tax justice network

Summary: The Implied Tax Revenue Loss from Trade Mispricing
by Ann Hollingshead, Global Financial Integrity, Washington, DC, February 2010.

This study by Global Financial Integrity (GFI) aims to estimate the loss of tax revenue to developing country governments resulting from a form of trade mispricing known as *reinvoicing*. The study estimates that all developing countries lost between **US$98 billion and US$104 billion** in average annual tax revenue between 2002 and 2006 from this practice. This represents an average loss of about 4.4 percent of the entire developing world's total tax revenue, and is roughly the same amount as total annual Official Development Assistance (ODA) from developed countries to developing countries.

Reinvoicing happens when goods are exported from one country under one invoice, then the invoice is redirected to another jurisdiction – typically a low-tax or no-tax jurisdiction (or tax haven) where the invoice price is altered, then the revised invoice is sent to the importing country for clearing and payment purposes. By artificially overpricing imports or underpricing exports, this process shifts profits out of developing countries, usually for purposes of tax evasion.

This study follows GFI's 2008 report *Illicit Financial Flows from Developing Countries: 2002-2006,* estimating that illicit financial flows from developing countries were between U.S. $859 billion to U.S. $1.06 trillion annually from 2002 through 2006. Reinvoicing constitutes a portion of this illicit outflow. Illicit financial flows are defined as the cross-border movement of money that is illegally earned, transferred, or utilised, and the term includes the transfer of funds earned through illegal activities such as corruption, transactions involving contraband goods, criminal activities, and efforts to hide assets from a country's tax authorities.

The February 2010 Hollingshead paper uses the International Monetary Fund's *Direction of Trade Statistics* data, and it focuses on reinvoicing on a country-by-country basis. It does not analyse trade mispricing that occurs within the same invoice, nor trade in services and intangibles, which IMF data does not cover. However, the paper notes

Christian Aid's 2008 study, *Death and Taxes: The True Toll of Tax Dodging*, which estimated that the annual lost tax revenue of developing countries was about US$160 billion, but points out that the Christian Aid study also includes an estimate of "same invoice faking" (which is not included in the Hollingshead paper).

The paper also indicates that the annual loss of tax revenue from developing countries increased substantially from 2002 (about US$65 billion) to 2006 (about US$130 billion).

Curtailing this tax loss will therefore greatly contribute to revenues available for poverty alleviation and sustainable growth in poorer countries. The report recommends certain solutions to the transfer mispricing problem.

The full report can be downloaded at www.gfip.org