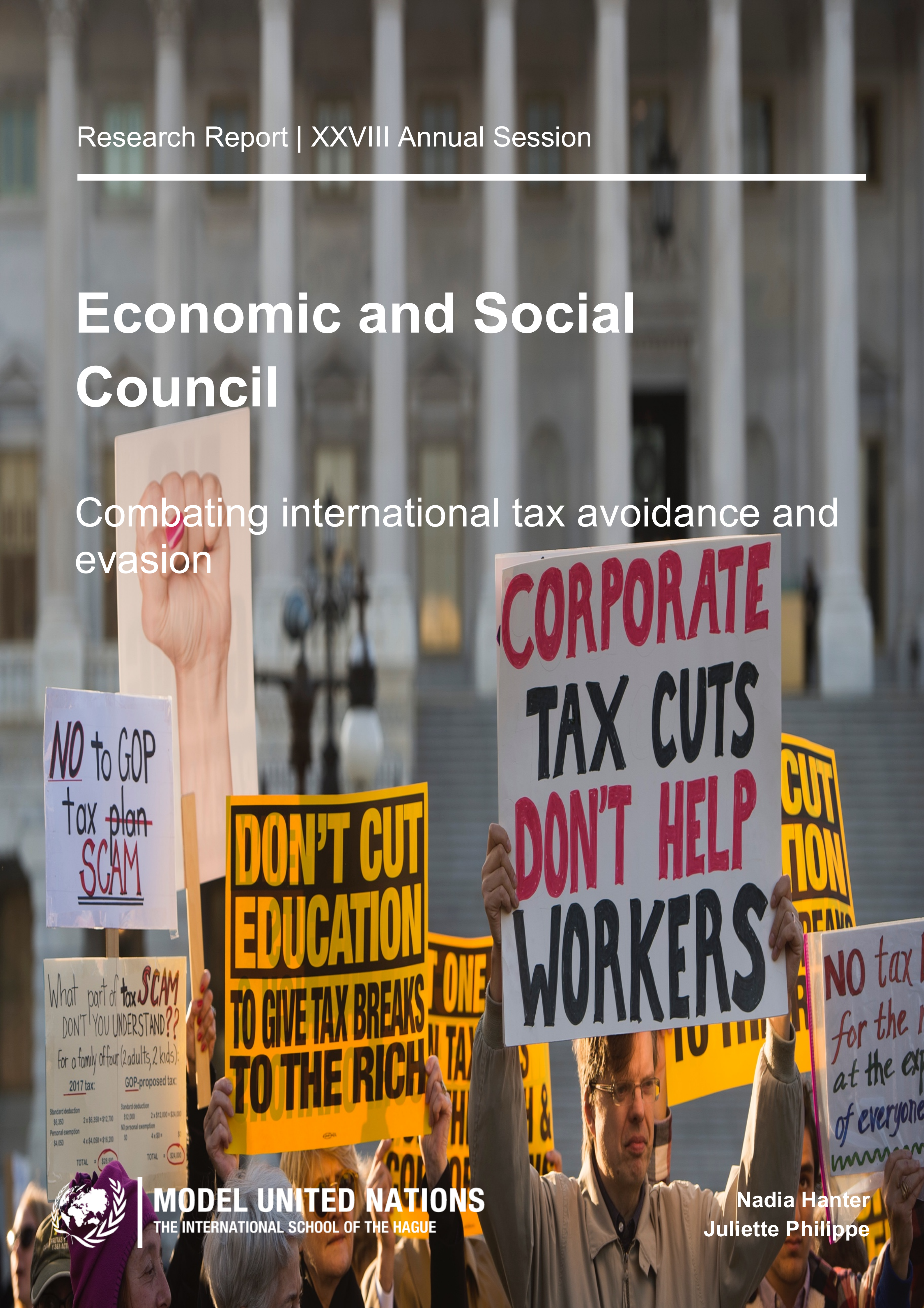
Combating international tax avoidance and evasion



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Introduction

Taxes are a necessary facet of each country's economy. Without them, basic government utilities would no longer be available, and infrastructure would not be maintained. Unfortunately, many businesses take advantage of loopholes in tax laws to pay less taxes, which is damaging to local economies and puts a strain on both the government and the people. These methods often comprise of tax avoidance, aggressive tax avoidance, and tax evasion. Governments must work together to ensure that such unjust exploitation comes to an end through the strengthening of existing frameworks and the creation of new laws.

Definition of Key Terms

Tax

A tax is a levy or charge imposed by a government on goods and services in order to make a profit on the business transactions that occur within the country. A tax can be direct (imposed on income and the profits of a company) or indirect (imposed on spending). The money is then used to improve public utilities such as infrastructure, education, and rule of law.

Tax Avoidance

Tax avoidance is the legal prevention, by companies or individuals, of paying a tax. Multinationals can avoid paying taxes by ensuring their headquarters are located in a country with lower taxes, and by working through holding companies to take advantage of treaties between certain countries. For individuals, investing their money in certain sectors, such as real estate and investment funds, can allow them to temporarily avoid taxation on the money. When it is extracted, the taxes imposed on it are not as high, allowing them to completely avoid paying a portion of the tax. Tax avoidance is not only legal, but encouraged by many governments, as it is said to improve the economy.

Aggressive Tax Avoidance

Recently, countries have begun to identify certain types of tax avoidance as aggressive, and therefore challengeable in court. There isn't a concrete definition of aggressive tax avoidance and specifics are up to the discretion of the government, but it is generally a way to avoid tax that, while not implicitly being illegal, violates the purpose of the law. Businesses storing money in offshore accounts, for example, can be charged with violating tax laws in certain countries. The argument is that tax laws are meant to tax companies making a certain profit, and regardless of where that profit is held, the company has still made it, so the tax is still applicable.

Base Erosion and Profit Shifting

BEPS refer to the shifting of profits to countries where they face less taxation, as well as other strategies employed by multinational to lessen the taxes they must pay. Since tax laws are not always up to date, companies use gaps and loopholes in laws to avoid paying as much tax as they would usually.

Tax Evasion

Tax evasion is the action of breaking the law in order to pay less or no tax. It can consist of hiding income or profit from the government, for example, to avoid paying taxes on it, or misreporting relevant information to tax authorities for personal gain. Engaging in black market or illicit trade also involved tax evasion. Unlike tax avoidance tax evasion is always illegal.

Tax Havens

Tax havens are countries where foreign companies and individuals are only liable to pay little taxes, if any. These countries also share less information with foreign tax authorities than others might, or none at all. Tax havens include Andorra, the Bahamas, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Channel Islands, the Cook Islands, Hong Kong, The Isle of Man, Mauritius, Lichtenstein, Monaco, Panama, and St. Kitts and Nevis. These countries benefit by drawing capital to their banks, leading to a stronger financial sector, and the companies and individuals that shift their money there benefit from the decreased tax liability offered.

Tax Non-compliant

Tax non-compliant refers to any person or company who does not pay taxes, either through avoidance (mainly aggressive avoidance) and evasion. In contrast, a tax compliant company or individual refers to a person who does pay their taxes.

General Overview

The issue of tax avoidance and evasion can be rather complicated, mainly due to the ambiguous legality of the issue. Tax avoidance, for example, can be completely legal. However, certain forms of tax avoidance can still be extremely harmful to people, specifically those in Less Economically Developed Countries (LEDCs). Because of this, the aggressive tax avoidance has been recently coined, and efforts to reclassify certain actions as illegal have begun. Tax evasion is explicitly illegal, but can be hard to track.

Tax Avoidance and Its Impact

When companies and wealthier people deliberately forgo paying taxes, either through aggressive tax avoidance or evasion, they do so with the incentive to save money. Certain laws, such as double taxation laws, make this more appealing. Double taxation laws requires a company to pay a tax on its income, and then further requires the individuals running the company to pay a tax on their own personal income gained from the company. As a result, companies may decide that paying taxes will be harmful to their income, and choose to non-comply with taxation laws. Since aggressive tax avoidance is more of a grey area, and still legal in many countries, companies often choose it over all-out evasion. BEPS is one of the most common forms of aggressive tax avoidance, as it uses existing gaps and loopholes to help companies pay less taxes. Since these aggressive tax plans can become extremely complicated, companies may need to hire professionals in order to keep their affairs in order. These mainly consist of lawyers and bankers willing to skirt the law, and due to the nature of their services they can be very expensive to hire. Because of this, larger, multinational companies tend to be the ones who participate in aggressive tax avoidance.

When larger companies pay less taxes, they still use the services provided by the government as they did before. Because of this, the government must increase taxes for everyone to make up for the financial gap that this creates. This puts financial pressure on individual citizens and smaller companies who cannot avoid taxes, harming a lot of local economies in the process. It also makes it harder for local businesses to compete, and multinationals are then able to grow their reach.

In LEDCs, the impact of tax avoidance only grows. In these countries, taxes make up a much larger part of government income than they do in other countries. In addition, these governments lack the means to tackle tax evasion that other, more economically developed countries may have. Because of this tax avoidance and evasion becomes more prevalent, and the effects only worsen. This leads to a never-ending cycle of exploitation. It is mainly because of this that many believe that any successful strategy to combat tax evasion and avoidance must be international.

The other reason an international strategy is required is to limit tax havens. While tax havens are often used in aggressive tax avoidance, especially in BEPS strategies, they also present their own problems outside of those plans. Tax havens are often countries, and are therefore independent in their choices to tax foreign companies. Their economies are often reliant on foreign investment, so they benefit greatly from their tax laws and have no incentive to change them. In many cases, a lack of such profit can prove extremely damaging not just for the economy of these countries, but for the livelihoods of the individuals residing there. An international incentive must thus be created that gives these countries a way to transition to different forms of income that can sustain them.

Major Parties Involved

The Organization for Economic Cooperation and Development (OECD

The OECD is an international organization that aims to provide a platform for cooperation between states with the goal of improving the economic and social well-being of their people. The OECD has collected data on all member states in order to further its understanding of the issue, and has written many reports on the topic of tax evasion and avoidance.

European Commission

The European Commission fights tax avoidance and evasion within the European Union (EU), but many of its strategies do aim to lower tax non-compliance on a global level. For example, it has made a list of non-cooperative jurisdictions that has increased pressure on these countries to change their tax laws. Already, this has lead to increased commitment from various countries to improve their tax laws so as to continue trade with the EU.

Committee of Experts on International Cooperation in Tax Matters

A subsidiary of the ECOSOC, the Committee of Experts on International Cooperation in Tax Matters is responsible for regularly updating the United Nations Model Double Taxation Convention between Developed and Developing Countries and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries. It also serves as a platform for dialogue between member states on the issue of taxation.

The G20

The Group of Twenty is the group of nations whose members' economies make up 80% of the world economies. The G20 often promotes tax transparency, and its members plan to start automatically exchanging tax information by the end of the year, so as to prevent tax evasion.

LEDCs

As mentioned above, LEDCs tend to bear the brunt of consequences that come from tax non-compliance. Because of this, it is essential that they are included in discussions regarding tax avoidance and evasion, and that they are considered in all plans to resolve the issue.

Timeline of Key Events

Date	Description of Event
5 November 2017	The 13.4 million documents comprising the Paradise Papers are leaked to the public.
2017	The United Nations Model Double Taxation Convention between Developed and Developing Countries is adopted
16 May 2016	The 11.5 million documents comprising the Panama Papers are leaked to the public
2010	The Standard for Automatic Exchange of Financial Account Information (AEOI) succeeds the EOIR
2009	The OECD establishes its Standard of Exchange of Information Upon Request (EOIR)
2003	The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries is adopted

Previous Attempts to Resolve the Issue

The EOIR's goal is to allow governments to request necessary data from each other regarding financial information. This way, any suspected tax evasion can easily be pursued. The AEOI only furthers this transparency by allowing governments to seek information from their banks and financial organizations to help themselves and other countries. This cooperation aids in keeping track of offshore tax evasion.

The United Nations Model Double Taxation Convention between Developed and Developing Countries, one of the documents published by the Committee of Experts on International Cooperation in Tax Matters, allows governments to track double taxation that can often occur with multinational companies. In this way, one of the incentives for tax avoidance is avoided, and governments can cooperate on tax laws.

The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries stresses the important of transparency between LEDCs and MEDCs. This transparency makes tax evasion much more difficult for multinationals and allows tax evasion to be more easily tracked.

These measures have all helped to strengthen cooperation between MEDCs, and in this way have helped decrease tax evasion. However, LEDCs were not overly helped with the passing of these measures.

Possible Solutions

Transparency between countries has proven essential in combating international tax avoidance and evasion. Increasing the transparency between MEDCs and strengthening the data exchange to and from LEDCs will allow countries to use more resources when attempting to combat tax evasion.

Additionally, a comprehensive method in addressing tax havens will help lessen tax avoidance and evasion. Such a method must comprise of not only ways to ensure the countries collaborate, but of ways to keep their economies afloat in the process, so as to not destabilize them completely. A list similar to that of the European Commission may prove helpful in this task.

The issue of aggressive tax avoidance must also be solved. A concrete definition of the term would aid in ensuring there are no loopholes or grey areas in the matter, the establishment of laws or tariffs specifically targeting aggressive tax avoidance will help ensure that companies do not abuse existing measures.

Appendices

Appendix A

Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries and Model Double Taxation Convention between Developed and Developing Countries:

http://www.un.org/esa/ffd/wp-content/uploads/2014/09/UNPAN008579.pdf

Appendix B

OECD glossary of tax terms:

http://www.oecd.org/ctp/glossaryoftaxterms.htm

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