Group of Twenty

Combatting international tax evasion

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Forum: Group of Twenty

Issue: Combating international tax evasion

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Introduction

International tax evasion is a big global issue especially for developing countries for whom import and export taxes are a vital source of income. Tax noncompliance takes place on different levels on a global spectrum. Tax evasion occurs on many different levels, starting at individuals that hold back financial information concerning small transactions. This is quite insignificant compared to the large financial assets, gains, profits, and income misrepresented to governmental organizations by global corporations and very wealthy people.

Tax evasion is not only an issue because it's a dubious way for businesses to increase their income but more because it decreases the income of governments. Governments use their tax income to make sure a nation can function properly. The tax income is used for hospitals, law enforcement, schools, infrastructure etc. Companies and communities all benefit of this in one way or another. Tax evasion is a real crime that affects us all and we aim to solve through international cooperation.

Definition of Key Terms

Tax evasion

Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts earned, or overstating deductions. (source: https://en.wikipedia.org/wiki/Tax_evasion)

Tax gap

The unreported income representing the difference between the actual amount of income reported to the authorities and the reported amount.

Tax avoidance

Tax avoidance is a legal practice used to decrease one's tax burden by finding loopholes in tax laws.

Tax noncompliance

A range of activities subverting tax systems such as tax evasion and tax avoidance. Avoidance is lawful to a certain extend.

Offshore account

An offshore account is a bank account located outside the country of residence of its holder. These are often used to avoid tax liability by complying with the tax system of another nation that might be less burdening.

Tax haven country

Countries known as a tax haven are countries with a very favourable jurisdiction concerning tax laws. This causes wealthy citizens of other nations to open an offshore bank account at a bank located in such a tax haven. Tax haven countries are often not only used for tax avoidance but also for other illegal practices.

Subsidiary

A subsidiary is a company or organization hold by another company. In the context of the issue at hand, however, it has a definition that is a bit different. Companies often establish a subsidiary in a tax haven country in order to keep an offshore account with their profits and benefit from the more favourable tax rates.

Different kinds of tax

Corporation tax

Corporation tax or company tax is a direct tax imposed by government's jurisdictions on the capital or income of corporations or legal entities.

Inheritance tax

Inheritance tax is a tax imposed on the money a heir inherits. This does not apply to property and possessions.

Capital gains tax

Capital gains tax is a tax that is to be imposed by a government on profit gained by the sale of a non-inventory asset. Some examples are bonds, precious metals, stocks and property. This tax is also known as CGT.

Personal income tax

Personal income tax, also known as PIT, is a tax directly levied on the income of an individual.

Gift Tax

The gift tax applies to all transferred ownerships of property, this includes money.

General Overview

Tax evasion by companies

Taxes are an indispensable source of income for economically developing nations. These countries need the financial support to be able to afford the necessary expenses such as infrastructure, education, and law enforcement. These are all essential for them to become a financially stable nation. Due to loopholes, subsidiaries and non-cooperation, companies dodge millions or even billions of dollars. These financial assets will end back up in the hands of the very wealthy and increase the wealth gap. Companies benefit off government expenses such as law enforcement and infrastructure but refuse to pay their part. Multinationals that take part in this activity often employ professionals to make sure no flaws or mistakes are made. The lawyers and experts do everything in their power to secure the company's profit. For multinationals and big companies, this concerns enormous sums of money. The Internal Revenue Service (IRS) estimated the total on $458 billion per year for the United States alone for the year 2010. Estimates diverge largely but it is very complicated to make a correct estimate due to the secrecy and sensitivity of financial records, especially those of international companies with subsidiaries and offshore accounts. Acts of tax evasion are prosecuted harshly, section 7201 of the IRS reads: "Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Tax evasion by individuals

Tax evasion is not only done by corporations; it is done by individuals too. This does not concern as large amounts as companies but it is still a crime. Individuals misrepresent their financial records and income for all different reasons. Starting with an unwillingness to pay taxes, which is quite understandable and easy to solve. Another, more concerning, the reason might be money laundering or other illegal activities that need to be hidden. By reporting their true income, they would admit to guilt and face criminal charges. Some individuals try to report their income as coming from a legitimate source but they often end up being charged with money laundering. Another often occurring case of tax evasion is when a person holds an offshore account with saving money to benefit from a higher interest rate and lower inheritance tax rate. Although this doesn't concern as much money as corporate tax evasion, it is still a crime. It makes it harder to trace individuals taking part in criminal activities.

Major Parties Involved

Luxembourg

Luxembourg only has about 550.000 citizens but is well known as a tax haven. Luxembourg's tax jurisdiction is very friendly towards foreign companies. Their laws allow multinationals to park portions of their business in the small European country to avoid their local tax jurisdiction. According to a 2014 report from Citizens for Tax Justice and US PIRG Education Fund, approximately 33% of the US Fortune 500 companies are familiar with using Luxembourg as a tax haven.

Cayman Islands

To many, the Cayman Islands are known as the biggest loophole in the global tax jurisdiction. This is not only applicable to multinational companies but also to individuals. In their jurisdiction companies, can retain assets without paying any taxes. Although this system is very favourable, it is very complicated and professionals are necessary to succeed profiting from the jurisdiction. The Cayman Islands retain more than a 15th of the world's total banking assets (source: https://www.theguardian.com/world/2017/jul/25/netherlands-and-uk-are-biggest-channels-for-corporate-tax-avoidance)

The Isle of Man

The Isle of Man is not much known for anything else but their low tax rates. The tax jurisdiction in the Isle of Man lacks corporation tax, inheritance tax and capital gains tax. One of their most well-known advantages is the extremely low income tax, with the highest rate of 20%. The Isle also offers great benefits for pensions. This causes many multinational companies to hold their employee pension plans in accounts situated in this tiny country. The island is located between England and Ireland. On June 11th, 2017, the Isle of Man signs an international treaty, joined by 70 other nations. This treaty is focussed on reducing tax avoidance by multinational companies by incorporating new measures into thousands of existing tax treaties. It was signed on the Organization of Economic Co-operation and Development (OECD) convention in Paris to prevent Base Erosion and Profit Shifting (BEPS). *'The signing of this multilateral convention marks a turning point in tax treaty history*,' said OECD Secretary-General Angel Gurraa.

Jersey

The popularity as a tax haven of the small island of Jersey, located between England and France, rose mid-20th century. In the United Kingdom, the inheritance tax on assets over 1 million pounds was 80%. The very wealthy British citizens moved their financial wealth to the self-governed island of Jersey. Jersey still has no such thing as inheritance tax, capital gains tax, or corporate tax in their tax jurisdiction. Only companies in the sector of financial services, utilities and property ownership are excluded from this 0% tax rate. These extremely favourable tax rates make Jersey an attractive tax haven for the UK. The island hosts over 5 billion US dollars per square mile.

Ireland

Although Ireland is often referred to as a tax haven, many Irish government officials deny the accusations. Ireland recently made headlines due to their involvement in the merge between the two multinational pharmaceutical companies Pfizer and Allergan. There were plans to move them to headquarter to Ireland. The Tax inversion could help Pfizer dodge as much taxes as $148 billion on international profits. (according to Americans for Tax Fairness) Ireland was rated 6th on a list created by development agency Oxfam of the 15 countries that facilitate corporate tax avoidance on a large scale through profit-shifting. This caused multinational tech company Apple to dodge $59.2 billion in US taxes by booking over $180 billion in offshore profits through its international subsidiaries. Many Fortune 500 companies such as Google do this.

Mauritius

The small island of Mauritius is a well-known gateway for foreign investments, especially the ones directed towards India. Capital gains and interest are not taxed in Mauritius and it only levies a 15% corporate tax. Companies located on the island are also granted tax breaks granted through double tax treaties. Finance minister Pravind Jugnauth calls the island of Mauritius an “international financial centre of excellence and repute”.

Mauritius houses over $630 billion in direct foreign investments. Only Luxembourg has a bigger stock of foreign investments compared to the size of their economy. Mauritius has had an enormous backlash from the global community on their tax policy. According to the United Nations Mauritius is responsible for an income reduction of $100 billion for developing nations. The ministry of finance agreed to make the appropriate changes to the tax system in order to make sure, less tax avoidance will take place. The tax advantages of using Mauritius to invest in India will be gone in the year 2019.

Bermuda

Bermuda is one of the most extreme tax havens according to a recent list released by Oxfam. Bermuda is on this list along with Jersey, the Cayman Islands and the British Virgin Islands. All these islands are, no coincidence, all under the sovereignty of the United Kingdom. Although Oxfam claims Bermuda is offering unfair and unreasonable tax incentives and nearly no corporate tax rates, the government of Bermuda pointed out several "substantial errors" in the Oxfam report. Bermuda disputed the so called anonymous shell corporations situated on the island. One of the biggest accusations made by Oxfam were also not true according to the government of Bermuda. Oxfam accused Bermuda of not cooperating with combatting tax avoidance on an international level. The response of Ana Arendar, Oxfam's head of inequality, on the denial of Bermuda, was "Tax dodging isn't an abstract accounting game – the lost revenue has devastating consequences for the world's poorest people who miss out on life-saving medicines and the chance to go to school".

Monaco

Monaco is broadly known for its casino's, formula one, over luxurious superyachts and its reputation as a tax haven. Although it is correct that citizens of the tiny principality located in the Riviera pay a 0% tax rate on their income and are entitled to keep all their earned assets, it is a great misconception that Monaco is a tax haven. Every citizen pays 19,6% VAT on all goods and services. Monaco shares their VAT system with France so you could even say that Monaco's residents pay French tax. One in every three citizens of Monaco is a millionaire and real estate is the most expensive in the entire world with just over $1 million for only 160 square feet. Monaco is not to be considered a tax haven for companies due to their 33% tax rate on profits.

Switzerland

Switzerland is located in the centre of the European Union but is not a member of the union and considers their sovereignty and neutrality as an absolute priority. Switzerland doesn't have the lowest tax rate of all tax haven countries but has a different advantage. Swiss banks have a system that protects all account holders' secrecy above all else. This in combination with low taxes makes Switzerland a popular destination for funds from overseas.

The Bahamas

The Bahamas are a very popular tax haven for the very wealthy American citizens and American corporations. The very rich individuals using the Bahamas as a tax haven enjoy the lack of inheritance tax and gift tax. While US companies enjoy the lack of capital gains tax and personal income tax. In the year 2010, approximately $10 billion in profits was transferred to Bahamas subsidiaries. This equals 123% of the nation's own GDP.

Timeline of Key Events

Timeline of events in reverse chronological order leading up to present day.

Date	Description of Event
April 2008	The first G20 summit on the topic of taxation held in London.
19 August 2016	84 countries sign a multilateral approach, that aims to close loopholes and increase global co-operation. Some tax havens such as Singapore, Panama and the Bahamas refused.
7 June 2017	OECD convention in Paris, international tax treaty signed by 70 nations focussing on tax reform and tax certainty.

Previous Attempts to Resolve the Issue

Governments have tried to solve this issue for a long time. Many changes were made in tax jurisdictions in order to decrease it. For instance, the multilateral treaty that was signed on June 7th, 2017. 70 countries signed the treaty. This is a good example of international cooperation on combatting this issue. The G20 is not the only organization trying to solve the issue, in the 3rd appendix you can find all the past resolutions and decisions of the UN ECOSOC on tax evasion. The issue is already high on the agenda and many efforts have been made. The only issue is that some nations refuse to share financial records since that would violate privacy laws.

Governments and law enforcement try to make coming forward with information about offshore accounts easier by providing all kinds of deals. When an individual comes forward on their own initiative their punishment will decrease.

Possible Solutions

In order to solve this issue, multiple smaller actions need to be taken and international cooperation is key. The next aspects need to be covered to solve the issue. All efforts need to be done by a neutral party that does not have any personal interest, for instance an Non-Governmental Organization (NGO).

Exchange of financial data

Because tax non-compliance and tax evasion take place on an international level, it is of ought most importance that banks share their financial records if any suspicion takes place. Of course, this must only happen after any suspicion, otherwise, privacy laws will be violated. This could encourage international efforts to decrease the amount of tax evasion.

Closing loopholes

Financial experts are hired by multinationals to find loopholes in tax jurisdictions. Many efforts have been made and a number of loopholes has already decreased but more efforts need to be made in order to solve the issue entirely.

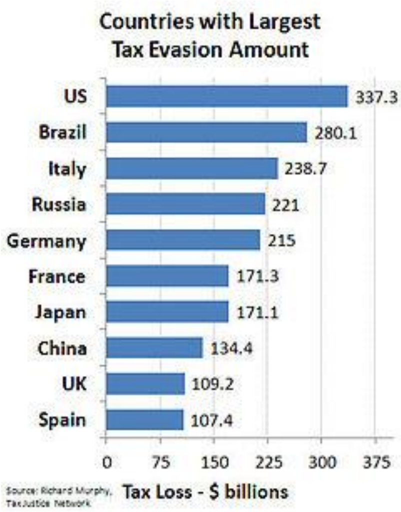
International efforts

The governments of economically developing nations suffer from the lost tax revenue. The more economically developed nations that benefit from this practice need to cooperate in finding and prosecuting the corporations and individuals that take part in illegal activities concerning tax evasion and profit shifting.

Appendices

Appendix 1

In this chart, you can see the estimated amount of lost revenue due to tax evasion for governments. As you can see, this chart is not in line with the estimate that the IRS made, which was $121 billion dollars higher for the United States of America. Since the numbers concern financial records, secrecy and privacy make making a correct estimate very complicated.



Appendix 2

In this appendix, you can find useful links and websites. For further references and sources, see the Bibliography.

This is an article on the international efforts of the Isle of Man to combat international tax evasion: http://www.iomtoday.co.im/article.cfm?id=34166&headline=Isle%20of%20Man%20signs%20new%20international%20treaty%20against%20tax%20avoidance&sectionIs=news&searchyear=2017

This is an article on the efforts of Mauritius to combat tax evasion: https://www.ft.com/content/64b083bc-75b1-11e6-bf48-b372cdb1043a

This is an article by the Guardian about a list released by Oxfam with the world's worst tax havens: https://www.theguardian.com/world/2016/dec/12/bermuda-is-worlds-worst-corporate-tax-haven-says-oxfam

This is an article arguing that Monaco is despite the lack of income tax not a tax haven : http://www.telegraph.co.uk/finance/globalbusiness/7243401/Monaco-might-not-charge-residents-income-tax-but-its-no-tax-haven.html

This is an article naming the top ten best tax havens : https://www.fool.com/investing/general/2016/01/03/10-best-tax-havens-in-the-world.aspx

This is an article about the Bahamas as a Tax havens : http://www.taxjustice.net/2016/09/08/bahamas-tax-haven-emerging-global-menace/

Appendix 3

In this appendix, you can find all documents (resolutions, draft resolutions, and decisions) from the United Nations Economic and Social council (ECOSOC) concerning taxes and tax evasion.

Resolution/document number	**Date**
E/2004/INF/2/add. 3, page 14	11 November 2004
E/2006/INF/2/Add. 1, page 160	28 July 2006
E/2007/INF/2/Add.1, page 156	27 July 2007
E/2007/INF/2/Add.2, page 5	4 October 2007
E/2008/INF/2/Add.1, page 44	24 July 2008
E/2009/INF/2/Add.1, page 156	31 July 2009
E/2010/L.10	2 July 2010
E/2010/L.28	20 July 2010
E/2010/INF/2/Add.1, page 204	23 July 2010
E/2010/INF/2/Add.1, page 152	23 July 2010
2011/23	27 July 2011
2011/253	27 July 2011
E/2012/L.19	23 July 2012
E/2012/L.20	23 July 2012
E/2012/L.30	25 July 2012
2012/255	27 July 2012
E/RES/2012/33	27 July 2012
E/2013/L.9	12 June 2013
E/2013/9/Add.10	28 June 2013

E/2013/L.22	10 July 2013
E/2013/L.39	23 July 2013
2013/239	24 July 2013
E/RES/2013/24	24 July 2013
E/2014/L.9	21 May 2014
E/2014/L.11	5 June 2014
E/RES/2014/12	13 June 2014
E/2014/L.17	13 June 2014
E/2015/L.9	21 May 2015
E/2015/L.12	4 June 2015
E/2017/L.2	31 August 2016
E/2017/L.2/Rev.1	15 September 2016
E/2017/L.5	30 September 2016
E/2017/L.6	30 September 2016
E/2017/L.7	30 September 2016
E/RES/2017/2	5 October 2016
E/2017/L.10	7 December 2016

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“Why Do Offshore Tax Havens Still Exist?” BBC News, BBC, 30 July 2015, www.bbc.com/news/business-33628020. Accessed 16 June 2017.

“G20 On Taxation.” Taxation - OECD, www.oecd.org/g20/topics/taxation/. Accessed 16 June 2017.

Longley, Robert. “What Is the US Tax Gap and Why Does It Cost You Money?” ThoughtCo, www.thoughtco.com/what-is-the-tax-gap-3321958. Accessed 16 June 2017.

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“Tax Gap - IRS.” The Tax Gap, 22 Sept. 2016, www.irs.gov/uac/the-tax-gap. Accessed 16 June 2017.