MINUTES OF A MEETING OF THE TAX JUSTICE NETWORK COUNCIL ON TUESDAY 2nd AND WEDNESDAY 3rd MAY 2006 IN ATHENS, GREECE

Participating -	John Christensen JC	(International Secretariat)
	Bill Fant - BF	(US Secretariat)
	François Gobbe FG	(Belgium)
	Pierre Guindja PG	(Belgium)
	Bruno Gurtner BG	(Switzerland)
	Lucy Komisar LK	(USA)
	Detlev von Larcher DL	(Germany)
	Mike Lewis ML	(International Secretariat)
	Andreas Missbach AM	(Switzerland)
	Michel Roy MR	(France)

Apologies - Raphael Calvelli (Italy), Sven Gielgold (Germany), Sony Kapoor (UK), Patrick Ruymen PR (Flanders), Juan H Vigueras (Spain)

1. Election of Chair

Bruno Gurtner was elected to Chair the Meeting.

2. Election of the Secretary

John Christensen was elected as Secretary of the Meeting.

3. Agreement of Agenda

The Agenda circulated on *Intertax* by the International Secretariat was agreed.

4. The Constitution for Tax Justice Network International Association Sans But Lucratif (hereafter 'The Association')

The draft Constitution in different language texts was considered and agreed subject to a minor amendment to the order of the opening sentence of Article 3, paragraph 1, recommended by MR. It was agreed to change the wording from:

> *"The Association operates on a not for profit basis to bring together organisations, social movements and individuals working for tax justice and tax cooperation and against tax avoidance, tax evasion and tax competition."*
>
> to:

"The Association promotes tax justice and tax cooperation and resists tax avoidance, tax evasion and tax competition. It operates on a not for profit basis by bringing together organisations, social movements and individuals working towards these goals."

AM noted that the original wording was taken from the TJN Mission Statement and it was agreed to change the Mission Statement accordingly. Action: International Secretariat to alter Mission Statement and English language Constitution. FG to alter French and Flemish language Constitutions.

It was agreed that other more substantive alterations to the Constitution suggested by MR should be delayed until the next Council Meeting.

5. Ratification of the Membership of the Founder Members

The following organisations were ratified as Founding Members of The Association:

- The Association for Accountancy & Business Affairs (UK)
- AllianceSud (Switzerland)
- L'Association pour la Taxation des Transactions Financières pour l'Aide aux Citoyens (ATTAC) (Germany)
- Berne Declaration (Switzerland)
- Citizens for Tax Justice (USA)
- Kairos Europe (Belgium)
- Secours Catholique – Caritas France
- Tax Justice Network - USA

6. Election of Interim Board of Directors

The following individuals were elected to serve as Board Directors of The Association on an interim basis until the Council Meeting scheduled to be held in January 2007:

- Sven Giegold
- François Gobbe
- Bruno Gurtner

It was agreed that until the election of the permanent Board of Directors the executive functions of the International Steering Committee will continue to be delegated to the current Office Group.

7. Registration of the Constitution

The Council requested that the Association's Directors proceed without delay with registering The Association's Constitution with the relevant Belgian Authorities. Action: FG to organise Minute of a Director's Meeting authorising him to proceed with registering the Constitution.

8. 'tax us if you can'

Recommendations 1 to 12 of the list submitted to the editors were discussed and proposals agreed on how to alter the text as necessary. In the case of recommendation 13, relating to source, residence and unitary taxation, it was agreed - in the absence of Sven Giegold - that he would be requested to reply to the letter sent by Richard Murphy on 19th August 2004 (appended below) in order that the editorial team can fully consider his views on the matter raised. Action: Sven Giegold to reply to Richard Murphy's letter dated 19th August 2004.

Recommendations 14 and 15 were not considered but will be acted on by the editorial team.

Action: Editorial team to proceed with amendments and circulate to Office Group for discussion.

9. Corporate Responsibility and Accountability

It was agreed that the term Corporate Responsibility and Accountability would be used instead of Corporate Responsibility or Corporate Social Responsibility.

10. Policy with respect to Press Releases Issued by the International Secretariat

After discussion ML proposed the following protocol for approval of press releases:

1) All external communications are to be circulated to the Office Group

2) For proactive communications work (e.g. planned releases of reports, TJN actions):

- all media and communications materials are to be sent to Office Group 7 days in advance of release

3) For both proactive and reactive communications work:

- positive clearance must be given by two office group members, including a country representative/expert relevant to the subject of the communication

11. Policy with respect to Communications between the International Secretariat and the Office Group.

It was noted that the principal means for communication between the International Secretariat and the Office Group was the monthly written and oral report of the Secretariat's Director. The Director expressed concerns that the written report has not always been paid sufficient attention.

12. Date of the next Council Meeting

The next Council Meeting will be held in week 4 of January 2007 in Nairobi, Kenya.

Appendix 1: Letter from Richard Murphy to Sven Giegold

By email

19 August 2004

Sven Giegold

ATTAC Germany

Dear Sven

The residence basis of corporate taxation

John Christensen has forwarded to me your mail regarding the proposed update to the Oxfam report. I note:

- your opposition to the proposal that it encourage use of a unitary basis for corporate taxation
- that you remain committed to the residence basis for this tax
- that you say:

> *The residence principle could be taken seriously by taxing profits from daughter companies regardless whether they are repatriated or not at the tax rate of headquarter countries (=getting rid of deferral). This is efficient as only profitable parts of a company are taxed but assumes that relocation of headquarters remains rare.*

I regret that I think you are over optimistic about how the residence basis both does work now and might work in the future. I also think some of your comments about a unitary basis for corporation tax are also inappropriate, especially where you say:

> *If poor countries shall be able to get any taxes from TNCs it is not enough to fix rules for unitary taxation. There must be a harmonisation of tax rates as well. Unfortunately, this is the least likely outcome that we might achieve. Why should weak countries be able to overcome the current collective action problem to raise source taxes only because you change the rules how rights to tax are divided between countries. In the current division of power between mobile TNCs and weak states I cannot see why most poor countries should be able to gain a lot from unitary taxation. Unitary taxation is therefore not the solution for weak countries.*

I do welcome these comments though because they give some indication of your motivation in arguing as you do. I think it important that we set out very clearly what principles we are following and what objectives we wish to achieve when conducting this debate.

I would suggest that the principles that should underlie any suggestions we make as to changes in international corporation tax are:

1. they should assist the poorer and developing nations of the world to raise the revenue they need to provide the programmes their populations want and need;

2. they should not unduly reduce the taxation yields of the more developed countries of the world since they too have legitimate concerns about protecting their corporation tax revenues;

3. they should be as simple as possible within the necessary constraint of being effective;

4. they should not discourage trade, or at least should do so as little as possible since trade is a necessary part of the process of meeting human need.

In addition to these principles we must also be aware that any debate about international taxation of corporations must take into account the fact that the income of these organisations is often complex in nature. At its very simplest it must be borne in mind that the profit flows of corporations might be generated by one or all of:

1. trading profits;

2. investment income (which in itself covers a multitude of financial flows);

3. capital gains.

Any solution has to encompass all these scenarios. Additionally, social responsibility on the world stage suggests there are other objectives:

1. capital flight must be discouraged by any taxation system;

2. the system must reduce the risk of corruption distorting taxation flows;

3. the payment of tax must be encouraged.

Given this wide range of objectives (and I readily admit there could be others, or those noted above could be subdivided) I think any argument that says there will be one sort of tax system that meets all needs is likely to be flawed. Indeed, recent consultancy work I have been undertaking on the future of local taxation in the UK has only emphasised to me the error of believing in any tax system that relies on just one basis of taxation. It's rather like playing golf with just one club. A putter is no use on the fairway, a driver no use on the greens. A solution has to encompass a range of measures, and I think we might need to consider this carefully in TJN if we are to put forward a really progressive "world solution" to this problem.

So let me now consider the options we have available:

1. **Source based taxation**. We should not ignore this as a basis of tax as for most corporations the world over it is effectively the only one that applies. In effect they generate all their income within a state and pay tax on it there. I accept this could also be considered residence based taxation for those companies. The point is important though, the issue we are discussing is only of consequence when the corporation creeps across state boundaries.

   Internationally source based taxation is relatively simple. The state in which the economic activity to generate the profit occurs is the one which has the right to tax it. The difficulties are obvious though and becoming increasingly complex in the electronic era:

   - What is an activity?
   - In which state does activity take place?
   - How can you know?

   The answer is that in many cases you can't answer these questions. Most particularly it's hard to answer them with regard to trading transactions where a substantial number of activities have to be combined to make a product. In these cases source based taxation does not really work.

   But that it not to say it still has no role in modern international corporate taxation. For many financial transactions these questions can be answered. As such the option of using source taxation remains for such transactions, and is powerful. This is a point I return to below.

2. **Residence based taxation.** It is easy to get confused about what is meant by residence based taxation. In the case of a trading/manufacturing concern in my opinion it means that the profits of a corporation are taxed in the country in which it is resident. It also means that a parent company is considered to have access to and control over the profits of its subsidiary companies if they are held in territories other than its own and as such the parent company can be held liable to tax on the profits of its subsidiary

companies. What the "residence" basis of taxation cannot mean for a trading company is that the profit is taxed where the final recipient of the goods or services supplied is located, not least because it would frequently be difficult to prove this.

For investment income the rule is different. It means that the income is taxed where received and not where it arises. Once more the difference is important.

The difference is also important with regard to capital gains, although these will tend to follow the rules of investment income.

3. **Unitary taxation.** This term is again open to wide interpretation. I suggest it is a basis for a group of taxing authorities to agree that they will consider the profits of states subject to their law to have pooled their profits and that they are reallocated in accordance with a formula to each those states to tax at whatever rate they choose to apply.

   I would stress that this gives rise to a number of issues:

   - How do the States involved in the apportionment determine which corporations are to be subject to that process?
   - How do they determine what profits of those corporations are brought within the charge to unitary taxation?

   The experience of California when it tried to apply a unitary tax on the world wide profits of states trading there highlighted these issues. The point is, I think, clear. Unitary taxation might solve some tax problems, but it does not solve them all. The issues of source and residence bases of taxation will continue to be an issue in corporate taxation until such time as all nation states agree to be covered by unitary taxation rules.

   This, however, is not to underestimate the importance of unitary taxation. It clearly is of benefit in the USA. Given the broad membership of the EU it is also clear that much of the trading income of many of the countries which trade within it would also be almost entirely, or entirely covered by a unitary basis if that were to be introduced in the EU and many of the current problems being faced by national taxation authorities e.g. those in the UK who are facing considerable difficulties as a result of conflicts between UK and EU tax laws could be either eliminated or reduced if it were in use. So it may not solve all problems, but in a world where all solutions remain sub optimal that's not an issue for dismissing it.

Let me explain why I think this is the case by comparing it with the residence basis of taxation (and for the time being putting the source basis to one side as being largely applicable only to financial transactions since only they have the characteristics that facilitate its use). I am familiar with the residence basis as the UK effectively moved to it over a decade ago when it did two things:

1. it assumed that all companies incorporated in the UK were resident for tax in the UK (so closing a previous major loophole which had made the UK the premier tax haven before then because prior to that date only UK companies managed and controlled in the UK were considered resident here, a situation that persists in Ireland and which partly explains its haven status);

2. introduced what is called "controlled foreign company legislation". Under this (and to simplify it somewhat) if a UK company owns a subsidiary in another state and:

   a. it cannot prove that the subsidiary has a substantial trade in that other state, and;

   b. the tax paid in that other state is less than 75% of the tax that would have been paid if the same profits had been subject to tax in the UK

   then the profits of the subsidiary are deemed to have been remitted to the UK and are subject to UK corporation tax whether or not they are actually remitted to the UK.

Now, I accept this is only one model of a residence basis of tax but it immediately demonstrates several important things:

1. the residence basis of tax currently benefits the countries to which remittances are made, not those from which they are made i.e. the UK benefits in this case, and the low tax area does not (as Jersey is now finding to its cost; its cut in corporation tax to 0% will benefit the UK by about £25 million a year with no benefit at all accruing to Jersey). Note also that no deemed remittance is ever made from a higher tax jurisdiction to the UK, there is no point in deeming that to be the case;

2. it could be argued that because a major trading area linked to a low tax area works on a residence basis the low tax area should be able to raise its rates with impunity, but that logic has clearly not worked in Jersey, as noted above, where the link with the UK is very strong but they have moved to 0% corporation tax all the same. In other words, the evidence on the ground is that a residence basis amongst developed countries does not provide the shelter which enables developing counties or havens to raise rates.

3. unless all countries work on a residence basis for head offices then many offshore and low tax regimes will still be under considerable pressure to lower rates because some corporations will still benefit from them by locating their head offices in territories where the residence basis will not apply or where tax rates are low, and this trend might increase as the number who tax on a residence basis also increases. In this last respect it is worth noting that recent EU rulings have made it much easier for companies to relocate head offices by effectively making inter EU exit charges on relocation illegal and at present a US exit has no cost, so your assumption in this respect of rare relocations is unlikely to be sustained in practice. For example, I note strong rumours in the UK financial press last week that HSBC, our biggest bank, is considering relocating.

4. overall tax yields in developed countries would reduce if there was a widespread move to relocate head offices out of them – and in this respect note that Cayman is becoming an increasingly recognised Stock Exchange so it may be anticipating this move. There may be no corresponding increase in developing country yields;

5. I accept that if all parent companies were in territories where a residence ruling applied then there would be limited incentive for developing countries to reduce their tax rates. But Ireland already has a 12.5% tax rate. Effective rates in the UK are about 23% in my estimate (and remember it's effective, not actual rates that matter here). So, residence is not going to support any increase in rates much above these I suspect, and they may not be adequate.

But that's not all that matters. Rates are only part of the tax scenario, but they are I think your motive for suggesting a residence basis for tax (not that I think one country will ever be able to impose rates on another unless part of a larger alliance e.g. the EU). The real issue is more complex than rates. Most poor countries have tiny and often ineffective international tax divisions. John and I certainly encountered this at the UN. This fact should in itself be a major campaigning point for us. But it also has an important practical dimension. As soon as poor countries (and I assume here we are really referring to those who are both poor and have mass populations) can raise tax rates multi national corporations will find ways of transfer pricing out of them (look at Russia if you want emphatic evidence) and without:

1. substantial numbers of well briefed personnel;

2. deep pockets to fight cases, and

3. data of the sort my proposed international accounting standard would provide (and some poor countries at the UN very warmly welcomed it)

then all that will happen is that developing countries will have higher rates and a fast disappearing tax base that they will not be able to stop eroding. I stress, we encountered international tax divisions with just a handful of personnel to deal with issues like this. They simply don't have a hope against transfer pricing abuses.

It is at this administration level that a unitary tax base works. The allocation of profit should be unavoidable if a robust formula could be agreed, and for many developing countries there would be a massive advantage to agreeing this. As such it is ideal in tackling this key and incredibly important deficiency in the international tax system which I rate as being systemically more significant than any problem with disparate tax rates. If a profit is transferred out of a developed country it can't tax it, and residence allows this whilst unitary taxation will put it back where it belongs i.e. with them.

That doesn't solve all problems of course. Under a unitary system it is politically essential that the state which has been denied the chance to determine the taxable profits of its TNCs does at least have the chance to set their tax rates. If you deny that you undermine too many key elements of democracy for unitary tax to be adopted. I think this is key to any solution. Consistent accounting and disclosure is another key part too.

What I also accept though is that planning abuse would remain whilst combinations of systems were in operation. For example, most unitary taxation apportionment involves a part allocation on where tangible assets are owned (but not where they are located). So, to quote from a US tax planning web site (and in the US some states are wholly unitary and some are resident based, or as they call them "separate accounting states"):

> *Tax planning opportunities are particularly strong when operating in both types of states (i.e. unitary and separate accounting based). Set up a subsidiary in each state. Concentrate property and payroll in the separate accounting state but use transfer prices to shift the bulk of income to the unitary state. Your taxable income in each state will be very low.*

This brings into obvious focus the need for co-ordination of:

- transfer pricing issues
- unitary formulae
- tax systems

and can only stress the international dimension of our work at things like the UN level. This is the only sure way to stop any abuse.

Other abuse will of course occur because unitary taxation is only effective for trading profits. A source basis is the obvious need for taxing financial products and we should argue for it. If there was tax at source in the UK London would not be a tax haven, but there isn't, so it is. Source basis taxation of capital and financial income is the most effective block to capital flight there is. So I am keen on it. We should call for it.

But that doesn't stop the need for a residence basis for these sorts of income too. It is easy to book financial income just about wherever you like and if a territory either refuses to impose source taxation or does so at negligible rates then a residence basis of tax on that income stream seems an obvious response to such a scenario, and whether remitted or not. The UK system of controlled foreign company legislation would seem to be a useful basis for this, although disclosure of data is key for this, as it is for much else in this sector, which is why that is also vital for our campaign.

What a residence basis would do when applied to financial income over a unitary basis applied to trading profits would be to prevent profits being made in a low taxed area being distributed to a parent company in high tax area for distribution as a dividend to members without tax having ever been applied on the way. But to be really effective this would mean that provisions against what are called constructive remittances in UK tax law (which means remittances which are disguised as other things such as inter group loans are brought into the scope of tax) would have to be built into this system.

This might finally remove the appeal of the haven to the corporate world. But it would still leave the more important personal client in action in those territories. However, for the less developed country this system could be very effective in allowing the collection of real corporation tax revenues on fairly allocated profits.

But the points I make are these:

- only by using a combination of tax measures and bases can this system work
- without unitary systems I do not believe developing countries can get the profit they want to tax into their countries
- there is a role for a residence basis, but it's largely for financial transactions
- we must not ignore source basis as an anti capital flight measure.

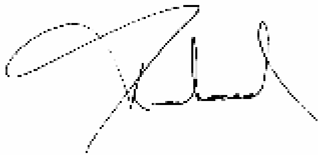
All of which says we must recognise that what we are about is complicated, and to argue on simplistic lines that "I'm for residence and against unitary" (or vice versa) is not helpful. And it's also not enough to look at rates. We have to look at:

- collection systems
- disclosure
- information exchange
- accounting rules
- international treaties

and so on as well. Our campaign has to be at this high level, or we'll lose – not least by promoting schemes which the evaders would love.

I'll also be happy to discuss this, and will circulate this letter amongst those I might think interested to see if it encourages debate (and to see if someone thinks I have missed the point).

Yours



Richard Murphy