



## **PROPOSALS BY THE TAX JUSTICE NETWORK TO THE MEETING OF THE GROUP OF EXPERTS IN ROME:**

**September 4-5 2007**

### **Tax Aspects of Domestic Resource Mobilization: A Discussion of Enduring and Emerging Issues**

The United Nations in the Monterrey Consensus has challenged developing countries to mobilize domestic resources. This was confirmed by the UN's General Assembly in the 2005 World Summit.

But if developing countries are to mobilize domestic resources, it is necessary to confront the problem of capital flight from developing countries, and the resulting tax evasion in developing countries. The UN's General Assembly in the 2005 World Summit, in the section on Domestic Resource Mobilization, resolved to "support efforts to reduce capital flight and measures to curb the illicit transfer of funds."

In order to assist those efforts, the Tax Justice Network has the following recommendations:

#### **(1) Code of Conduct on Cooperation in Combating Capital Flight and International Tax Evasion and Avoidance**

The Tax Justice Network ("TJN") recommends that the UN Tax Committee request that ECOSOC approve the resolution concerning the development of a Code of Conduct on Cooperation in Combating Capital Flight and International Tax Evasion and Avoidance,

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presented by Professor Michael McIntyre to the UN Committee of Experts on International Cooperation in Tax Matters (“UN Tax Committee”). A copy of a proposal for such a draft code of conduct is attached hereto as Annex A. TJN believes that such a Code of Conduct would be a step forward in helping developing countries mobilize domestic resources, as emphasized by the United Nations.

**(2) Effective Exchange of Information: What constitutes “Effective Exchange of Information?”**

TJN recommends that the UN Tax Committee prepare a report about what constitutes “effective exchange of information” for purposes of Article 26 of the UN Model Double Taxation Convention between Developed and Developing Countries (“UN Model Income Tax Treaty”). The UN Tax Committee should report on what information a jurisdiction should routinely obtain and have available, in order to be able to comply with its obligations to exchange information pursuant to Article 26 of the UN Model Income Tax Treaty and other income tax treaties. This should include information about (a) cross border payments (including names of the actual beneficiaries of such payments) and (b) beneficial ownership of companies, trusts, institutions and other entities, including the identity of those with powers to dispose of the assets, and the beneficiaries of such entities. Obtaining such information would also be in accordance with Recommendation 33 of the Financial Action Task Force (FATF). TJN is concerned that the tax authorities in many jurisdictions do not routinely obtain domestically the appropriate information (resulting in de facto bank secrecy), and therefore those jurisdictions are not financially transparent. Consequently, those jurisdictions can not engage in “effective exchange of information”. The OECD has emphasized that in order to combat tax evasion and tax avoidance, exchange of information should be “effective”.

**(3) Role of International Financial Institutions in Capital Flight and Tax Evasion: Monitoring and Surveillance Responsibilities**

TJN recommends that the UN Tax Committee request that the International Monetary Fund (IMF), in fulfilling its responsibilities of the monitoring and surveillance of financial centers and the international financial architecture, include in its Reports on Observance of Standards and Codes (ROSCs) whether a jurisdiction that is a financial center complies with standards of international financial transparency. This should include (a) whether the jurisdiction (i) overrides bank secrecy and other confidentiality laws in tax matters, and (ii) requires the automatic reporting domestically of tax related information

by payers of income to foreign payees and therefore such jurisdiction has tax related information available to be exchanged with other jurisdictions, and (b) whether the jurisdiction in practice does engage in effective exchange of information with other jurisdictions.

#### **(4) Capital Flight and Tax Evasion as Corruption**

TJN recommends that the UN Tax Committee consider whether capital flight and the resulting tax evasion should constitute acts of corruption within the scope of the United Nations Convention Against Corruption, as follows

- (a) Private sector corruption by the person (individual or company) that transfers funds to another jurisdiction and evades taxes. That person is illegally diverting for his/her/its private use, funds (tax revenue), that belong to the public sector.
- (b) Private sector corruption by financial intermediaries that knowingly encourage or facilitate capital flight and the resulting tax evasion in other jurisdictions, because they are enabling the illegal diversion for private use of funds (tax revenue), that belong to the public sector .
- (c) Public sector corruption by the governments in the onshore and offshore financial centers that provide de jure bank secrecy or de facto bank secrecy and other confidential treatment of financial transactions without providing effective exchange of information in tax matters. Such treatment facilitates and encourages capital flight from other jurisdictions, and tax evasion in those other jurisdictions. Thus, governments in such financial centers knowingly aid and abet corruption by enabling the illegal diversion for private use of funds (tax revenue), that belong to the public sector.

#### **(5) The Uniform Framework For Preventing and Combating Fraud and Corruption Elaborated by the International Financial Institutions**

TJN recommends that the UN Tax Committee urge the international financial institutions (African Development Bank, Asian Development Bank, Inter-American Development Bank, European Investment Bank, European Bank for Reconstruction and Development, the International Monetary Fund and the World Bank) to expand the definition of corruption in that Uniform Framework to include the following: (a) private sector corruption by the persons as described in paragraph (4)(a) above; (b) private sector corruption by financial intermediaries described in paragraph (4)(b), above; and (c) public

sector corruption by governments in financial centers, as described in paragraph (4)(c), above.

**(6) Capital Flight and Tax Evasion as Money Laundering, and as a Suspicious Activity**

TJN recommends that the UN Tax Committee consider whether money laundering laws should include as an offense, the cross border transfer of assets from the jurisdiction of a person's residence or citizenship, without those assets and/or the income thereon being declared for tax purposes in the jurisdiction of residence/citizenship. Also, TJN recommends that the UN Tax Committee suggest that the evasion and/or avoidance of domestic and/or foreign taxes be considered a suspicious activity that would be covered by suspicious activity reporting requirements.

**(7) Tax Evasion/Tax Avoidance as Corruption and Money Laundering for Purposes of the Financial Action Task Force (FATF)**

TJN recommends that the UN Tax Committee urge the Financial Action Task Force (FATF) to include tax evasion and tax avoidance (both domestic and foreign) in the FATF definition of Designated Categories of Offences.

**(8) Capital Flight and Repatriation of Assets**

TJN recommends that the UN Tax Committee prepare a report on the legal measures reasonable and necessary for jurisdictions to recover and repatriate assets, and the income thereon, which have been illegally transferred from that jurisdiction to other jurisdictions, and accumulated in other jurisdictions, including (but not limited to) OECD financial centers and non-OECD financial centers. These could include provisions pursuant to Chapter V, Asset Recovery, of the United Nations Convention Against Corruption and Article 27 of the UN Model Income Tax Treaty. TJN also suggests that the UN Tax Committee consider and evaluate a range of measures, including but not limited to those which have been used by some countries such as tax amnesties, to encourage and facilitate repatriation of such assets.

**(9) Issues in International Tax Collection and Tax Enforcement**

TJN recommends that the UN Tax Committee study how Article 27 of the UN Model Income Tax Treaty, Assistance in the Collection of Taxes, could be further developed or supplemented by other measures which would be appropriate and reasonable in order to strengthen procedures for international tax collection and international tax enforcement.

**(10) The March 13, 2002 Joint Proposal by the Staffs of the IMF, OECD and World Bank: Developing the International Dialogue on Taxation (“Joint Proposal”)**

In the Joint Proposal the IMF, OECD and World Bank committed to assist developing countries in *“strengthening of national tax systems, which in turn will assist the mobilization of tax revenues for development highlighted in the ... documents for the UN Financing for Development Conference”*.

The Joint Proposal states in relevant part that:

*“While the current international tax scene is rich in initiatives and programs, it lacks:*

- *Clear and transparent mechanisms for the co-ordination of these programs; and*
- *A real input from developing countries in the way programs are constructed and international tax issues debated.”*

TJN recommends that the UN Tax Committee present to the IMF, OECD and World Bank specific proposals, such as and including those specified in this memorandum, for those institutions (including the Committee on Fiscal Affairs of the OECD and the Fiscal Affairs Department of the IMF) to assist developing countries to mobilize domestic resources by (a) strengthening the national tax systems of developing countries, including by assisting them to better confront the loss of government tax revenues resulting from capital flight to OECD financial centers and non-OECD financial centers and the consequential tax evasion in developing countries, and (b) working with all financial centers in order that those financial centers discontinue facilitating capital flight from developing countries and the resulting tax evasion in developing countries

**(11) Transfer Mispricing**

TJN recommends that the UN Tax Committee prepare a report on (a) the economic impact (the quantification) of transfer mispricing, in particular the economic impact (loss of tax revenues) on developing countries of transfer mispricing, and (b) the most appropriate measures to combat transfer mispricing.

TJN recommends that the UN Tax Committee prepare a report evaluating the effectiveness in practice of the so-called arm's - length method and comparing it with methods based on combined reporting with formulary apportionment as the most appropriate approach to combat transfer mispricing. . This could take account of the extensive technical work done by the European Commission on the possible use of a Common Consolidated Corporate Tax Base of combined reporting with formulary apportionment within the European Union, as well as the experience of combined reporting with formulary apportionment within federal states such as the United States of America, and the experience of methods used in practice for resolving problems of Corresponding Adjustment between Competent Authorities or Arbitrations under tax treaties.

TJN recommends that the UN Tax Committee liaise with the International Accounting Standards Board (IASB) with regard to the disclosure by multinational corporations of tax and other payments in order to enhance transparency in corporate reporting, by requiring each multinational corporation to adopt on its financial statements (a) country-by-country reporting of tax and other payments to the government in each country in which it does business, and (b) disclosure of basic information about the business done by that multinational corporation in such country.

**(12) Tax Competition**

TJN recommends that the UN Tax Committee consider the harmful aspects of tax competition: the depletion of government tax revenues and the reduction of basic government services including health, education and other basic government services. The 1998 report by the Organization for Economic Cooperation and Development (“OECD”) entitled “Harmful Tax Competition: An Emerging Global Issue,” raised the issue of harmful tax competition. TJN recommends that the UN Tax Committee be asked to determine whether tax competition involving developing countries is undermining their ability to mobilize domestic resources for development and to create the “enabling domestic environment” called for in the Monterrey Consensus.

### **(13) The Role of Intermediaries in Tax Compliance in the International Context, and The OECD Intermediaries Project**

TJN recommends that the UN Tax Committee study the role of “intermediaries” tax compliance in the international context.

TJN Recommends that the UN Tax Committee include in the definition of “intermediaries,” and that the UN Tax Committee suggest to the OECD that the OECD Intermediaries Project include in its definition of “intermediaries”, all of the following: attorneys, accountants, and other tax advisers (“Tax Advisers”), corporate service providers, promoters, corporate administrators, and trust administrators (“Service Providers”), and financial intermediaries such as banks, trust companies, brokerage firms and other financial institutions (“Financial Intermediaries”).

TJN recommends that the UN Tax Committee include on its agenda, and that the UN Tax Committee suggest to the OECD Intermediaries Project that it include on its agenda, a proposal that would require Tax Advisers, Service Providers, and Financial Intermediaries:

- (i) not to provide any services to persons (companies, trusts and other entities and individuals), knowing or having any reasonable cause to believe that such services would assist such person to violate the tax laws of any country, domestic or foreign.
- (ii) if the transaction is for a foreign client, to obtain from the client a written confirmation that the client is complying with all applicable foreign tax laws, and their consent that this declaration may be sent to the tax authorities in question.
- (iii) if the transaction is for a domestic client but the matter has a foreign tax element, to obtain from the client a written confirmation that the client is complying with all applicable foreign laws.

TJN also recommends that the UN Tax Committee submit these proposals to private sector professional groups, such as the International Fiscal Association, the International Bar Association and other relevant professional groups, and especially those in countries with specific influence on or interest in this issue.

**(14) The Tax Aspects of Misuse of Corporate Vehicles**

TJN recommends that the UN Tax Committee prepare a report on the tax aspects of the misuse of corporate vehicles, including

- (a) “shell companies,” such as companies organized in a jurisdiction but which have a special status, e.g. they are not permitted by the laws of that jurisdiction to do business in that jurisdiction, and whether the corporate identity of such corporations be recognized: the study should examine various techniques for challenging such grants of corporate status (See for example the reasoning of the International Court of Justice in its *Nottebohm* decision, in the case of citizenship of individuals); and
- (b) fiscally transparent entities (in the context of the definition of “residence” for purposes of income tax treaties, and also the use of fiscally transparent entities in non-treaty situations).

**(15) Liaison with OECD on Technical Aspects of Exchange of Information**

TJN recommends that the UN Tax Committee liaise with the OECD’s Fiscal Committee about the technical work being done by the OECD on the mechanics of exchange of information, including the OECD’s *Manual on the Implementation of Exchange of Information Provisions for Tax Purposes*, approved by the OECD Committee on Fiscal Affairs on January 23, 2006, including but not limited to automatic exchange of information.

**(16) Assistance to the Governments of Jurisdictions Dependent on the Offshore Sector**

TJN recommends that the UN Tax Committee consider measures for jurisdictions which are substantially reliant economically on the “offshore sector” to diversify their economies and become less reliant economically on the offshore sector. In order to replace lost government revenues such as from license fees previously collected by such governments, TJN recommends that the UN Tax Committee consider whether such measures might include the possible allocation to such governments of some tax revenues resulting from the taxation of income previously untaxed on assets invested in OECD financial centers and non-OECD financial centers.



**(17) Tax Administration Issues**

TJN recommends that the UN Tax Committee work with international entities and organizations specialized in tax administration, including the Committee of International Organizations on Tax Administration (CIOTA), in order to implement the relevant recommendations in this memorandum.

**(18) Creation of a Subcommittee of the UN Tax Committee, and An Annual Report by the UN Tax Committee to ECOSOC about the Work of the UN Tax Committee to Reduce Capital Flight and the Resulting Tax Evasion, and to Assist Developing Countries to Mobilize Domestic Resources**

TJN recommends (a) that the UN Tax Committee create a subcommittee to coordinate the work of the UN Tax Committee, in accordance with paragraph (24) of the 2005 UN World Summit, in supporting efforts to reduce capital flight and the resulting tax evasion and to help developing countries mobilize domestic resources, and (b) that the UN Tax Committee submit to ECOSOC annually a report detailing specifically the work of the UN Tax Committee to support efforts to reduce capital flight and the resulting tax evasion, and to help developing countries mobilize domestic resources.

**THE ROLE OF TJN:** The Tax Justice Network is interested in working with UN Committee of Experts on International Cooperation in Tax Matters, on these recommendations and TJN believes that it can provide or introduce expertise to assist achievement of this objective.

[www.taxjustice.net](http://www.taxjustice.net)

## Suggested Draft Resolution from ECOSOC to Expert Committee

*The Economic and Social Council of the United Nations,*

*Reiterating* its concern about the growing problems of capital flight and international tax evasion and avoidance,

*Recognizing* that these problems have become of increasing importance to developing countries and are undermining their ability to mobilize domestic resources for development and to create the “enabling domestic environment” called for in the Monterrey Consensus,

*Concerned* that countries that have demonstrated their willingness to enter into cooperative arrangements for combating capital flight and international tax evasion and avoidance will be put at a competitive disadvantage with financial centers that are uncooperative,

*Recalling* that the General Assembly of the United Nations in its Resolution 60/1 on World Summit Outcome (24 October 2005) has resolved “to support efforts to reduce capital flight and measures to curb the illicit transfer of funds,”

*Understanding* that the Committee of Experts on International Cooperation in Tax Matters has discussed, at its meeting in Geneva of December 2005, the possibility of formulating a Code of Conduct that would set minimum standards the countries should meet with respect to cooperation on measures to combat capital flight and international tax evasion and avoidance,

*Believing* that such a Code of Conduct could serve as a useful tool in encouraging international cooperation on combating capital flight and tax evasion and avoidance:

1. *Encourages* the Committee of Experts on International Cooperation in Tax Matters to consider the development of a Code of Conduct on Cooperation in Combating Capital Flight and International Tax Evasion and Avoidance.
2. *Welcomes* the advice of the Expert Committee on the role that this council might serve in advancing the acceptance of such a Code of Conduct.
3. *Requests* that the Expert Committee provide to this council a report that summarizes the steps the Expert Group contemplates taking in preparing such a Code of Conduct

[Prepared by Michael J. McIntyre, 2 July 2006.]