



## **A constructive critique of and comments on 'Tax Havens and Development', NOU 2009:19**

**Sony Kapoor, [Sony.Kapoor@re-define.org](mailto:Sony.Kapoor@re-define.org)**

**October 2009**

### **The context of Re-Define's comments**

The fact that such a report exists is very useful. Re-Define has already successfully used the example set by Norway and the Commission's work to push other countries to follow in its footsteps. It provides a great tool for international advocacy.

Below we focus primarily on the shortcomings and missing elements in the report. The report had received ample praise from many quarters including from Re-Define and we are sure that an efficient use of the public consultation involves offering a crisp and constructive critique.

### **Deficient Mandate**

The commission's mandate is missing coherence and completeness and seems to be a mix of the very general - 'improve insight into the understanding of money flows' and the very specific 'company and trust configurations'.

It has an excessive focus on 'investments' but with the contradiction that any consideration of the Government Pension Fund – Global is explicitly ruled out. First, we believe that the report could have more usefully focussed on outflows through tax havens rather than inflows through them. Second, the relative magnitude of Norfund's portfolio is miniscule compared to both the investments of Norwegian firms abroad and the Government Pension Fund – Global so we think it makes little sense to have a Norfund focus without tackling investments by Norwegian firms or the Pension fund.

In fact, especially in light of the excessive attention that the Norfund issue has received from both Civil Society organizations as well as the media, Re-Define believes that this issue has turned out to be a bit of red herring having crowded out the space for the discussion of more substantive issues such as possible unilateral actions Norway can take to help tackle tax flight from developing countries.

It is somewhat unclear whether this report is about 'capital flight' or about 'tax havens' or about 'tax flight from developing countries' or 'tax flight from Norway'. The mandate could have been more coherent by focusing on

- Capital flight out of developing countries
- Or the role of Tax Havens in International Finance Flows
- Or the use of Tax Havens for Inward Investments including by the GPF- Global owned companies
- Or the role that Norway could unilaterally play in helping tackle capital flight etc

### **Confusion as regards composition and working method**

The methodology for the selection of Commission members was not very clear nor why decisions were taken to

- Not include relevant entities such as Toll and Kredittilsynet in the membership

- Not use international experts as members
- Not consult relevant experts in Norway

### **Brief Comments on the Commission's Recommendations**

While it is good to have a number of recommendations there seems to be some lack of structure and it is not clear what the criteria for prioritizing what to recommend is.

Is the commission trying to identify capital flight from developing countries? Highlight the role of tax havens? Reduce capital flight from developing countries? Make suggestions on what role Norway could play in these issues? Identify the problems as they relate to tax flight for Norway? Or all of the above?

The determination of the themes of the chapters and the structure of the report does not seem to have given due consideration to the weight and importance of various issues – nor do they seem to follow a cohesive theme or line of argument. This perhaps flows at least partly from the deficient mandate highlighted earlier. Some of the recommendations do not necessarily flow from the analysis and that a number of very useful actionable recommendations are simply left off the menu.

*“Development policy. The Commission has noted that the Norwegian authorities should increase their commitment to strengthening and improving tax regimes and anti-corruption efforts in developing countries.”*

This is a sensible recommendation but not very helpful because it is far too general. It needs to be made more specific and linked more closely to the deficiencies observed by the commission through its own work and to other pieces of work such as the ‘Tackling Tax Flight from Developing Countries’ a Policy Paper written by Re-Define for the German Development Ministry. (Re-Define can make it available on request)

*“Information duty and annual accounts. The Commission takes the view that the Norwegian authorities should study whether multinational companies in Norway could be required to present in their annual reports key figures relating to such aspects as taxable profit and tax payable as a proportion of taxable profit in each of the countries in which they have operations.”*

This is on the whole a good idea. However the recommendation needs to be stronger. Instead of recommending that the Norwegian authorities study this idea the recommendation should have been to implement such a reporting requirement.

Re-Define strongly believes that the Norwegian government should institute a country by country reporting requirement for 1) firms with a majority Norwegian government stake 2) firms with a minority Norwegian government stake 3) Norway incorporated MNCs 4) Foreign MNCs operating in Norway – in this order of priority and timing.

*“On that basis, the Commission accordingly requests the Norwegian authorities to investigate a set of instruments which can be used to determine transfer pricing that are broader than those currently provided by Norway’s domestic legislation, and that Norway also promotes such instruments in international fora.”*

It is not very clear what this recommendation aims to achieve. Norwegian efforts would be much better spent in helping detect transfer mis-pricing based on existing guidelines rather than on making new guidelines. The problem lies less with the ‘arms length principle’ than with the fact that it is repeatedly flouted in a hard to detect way. See Appendix 1, our report for the German government, the policy brief in Appendix II and the attached TVINN presentation from the Toll authorities in Norway to see how detection mechanisms for mis-pricing could be put in place.

*“Accordingly, the Commission recommends the establishment of a centre of expertise which can conduct research into and support the Norwegian authorities on such issues, and which can simultaneously contribute to enhancing expertise on such issues in developing countries.”*

We fear that while the intention here is good the implementation might fall short. It is imperative that the centre of expertise is set up in a meritocratic and transparent way based on ‘who knows what’ rather than ‘who knows whom’.

Such a centre should be based on the best available skills not just in Norway but also internationally since as the report acknowledges that this is an international issue.

*“Cross-ministerial working group. The Commission recommends that the Ministry of Foreign Affairs appoint a cross-ministerial working group to develop networks with other countries which might cooperate with Norway to reduce and to eliminate harmful structures in tax havens.”*

Please see Appendix 1 on previous suggestions for the establishment of a cross-ministerial working group and the efforts and the meetings held in that regard. It is not very clear if the commission was aware of these measures.

While different forms of cross ministerial working groups are possible, we believe that there is real value to be had from having a working group which can help address what Norway can unilaterally to tackle the problems of capital flight and the issues posed by tax havens. (See Appendix 1 where you will find suggestions for what such a group could do for development and for Norway and Appendix II where we have suggested that countries seek to pursue the formation of such a working group modelled on the ‘Project Wickeby’ initiative in Australia)

*“The Commission accordingly recommends that Norway take both national and international initiatives to create new rules for (i) when a legal entity can be regarded as domiciled in a tax haven (including requirements for real economic activity in such jurisdictions) and (ii) assigning taxation rights between countries.”*

There is extensive work on these issues already. In light of the existing technical work, existing legal judgements (see [http://www.tax-news.com/archive/story/ECJ\\_Confirms\\_CadburySchweppes\\_CFC\\_Ruling\\_xxxx24838.html](http://www.tax-news.com/archive/story/ECJ_Confirms_CadburySchweppes_CFC_Ruling_xxxx24838.html)) on the issue and the scale of the political challenges involved it is not very clear to us that this would be a productive pursuit for Norway.

See for instance the extensive discussions on Controlled Foreign Companies as well as the moves made by countries such as Spain and Argentina to discriminate against what they perceive to be fictitious economic activity from entities based in tax havens.

*Convention on transparency in international economic activity. Norway should take the initiative to develop an international convention to prevent states from developing secrecy structures which are likely to cause loss and damage to other jurisdictions.*

This is conceptually appealing. However the commission has not contextualized the work properly. The financial system is being changed even as we write this. In many ways such as 1) tackling off balance sheet vehicles 2) extending regulation and oversight to all jurisdictions 3) mandating the registration of all derivatives etc the system is changing in a way that would make it far more transparent and less susceptible to being gamed for tax evasion and capital flight.

Norway’s efforts would be best expended by focussing on how the new regulatory agenda could be tweaked so as to maximise the reduction in tax flight and improving the development footprint. This can be done either by adopting the convention idea to this context and framing it right or by focusing on achieving this outcome outside of any discussion of the convention.

*In the Commission’s view, Norfund should gradually cease to make new fund investments via tax havens over a three-year period from the approval of the Commission’s report.*

While this issue has a standalone importance and a strong political resonance we strongly believe that given limited technical and political resources, the Norwegian effort would be much better focused on some of the other issues we have highlighted above.

We strongly believe that prioritizing actions on tackling tax havens and/or capital flight should be done on the basis of maximising potential impact. On this criterion, focusing excessively on Norfund does not make it to the top 5 possible actions on our list.

*Other missing elements*

While the report does contain a number of useful recommendations some are excessive general and lack actionability. Also, some of the more obvious, actionable and hard hitting (in terms of reducing tax flight) recommendations are missing.

Some of these are

- Analysing Norwegian customs data as suggested in Appendix I and II.
- Conducting an audit of Norwegian bank accounts and using the mechanisms under Norway's obligations to the EU Savings Tax Directive mechanism to unilaterally and on a non-reciprocal basis provide tax related information to non EU developing countries, especially low income countries
- Making efforts to incorporate a 'developing country information exchange' dimension in its negotiation of tax treaties
- Taking action through mandating a county by country reporting standard as we have suggested above
- Getting the Government Pension Fund – Global to act as we have suggested in the Norwegian Coherence Report (See Appendix III for an excerpt)
- Changing Norway's public procurement processes to penalize companies with significant operations in tax havens
- Following some of the many unilateral steps possible to tackle tax flight – for a detailed menu please see the Re-Define presentation made to the German Ministry of Finance in October 2009. (Available on request)

## Appendix 1 (Work undertaken by Sony Kapoor on Cross Ministerial Task Force as Strategy Adviser to MFA)

From **Sony Kapoor** <sony.kapoor@gmail.com>

[hide details](#) 01/04/2008

to morten.eriksen@politiet.no,  
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Elisabeth.frankrig@fin.dep.no,  
Glad Ingrid <ingrid.glad@mfa.no>

date 1 April 2008 04:51

subject **Suggested Cross-Departmental Group on Tackling Illicit Financial Flows!**

mailed-gmail.com

by

Dear Colleagues,

Yesterday, I had organized an informal cross-departmental meeting to discuss

- 1) How we can tap the expertise of the top international experts working with the Illicit Finance task Force to help Norway reduce its domestic problems relating to cross border tax evasion and illicit finance flows.
- 2) How the data that Norway already collects on customs, money laundering, financial transactions and taxes could possibly be used to help achieve some short term tangible progress on tackling illicit financial flows from developing countries
- 3) Other issues relating to what Norway can and should do internationally to take the work of the task force forward. This is especially very relevant from the perspective of the coherence agenda which is a critical point of discussion for Norwegian development policy.

The meeting was attended by representatives from

- 1) Customs
- 2) NORAD
- 3) Foreign Affairs
- 4) Finance
- 5) Economic Crime

As well as some of the top international experts on

- 1) Trade mis-pricing
- 2) Money Laundering
- 3) Cross border tax evasion
- 4) Capital flight
- 5) International Tax co-operation

This email is meant for internal cross-departmental communication so the external participants are not on the email list. This email serves three purposes

- 1) The creation of a relevant cross-departmental email list

2) This is an opportunity for me to suggest that we continue the work initiated in this first meeting on an ongoing and regular basis. I suggest meeting again in about one month again, say the first week of May.

3) To highlight the next immediate step in the process and invite you to participate

The meeting yesterday was very successful in highlighting the tangible progress that can be made on all three of the agenda points by continuing this inter-departmental communication and by tapping into the expertise of relevant external actors on a strategic basis.

While there were many areas of potential progress and co-operation about which I will be sending a more detailed memo and ideas at a later date, one area in particular stood out as highly promising.

The work of Simon Pak, one of the world's top experts on the statistical analysis of customs data (biography below), should in theory be easily applicable to Norwegian customs data. I have been working with Simon and following his work closely for over three years now and am confident that we will be able to use it for all of our original purposes which include

1) Applying Simon's statistical technique to Norwegian data to detect extreme mispricing and related tax evasion/money laundering which can help the Tax department, customs and economic crime unit to take action against the most egregious offenders and reduce the frequency of these offences in Norway

2) Using the results of this statistical tool to help detect and highlight significant mis-pricing that might be present in Norway's trade with developing countries in particular. This would be particularly useful for the work of the task force hosted by the MFA as well as for the anti-corruption work hosted by NORAD.

3) Building on the statistical analysis tools that have been developed to use them both for domestic purposes as well as for the purpose of offering technical assistance to developing country governments.

For this purpose, I have suggested that we have a follow up meeting at the Customs house on Thursday the 3rd of April.

Ideally, the meeting should be attended both by the top functionaries at the customs department (including the head of customs as well as the head of enforcement) as well as the technical staff with expertise and detailed knowledge of the data, of statistical analysis and the law surrounding the sharing of data etc.

It would also be useful to have relevant experts from the tax department (who work on tax evasion through trade mis-pricing for example) as well as experts from the financial intelligence unit (or economic crime) who work on the prosecution of offenders as well as on money laundering.

As the time is short and Simon and I only have time on Thursday, we suggest that the meeting time should be 3:30 - 5:30 PM which seems to suit the people I have spoken with best. If this does not work for the colleagues at Customs please call me today on 9683-8005 and let me know and we can try finding another time.

In order to make this meeting a success, may I make a request to the colleagues in customs to use the two days to the meeting to use Simon's work (which I have already sent to this email list) as well as feedback from Kari Richardson (who was present at the meeting yesterday) to start looking into the detailed and technical aspects of the data you do collect.

I suggest that for the meeting Thursday we start with a 25 minute power point presentation by Simon to be followed by 25 minutes or so of Q & A and discussion. We should then follow this up with a detailed discussion of the data and its characteristics and how to move forward etc....

As I mentioned in the meeting today, the most effort intensive part of Simon's work (or indeed any such analysis) is the data organization part of things. Once we have clean and well organized data, applying the statistical tool is relatively easy.

For those of you who are new on this email list or were not present at the meeting yesterday, all the relevant details of the discussion thus far (not the notes from the meeting today) can be found when you scroll below.

I would suggest that if you have something specific to say to me or a query, or a request for the addition of other people to the list, please do not do reply to all and use my email address [sony.kapoor@gmail.com](mailto:sony.kapoor@gmail.com) instead.

Warm regards and looking forward to successfully continuing this conversation

**Sony Kapoor**

On 31/03/2008, **Sony Kapoor** <[sony.kapoor@gmail.com](mailto:sony.kapoor@gmail.com)> wrote:  
Dear Colleagues,

**You will notice that the meeting venue is room 359 at the Ministry of Foreign Affairs today at 15:00.** Please try and be there in time as Harald Tollan will collect us at the main entrance. If you miss him, his mobile is 47273028.

If you have any questions regarding this email or any other queries please do not do reply to all but only email me or call me on 96838005

Attached you will find two pieces of work that Simon has done, One was for an experts meeting I had organized in London in 2006 and the other for the Closing the Floodgates report that Simon and I had co-authored along with other tax experts. It would be useful if you could glance through them.

As of now, the confirmed participants for the meeting are

- 1) Eva Joly - Special adviser on corruption at NORAD
- 2) Morten Eriksen - Senior Public Prosecutor, the Authority for the investigation and prosecution of economic crime
- 3) Henrik Harboe - Deputy Director, MFA (he will be there part of the time)
- 4) Simon Pak - International Expert on trade mis-pricing
- 5) Jack Blum - International expert on money laundering
- 6) Harald Tollan - Adviser, MFA (he is co-coordinating the task force work)
- 7) Asle Farberg - Head of Enforcement at Customs
- 8) Bjorn Rose - Head of Customs
- 9) Kari Richardson - Customs Expert on Trade Pricing/Money Laundering
- 10) Someone from the Ministry of Finance
- 11) Sony Kapoor - Strategy adviser to the task force and International Finance expert

**Sony Kapoor**

On 28/03/2008, **Sony Kapoor** <[sony.kapoor@gmail.com](mailto:sony.kapoor@gmail.com)> wrote:  
Dear Colleagues,

I believe that by now I have spoken directly or indirectly to all of you regarding this meeting on Monday the 31st of March.

The background is that for the illicit financial flows task force meeting we have some of the world's leading authorities visiting Oslo next week. So it is an unprecedented opportunity to get the great and the good from the Norwegian Landscape together with the International experts to see how

- 1) The international experiences and work on trade mispricing cross - border tax evasion and money laundering could help us in Norway

2) To see how any work we do here at customs can help the work of the task force

May I remind you that this just an informal meeting meant solely for the purpose of information exchange and brainstorming for now.

The suggested time and place for the meeting is 3:00 PM on Monday at NORAD - we are waiting for confirmation from TOLL whether they can do this time or another time would suit better.

I will moderate the meeting and try and be efficient (since everyone is very busy) and the suggested agenda is as follows (you are all very welcome to send in suggestions)

- 1) Brief Introductions - 5 mins
- 2) Quick background for the Task Force and the context of this informal meeting - 5 mins
- 3) A ten minute presentation By Simon Pak of his work on Trade Mispricing, Customs Data and Money Laundering - 10 mins
- 4) A ten minute Q & A - 10 mins
- 5) A five minute intervention by Jack Blum on the relevant work ongoing internationally - 5 mins
- 6) A five minute intervention by Morten Eriksen on how applying Simon's work to Norway can help the work of Toll and Okonomi - 5 mins
- 7) A five minute intervention by Eva Joly on how this work could help the work of the Task Force - 5 mins
- 8) A One hour free discussion moderated by me

I am assuming that everyone from Norway knows each other but please find brief bios for the external participants below

[morten.eriksen@politiet.no](mailto:morten.eriksen@politiet.no), [hans-jacob.arnestad@politiet.no](mailto:hans-jacob.arnestad@politiet.no), [Eva.Joly@norad.no](mailto:Eva.Joly@norad.no), [henrik.harboe@mfa.no](mailto:henrik.harboe@mfa.no), [kari.richardson@toll.no](mailto:kari.richardson@toll.no), [bjorn.rose@toll.no](mailto:bjorn.rose@toll.no), [asle.farberg@toll.no](mailto:asle.farberg@toll.no), [sjp14@gv.psu.edu](mailto:sjp14@gv.psu.edu), [jblum@bakerlaw.com](mailto:jblum@bakerlaw.com)

### **Simon J. Pak**

Simon J. Pak is the academic head of management and an associate professor of finance at the Penn State University, Great Valley School of Graduate Professional Studies. He is one of the world's leading authorities on the mis-pricing of cross border trade transactions and its use in the cross border transfer of funds.

Simon's current research interest areas include international trade price analysis, transfer pricing and capital movements through over- and under invoicing in international trade. He and his research partner John S. Zdanowicz were awarded US\$2 million research grant in 2003 by the U.S. Congress to expand their research on transfer pricing. Simon has been an expert witness in a number of legal cases involving customs fraud in the US.

### **Sony Kapoor**

Sony Kapoor is the Executive Director of DEFINE – Development, Environment & Finance International Exchange, a new international Think Tank. He is an expert on international finance, development and environment and has a professional background in investment banking, derivatives trading and development finance.

Sony has worked extensively with several governments, international organizations such as the UN and the World Bank, prominent non-governmental organizations such as Christian Aid, Tax Justice Network and Oxfam Novib advising them on key policy and strategic issues. He is currently also the strategy adviser and rapporteur for the task

force on illicit financial flows from developing countries and a consultant to the ministry of foreign affairs in several priority areas.

Sony has also been advising the UN financing for development office on international tax co-operation and is an expert on capital flight, cross-border financial flows and tax havens.

### **Jack Blum**

Jack Blum is Of Counsel to the Washington, D.C. law firm of Baker & Hostetler. He was Chair of the UN Experts Group on asset recovery, a co-author of the UN Report on Offshore Havens, and a consultant to the UN Centre on Transnational Corporations during the first effort to develop a convention on corruption.

Mr. Blum has served as Special Counsel to the US Senate foreign Relations Committee and is best know for his exposure of the criminal behavior of BCCI and the investigation of Lockheed Aircraft's bribes.

Jack is one of the world's leading experts on tax havens, money laundering and cross border criminal flows. He has been instrumental in taking forward the well known work of the US Senate permanent sub committee on investigations.

### **Sony Kapoor**

**Frankrig, Elisabeth** <Elisabeth.Frankrig@fin.dep.no>

to sony.kapoor@gmail.com

[hide](#)  
[details](#) 04/04/2008

cc kari.richardson@toll.no,  
"Nygaard, Rune H."  
<Rune.Nygaard@fin.dep.no>

date 4 April 2008 10:38  
subject Mis-pricing-project  
mailed-by fin.dep.no

Dear Sony,

Thank your for an interesting and helpful meeting yesterday. Yesterday agenda basically covered transactions related to goods. To our recollection, in your summary of the discussions, you asked for complementary information regarding services. To process you inquiry it would be helpful if you could specify what information you seek.

Kind regards

Elisabeth Frankrig

Rune Nygaard

**Richardson, Kari** <Kari.Richardson@toll.no>

to Sony kapoor <sony.kapoor@gmail.com>

[hide](#)  
[details](#) 04/04/2008

cc "Årseth, Karen" <Karen.Arseth@toll.no>

date 4 April 2008 10:50  
subject 2008 VFS TVINN presentation.ppt

Dear Sony!

Thank you for the interesting presentation and discussions yesterday. We received some very helpful information of highly relevance for our work.

Enclosed you will find our presentation on TVINN. I hope this will be useful to you.

Kind regards  
Kari Richardson

## **Appendix II Increasing Domestic Resource Mobilization by Tackling Tax Flight – A Re-Define Policy Brief**

**Sony Kapoor, Managing Director Re-Define**

**August 2008**

### **Why is Taxation Important and what is Tax Flight?**

Tax systems lie right at the heart of domestic resource mobilization. Resources mobilized from taxation are the biggest source of money for financing development activities including the provision of public services such as healthcare, education and infrastructure. Moreover, transparent and effective tax systems are also an essential component of the social contract between citizens and their governments and they engender good governance.

However, it is no longer enough for a country simply to have good domestic policies on taxation because an increasing amount of tax revenue, even from in-country sources, relates in one way or another to the international economy. This could be, for example, because the economic actors are international (such as Multinational Corporations MNCs) or have international linkages (such as importers and exporters) or have (legal or illegal) access to the international economy (rich individuals).

Changes to the international economy, such as 1) growing cross-border trade and financial flows 2) increasing complexity of MNC operations and international production networks 3) the liberalization of capital and current accounts and 4) the growth of jurisdictions such as 'tax havens' which legislate to help economic actors avoid regulatory and tax obligations in other jurisdictions, have significantly increased the opportunities for economic actors to legally and illegally reduce their tax payments.

The internationalisation of economic activity has not been accompanied by the internationalization of tax governance or even significant progress on cross-border co-operation on tax matters. This has allowed economic actors to use international economic linkages to escape paying taxes – a phenomenon called **tax flight**. This tax flight severely weakens domestic resource mobilization in both developing and developed countries and also damages the social contract and undermines good governance. That is why, it must be tackled urgently.

### **Why does Tax flight occur?**

Tax flight takes place most frequently through the unrecorded or mis-reported cross-border transfer of resources, also known as **capital flight**. Tax flight can either be the driving force behind capital flight or a by-product of it. However, the tax reduction motive is by far the biggest driver of capital flight. The main motivations for engaging in capital flight belong to two categories – the push factors and the pull factors.

The main push factors are 1) the economic actor does not want to pay taxes on otherwise legitimate wealth 2) the wealth was acquired illegitimately so there is a risk of confiscation 3) the actor is trying to circumvent other domestic regulations such as restrictions on foreign exchange.

The main pull factors often are provided by 'tax havens' mostly as the combination of 1) zero or low taxation and/or lax regulation which are both financially lucrative 2) anonymity provided through bank secrecy, shell companies & offshore trusts which minimises the risk of detection 3) and a lack of co-operation on tax matters with source country authorities which minimises the risk of prosecution

### **How big is the problem of Tax flight?**

Country level estimates of capital flight show that it is not unusual for a developing country to lose as much as 5% - 10% of GDP annually to capital flight. Globally, one set of estimates arrives at figure of \$539 billion - \$829 billion of annual capital flight from developing countries<sup>i</sup>. South Africa, for example, has been estimated to have been losing an average of 9.2 per cent of GDP (losing US\$13 billion in 2000)<sup>ii</sup>, China 10.2 per cent of GDP (losing US\$109 billion in 1999)<sup>iii</sup>, Chile 6.1 per cent of GDP (losing US\$4.7 billion in 1998) and Indonesia 6.7 per cent of GDP (losing US\$14 billion in 1997)<sup>iv</sup>. Nigeria is thought to have lost more than \$230 billion over the past few decades<sup>v</sup>.

While capital flight has accelerated in recent years, it has been happening for a long time. Much of the money that has been siphoned abroad in the past has been invested in various financial centres in assets so has been generating

returns. It is estimated that the stock of this wealth is of the order of \$4-\$5 trillion for developing countries alone<sup>vi</sup>. Based on various capital flight flow and stock estimates that exist for developing countries, there is a resultant annual tax loss to developing countries amounting to hundreds of billions of dollars. Clearly this undermines financing for development.

Tax flight is of course not limited to developing countries alone. As the recent high profile cases of secret Liechtenstein trusts uncovered by Germany and secret Swiss accounts investigated by the United States indicate, developed countries also lose large sums of money to tax flight. Tax flight from developed countries is likely to exceed the losses seen by developing countries. It undermines the welfare state, increases social tensions and drives higher inequality. That is why both developing and developed countries need to tackle Tax flight urgently.

### **Which mechanisms are used and who are the main actors involved?**

Some of the most common mechanisms used for tax flight (both by individuals and corporations) are listed below.

- **The mis-invoicing of trade transactions** – Under-pricing exports or over-pricing imports of goods and services is the biggest channel for secretly shifting funds across borders mostly into lower tax jurisdictions such as ‘tax havens’
- **Transfer mis-pricing** - When mis-pricing of the kind described above happens between international affiliates of the same multinational corporation MNC, it is referred to as transfer mis-pricing and is very hard to detect.
- **Using mis-priced financial transfers** - Another way of transferring profits abroad to reduce taxes is to mis-price financial transfers such as payments of interest, royalties and licence fees etc and payments relating to asset and purchase and sales.
- **Mis-categorized wire transfers** - These involve a bank or another financial institution transferring money out of a country illicitly through mis-reporting the source, destination or ownership of funds to disguise its true nature
- **Other mechanisms such as smuggling** - The smuggling of cash, diamonds, gold, illegal drugs and other high value commodities such as arts, antiques and rare coins is a means to siphon wealth out of a country and it depresses tax revenues.

Tax flight and Capital flight are driven by a complex web of perpetrators and facilitators who exploit an increasingly sophisticated but poorly regulated and badly co-ordinated international financial system to their advantage. These perpetrators include MNCs and domestic businesses seeking to reduce tax paid and circumvent regulations in a bid to maximise income; wealthy domestic business and political elites trying to evade taxes or hide ill-gotten money abroad to escape detection; criminals and terrorists trying to escape the clutches of law. However, without facilitators in the developed world, the means and incentives for tax and capital flight would not exist.

### **These facilitators include**

1) **complicit business counterparts** in developed countries (for domestic exporters and importers using trade mis-pricing) 2) **lawyers, accountants and company formation agents** who design aggressive tax evasion & transfer mis-pricing strategies and incorporate dummy corporations, form secret foundations and open secret bank accounts 3) **‘tax havens’ and other financial centres** which legislate for low taxes and the existence of bank secrecy and provide services such as the incorporation of shell corporations and other impenetrable legal structures such as unregistered trusts 4) **bankers and financiers** who solicit and enable the flight of capital and manage the illicit wealth once it has fled

### **What can be done to tackle tax flight and capital flight<sup>vii</sup>?**

Tax flight can only happen under a suitable confluence of conditions at the source, transit and destination points and in a suitable international environment. That is why it can be mitigated by actions at one or more of these points. By changing the risk to reward ratio – increasing risk (the likelihood of getting caught and/or severity of consequences) and reducing reward (the economic benefits) capital flight and associated tax flight from developing countries can be substantially reduced. Some of the main policy areas for action are:

#### **At the source**

- Addressing gaps in legislation would increase the risk of engaging in tax flight and reduce rewards. Adding tax flight to provisions under the Anti Money Laundering (AML) regime and the UN convention on corruption regime would be an effective policy tool.
- Addressing the lack of capacity and expertise in developing countries by providing training, technical assistance and resources to tax and customs authorities, prosecutors and the judiciary increases the risks associated with tax flight.
- Adopting successful unilateral measures of the kind that many developing and developed countries have adopted would be effective even in the short term 1) adopting a financial transaction tax (which generated information that helped substantially reduce domestic and cross-border tax evasion in Brazil) which increases the risk of detection 2) adopting special reporting requirements and fewer exemptions for investments and financial flows to and from 'tax havens' (Argentina and Spain) (reducing rewards and increasing risks) 3) requiring accounting firms to register tax shelters before selling them (USA and UK) (increasing risks) 4) initiating a cross-departmental program of the kind that exists in Australia (Project Wickenby – which is a task force that comprises the tax office, crime commission, security and investment commission and a number of other relevant governmental bodies) to tackle tax flight (increasing risks) 5) aiming for legal rulings (as done in the UK and Ireland) which would require banks to report customers with undeclared offshore bank accounts (increasing risks)

### **In transit**

Tax flight cannot take place without the active facilitation of intermediaries both at the source and destination. Professionals such as accountants, lawyers and bankers usually structure tax flight through transactions in a way that minimises risks of detection and maximises rewards. So targeting them can significantly increase the risks for those engaging in tax flight. Some measures are 1) Ensuring that tax crimes committed in foreign jurisdictions are a reportable offence 2) Targeting intermediaries to report suspected tax flight transactions at the risk of prosecution 3) Including tax flight in the AML and UNCAC regime will make it obligatory for intermediaries to report tax flight 4) Introducing professional codes of conduct for professionals which include not facilitating tax flight.

### **At the destination**

- Making the recording of beneficial ownership information by financial centres including 'tax havens' obligatory. This would need to include bank accounts, trusts, foundations, companies and all other legal vehicles. Maintaining public registers on such real ownership interests so relevant authorities can access them would seriously reduce anonymity and the benefits it offers.
- Moving towards a better sharing of information on the ownership of financial flows/assets associated with bank accounts, investments, companies, foundations & trusts registered in these territories significantly increases the risks of detection & prosecution. The Tax Exchange Information Agreements being currently negotiated and the mutual legal assistance instruments are often not good enough tools for an effective exchange and sharing of information. Moreover, most developing countries do not have such tools. A multilateral agreement on effective exchange of information would be an effective tool.
- Developed economies should share information on suspected trade and financial mis-pricing with the source developing country
- Sharing information on assets from developing countries (including bank accounts) with the relevant country authority

### **International environment**

Since tax flight arises mostly due to a co-ordination failure at the international level the best way to tackle it is also at the international level. Some of the policy measures that can change the present risk-reward to help reduce tax flight are listed below

The adoption of a country by country accounting standard would be a very effective tool in tackling tax flight 2) The extension of existing OECD and EU information sharing agreements to developing countries 3) Restructuring and upgrading the UN Committee on Tax Experts and increasing its resources and authority 4) Setting up a UN trust fund to finance alternative development paths for small island 'tax havens' which help tackle tax flight 5) Redefining the AML regime to include tax flight as a reportable offence 6) Reinterpreting the UNCAC to include tax flight as corruption 7) Extending the remit of the Stolen Asset Recovery (STAR) initiative to include fled capital associated with tax evasion 8) Building automatic exchange of information into the UN and OECD tax treaties, tax information

exchange agreements and working on a multilateral effective exchange of information regime 9) Constructing a policy map for successful unilateral policies which can be replicated 10) Introducing the fair payment of developing country taxation into all discussions of CSR and include a fair payment of taxes into the OECD guidelines for MNCs and the EU code on business taxation 11) Adopting a UN code of conduct on co-operation in combating tax flight 13) Giving Tax flight a higher public profile including through governments producing estimates of losses to tax flight

***Increasing the transparency of cross border financial flows would help 1) reduce tax flight 2) fight corruption and crime 3) improve financial supervision and 4) increase financial stability.***

### **Improving the current institutional landscape**

There are a number of inter-governmental institutions that currently deal directly or indirectly with the subjects of taxation, tax systems in developing countries and international co-operation on taxes. Some are – the OECD, the EU/EC, the IMF, the Multilateral Development Banks, the UN committee of tax experts, the Financial Action Task Force (FATF) and ad hoc initiatives such as the International Tax Dialogue, the Joint International Tax Shelter Information Centre, the Leeds Castle Group, the Seven country working group on tax havens and the Norwegian led Task Force on Illicit Financial Flows. While there is a lot of competence in many of institutions such as the OECD, these do not have the developing country focus. Others such as the World Bank have little technical capacity on tax and still others such as the UN committee and the Illicit finance task force do not have sufficient political weight.

There is a need for a body that can 1) Increase the visibility of the issue of tax flight from developing countries 2) Make existing relevant bodies divert some of their resources towards tackling tax flight from developing countries 3) Provide coherence to the various streams of tackling tax flight related work that is going on in various fora 4) Provide political clout and an influential international voice which can help translate technical work into action 5) Provide a permanent structure to help increase effectiveness, clout and institutional memory 6) Assist in developing relevant technical assistance tools

Such a body could take the form of a new permanent secretariat on tackling tax flight which, once the UN committee of tax experts gets upgraded as has been suggested in the draft Doha outcome document, can be subsumed into the UN system at a later date.

### **Conclusion**

Sustainable development can only take place in a context of 1) Raising domestic resources – helping build robust tax systems in developing countries 2) Retaining domestic resources – addressing the problem of tax flight at its source, transit and destination 3) Recovering domestic resources – helping identify, confiscate and repatriate fled capital 4) Reinforcing domestic resources - with aid and other forms of assistance where resource gaps exist

### Appendix III Taken from the Recommendations made by Sony Kapoor in the Norwegian Coherence Report

Norway should

- Actively advocate for the elimination of bank secrecy, shell companies and promote international co-operation and exchange of information on tax matters through every relevant fora including the UN, WB, IMF, OECD etc – especially through the ongoing FFD discussions
- Champion putting the development aspect of this issue on the international agenda through a deepening and broadening of the work of the illicit finance task force – any reduction in secrecy and increase in transparency will be synergistically beneficial to both Norway and developing countries
- Use active governance in its oil fund investments to push for a minimization or elimination of tax havens, use of shell companies and aggressive tax planning practices. A full disclosure policy of the corporate structure, tax strategy, use of tax shelters should be actively pursued for all investments
- Use this same policy for all partially and fully owned government firms (SOEs)
- Encourage a public procurement policy which is consistent with these principles
- Actively lobby for the adoption of the new proposed country by country reporting standard and proactively start reporting on this basis for all SOEs and push for the same through oil fund investments
- Be vocal about the problem and its own efforts at addressing these including through the promotion of CSR standards which include responsible tax and transparency policies
- Actively promote the understanding and publicity of the links between financial instability, corruption, tax evasion, development problems, erosion of the welfare state which result of lack of transparency in international finance and lack of co-ordination on tax matters

Norway should also

- Analyse its trade data (which is collected by customs) and inform developing countries of suspicious capital flight related transactions
- Check its banks to see if unauthorized fled capital from developing counties might be deposited with them

“The use of secretive jurisdictions, shell companies, trade mis-pricing, accounting shenanigans, payment of bribes and evasion of taxes damages the integrity of the financial system, increases the risks of financial crisis, makes corporations more susceptible to legal risks and reputation damage and undermines the rule of law. If the pension fund can even make a small dent in improving the governance of the system or of individual corporations it will have made a significant contribution to ethics as well as reduced the risks of the financial system to which it is heavily exposed.”

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<sup>i</sup> Raymond Baker, *Capitalism's Achilles Heel*, John Wiley & Sons, Hoboken, New Jersey, 2005

<sup>ii</sup> Gerald Epstein et al, *Capital Flight and Capital Controls in Developing Countries*, Northampton, MA, 2005

<sup>iii</sup> *ibid*

<sup>iv</sup> *ibid*

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<sup>v</sup> James Boyce and Leonce Ndikumana, “New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowings and Policy Options(Draft)”, 2007

<sup>vi</sup> Christensen John, Kapoor Sony and Murphy Richard, “Closing the Floodgates”, Norwegian Ministry of Foreign Affairs, 2006

<sup>vii</sup> This section is based on 1) Kapoor Sony, “Enhancing Domestic Resource Mobilization through Tackling Capital Flight”, United Nations 2008 and 2) Kapoor Sony, “Tackling Tax Flight – A BMZ/GTZ Briefing Paper”, German Development Ministry (BMZ) 2008