Research Report

Group of Twenty

Combating offshore tax evasion

MUNISH '14

Forum	Group of 20
Issue:	Combatting offshore tax evasion
Student Officer:	Natalia Karavassillis
Position:	Deputy President

Introduction

Offshore tax evasion is a pertinent issue that needs to be resolved immediately in order to prevent the loss of significant sums of money that could be used for the benefit of the people. According to the European Commission, more than 1000 billion euros are lost every year due to tax evasion. It has also been estimated that every year tax evasion amounts for 5% of global GDP. Tax evasion is unfair to the people who actually pay their taxes regularly and it reduces the money that governments receive to spend on public goods/services, and development projects.

The G20 International Tax Symposium took place in Tokyo on May 10th, 2014, where the collaboration between government policy makers, tax administrators, and tax experts was deemed essential to achieve an efficient and cohesive international tax system. During the symposium, matters such as fighting profit/income shifting by corporations and individuals to avoid paying tax were discussed.

Definition of Key Terms

Tax

Taxes are obligatory contributions to the state's/government's revenue. They are levied by the government on citizens' incomes and business profits, as well as added to the costs of some goods and services.

Profit Shifting

Profit shifting is a strategy of moving a person's income or a firm's profit from a region of higher income/profit tax rate to a region of lower tax rate. Businesses that are known to have been practicing this form of tax evasion include Starbucks, Apple, Google and Amazon. Profit shifting is usually not strictly illegal, however it has a façade of legality by using loopholes in the legislation system of different countries in order to achieve tax payment avoidance. Nevertheless, it is morally unjust because it deprives the government of the country where a company actually has operations of essential funds that could be used for the benefit of the citizens of that nation.

Tax Haven

A tax haven country is a country in which taxes (e.g. income tax, VAT) are charged at a very low rate (e.g. Switzerland, Hong Kong, Cayman Islands, Monaco, Japan, Belgium, Netherlands, and Luxembourg)

Tax Evasion

Tax evasion is the *illegal* under/nonpayment of tax and is usually performed by individuals or firms who misrepresent their income to the National Revenue Service (NRS) (either by underreporting income, profit shifting or hiding their money in offshore bank accounts).

Tax Avoidance

Tax avoidance is the under/nonpayment of tax through ways that abide by the law and are therefore not considered 'illegal' (one form of tax avoidance is profit shifting as defined previously).

Offshore Tax Evasion

Offshore tax evasion occurs when individuals or firms save their money overseas in offshore bank accounts in order to avoid paying the tax in their country of residence.

Offshore Bank Account

An offshore bank account is a bank account created by an individual or firm and located in a country offshore or foreign to their country of residence.

General Overview

G20 Agenda for Tax Evasion

In February 2014 in Sydney, the G20 members approved a new international standard for sharing tax information, which was developed by the Organisation for Economic Cooperation and Development (OECD). The new standard permitted tax information to be exchanged automatically between nations without the need for complicated and bureaucratic legal processes.

In November 2014, all G20 members will be meeting in Brisbane, Australia and discussing issues including: the importance of economic growth to development; employment; investment in infrastructure; transparency and anti-corruption; trade; the progress on combating tax evasion. The OECD will also participate and explain to the G20 member states the different challenges being faced by the new digital economy with regard to tax regimes.

Consequences of Tax Evasion

Tax evasion is very costly to any economy that faces this problem. When someone pays less tax than necessary, the government receives a reduced amount of money than it should. This therefore means that it has less money to spend on projects that are aimed at further developing the country, the standard of living and the quality of life of its citizens. Thus, it inhibits economic growth and other economic objectives. Economic growth is a priority for the G20 and thus resolving the issue of tax evasion, which prevents economic growth to occur, is of great significance.

Furthermore, businesses that practise tax evasion end up having an unfair advantage compared to businesses that pay their taxes in full because they end up possessing more capital which they can then use to solidify their comparatively dominant position in the market. This therefore reduces business competitiveness and may cause firms that operate fully according to the law to become insolvent and close down.

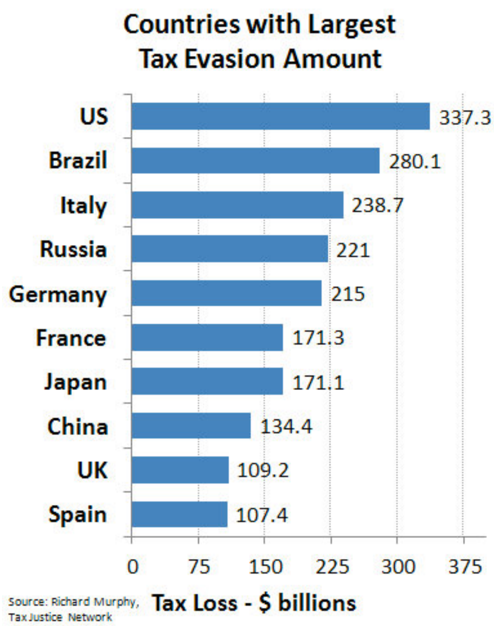
Additionally, individuals who hide money in offshore bank accounts and do not pay the correct amount of taxes exacerbate the difficult financial position of the rest of the law abiding citizens; firstly because the government will have less money to spend for their benefit and secondly because the government may be forced to increase taxation (e.g. income tax and/or VAT) in order to compensate for the loss.

In addition to this, when businesses shift their profits into tax havens, the countries in which these businesses actually operate lose out on a lot of potential tax revenue. This again reduces the government budget and prevents the country from spending money on different essential development projects. One example of this is Starbucks. Starbucks is an American company but has moved many of its headquarters in the Netherlands where taxes are very low.

Major Parties Involved and Their Roles

Organization for Economic Cooperation and Development (OECD)

The OECD plays a massive role in setting global standards for the automatic exchange of information between tax authorities all over the world. It presented its standard to the G20 in February 2014 at the G20 summit in Sydney, Australia.



Countries with largest tax evasion amount
Murphy, Richard. "Countries with Largest Tax Evasion Amount". *Photograph.* Reuters. 13 Dec. 2011. Web. 06 Aug. 2014. <http://blogs.reuters.com/david-cay-johnston/2011/12/13/wheres-the-fraud-mr-president/>.

G20 Countries

Many of the G20 members including the US, UK, Germany, France, Japan, Russia, Italy, China, and Brazil have a very serious problem with tax evasion and hence these countries need to focus more deeply on resolving the issue. The U.S. government for example loses an estimated sum of $337bn a year due to tax evasion.

Tax Haven Countries

Tax haven countries such as Switzerland, Luxembourg, Singapore and Japan play a big role in encouraging offshore tax evasion to occur. They have low tax rates and incite individuals and firms to open up bank accounts overseas and save their money there. This therefore means that these individuals and businesses avoid paying taxes to their country of residence.

Timeline of Events

Year	Description of event
November 2011	G20 Cannes summit: The importance of the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes was recognized
June 2012	The OECD and G20 commence collaboration, tackling offshore tax evasion.
July 2013	G20 Summit in Moscow: G20 leaders continue to make plans to combat international tax avoidance and evasion.
September 2013	St. Petersburg G20 Summit: where G20 world leaders agreed on making the automatic exchange of fiscal information an international standard.
June 9-10, 2014	G20 Anti-Corruption Working Group meets in Rome and discusses the G20

High Level Principles on Beneficial Ownership, which will help prevent the maltreatment of legal structures that have to do with corruption, tax evasion and money laundering.

Relevant Reports and Treaties

- June 2012, Tackling Offshore Tax Evasion the G20/OECD Continues to Make Progress (Report by OECD SG Gurría, Appendix I).
- Multilateral Convention on Mutual Administrative Assistance in Tax Matters- Currently over 60 countries have signed the Convention and it has been extended to over 10 jurisdictions (Chart of Signatures) (all G20 countries, all BRIICS, almost all OECD countries, major financial centres and many developing countries, Appendix IV).

Evaluation of Previous Attempts to Resolve the Issue

The G20 has previously mandated actions such as asking all countries to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and encouraging the OECD to improve automatic exchange, and start providing short-term progress reports. Additionally, it has been suggested that international organizations should further continue improving inter-agency co-operation in combating illegal activities - most importantly tax evasion. However, this is not sufficient as the amount of tax evasion still occurring is too high.

The short-term progress reports, although useful, have not actually done anything to prohibit this activity from happening; they purely give information on the works of the automatic exchange system. In general, all these previous actions have been a good first step to solving this issue but they are not enough to fully combat offshore tax evasion as they do not provide any ways to deal with the actual individuals and/or companies who carry out this felony.

Possible Solutions

There are a number of things that could be done to combat offshore tax evasion. It needs to be understood that the only way to effectively combat this ongoing issue is to combine solutions and look at all the aspects that relate to tax evasion. One of the more obvious actions to take would be encouraging governments to be harsher, and prosecute more people who break the law and do not pay the correct amount of tax. Over time this would discourage citizens from the risk of partaking in this illegal activity.

Furthermore, an automatic tax information exchange system between tax agencies and businesses/individuals could be introduced to make sure that money being illegally held offshore is easily acknowledged and accounted for. This could be done in combination with the expansion of information technology so that the movement of capital can be monitored by government authorities, before being transferred to countries that do not participate in these agreements.

Another method to consider would be to create a “near uniform global tax rate” which would discourage big companies from shifting their revenues to tax havens since tax rates will be very similar all over the world. This could of course involve many other problems, but if done right with the right regulations, it could be advantageous. International treaties would need to be made that would, for example, financially isolate with appropriate sanctions countries that are known to behave as tax havens, or which would penalize countries that enable the hiding in their banking system of capital which was obtained through tax evasion schemes. Countries will need to waive banking secrecy acts for their international customers so that tax evaders as well as money launderers and black marketers cannot legalize their illegally obtained capital.

Another example of legislation that could be made would be one which would force multinational companies with operations in a specific country to not be able to shift their profits to another country without paying a minimum amount of tax in relation to the revenue of that country.

Finally, the exposing of big globally renowned companies, which engage in the practice of offshore tax avoidance/evasion, to the international community may be quite effective. This will work as negative advertising for the companies and therefore have a large impact on their profitability. This may convince these companies to stop engaging in such tax avoidance schemes because whatever benefits they may gain from these unfair schemes will be lost from the deterioration of their reputation. It could also therefore prevent other businesses that may have been planning on using offshore tax havens to think twice before doing so.

Bibliography

"HMRC campaign targets offshore account holders in fresh clamp-down on tax evasion." Gov.UK. UK Government, Feb. 2014. Web. 19 June 2014. <https://www.gov.uk/government/news/hmrc-campaign-targets-offshore-account-holders-in-fresh-clamp-down-on-tax-evasion>.

"Tax Evasion." *Law Cornell*. Cornell University Law School, n.d. Web. 19 June 2014. <http://www.law.cornell.edu/wex/tax_evasion>.

"Media Release: G20 tax symposium shows international cooperation is key." *G20*. Group of 20, 10 May 2014. Web. 19 June 2014. <https://www.g20.org/news/media_release_g20_tax_symposium_shows_international_cooperation_key>.

"Reducing tax evasion and avoidance." Gov UK. UK Government, 2 June 2014. Web. 19 June 2014. <https://www.gov.uk/government/policies/reducing-tax-evasion-and-avoidance>."

"Senior G20 officials meet with engagement groups to discuss priorities for the Brisbane summit." Group of 20, n.d. Web. 26 June 2014. <https://www.g20.org/news/senior_g20_officials_meet_engagement_groups_discuss_priorities_brisbane_summit>.

"Penalties to tackle offshore tax evasion." *HM Revenue & Customs:*. HM Revenue and Customs, n.d. Web. 22 July 2014. <http://www.hmrc.gov.uk/offshorefunds/penalties.htm>.

"G20 agrees on new rules to combat offshore tax evasion." *The Sydney Morning Herald*. The Sydney Morning Herald, 24 Feb. 2014. Web. 26 June 2014. <http://www.smh.com.au/federal-politics/political-news/g20-agrees-on-new-rules-to-combat-offshore-tax-evasion-20140223-33alp.html>.

"G20 Meeting Targets an Additional 2% Economic Growth." *BBC news*. BBC, 23 Feb. 2014. Web. 30 May 2014. <http://www.bbc.com/news/business-26312338>

Milligan, Brian. "Tax Avoidance: What Are the Rules?" *BBC News*. BBC, 12 May 2014. Web. 24 July 2014. <http://www.bbc.com/news/business-27372841>.

Bowers, Simon. "OECD and G20 Tax Reforms: Key Points."*Theguardian.com*. Guardian News and Media, 19 July 2013. Web. 23 July 2014. <http://www.theguardian.com/business/2013/jul/19/oecd-g20-tax-reforms-key-points>.

Murphy, Richard. "World's Best Tax Havens." *Forbes*. Forbes Magazine, 7 June 2010. Web. 24 July 2014. <http://www.forbes.com/2010/07/06/tax-havens-delaware-bermuda-markets-singapore-belgium.html>.

Hurst, Daniel. "Joe Hockey Foreshadows Action on Global Tax Evasion from G20 Meeting." *Theguardian.com*. Guardian News and Media, 22 Feb. 2014. Web. 23 July 2014.

<http://www.theguardian.com/world/2014/feb/23/joe-hockey-global-tax-minimisation-g20-meeting>.

Appendix

I. Guerría. "Tackling Offshore Tax Evasion." *S4TP*, 1 June 2012. Web. 25 June 2014. <http://www.s4tp.org/wp-content/uploads/2012/07/Tackling-Offshore-Tax-Evasion-OECD-publication-Jun-2012.pdf>.

II. "G20 Backs Plan to Stop Tax Avoidance." BBC News. BBC, 20 July 2013. Web. 27 June 2014.

III. "Exchange of information." OECD, July 2014. Web. 9 July 2014. <http://www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm>.

IV. Saint- Amans, Pascal. "Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Information Brief." OECD, 1 Nov. 2013. Web. 17 July 2014. <http://www.oecd.org/ctp/exchange-of-tax-information/MAC_Background_Brief_for_Jounalists_November_2013.pdf>.