

The G7/G20 tax agenda: time to secure progress across the world

The results of initiatives to end tax avoidance and evasion will depend on how fully they are applied

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“Profits should be taxed where economic activities deriving the profits are performed and where value is created.” Such was the conclusion of G20 finance ministers at their February 2014 meeting in Sydney, Australia, on the issue of the taxation of multinational corporations.

Recognition of this principle at that political level was long overdue, but nevertheless historic. In close partnership with the Organisation for Economic Co-operation and Development (OECD), the G20 is currently working on a project to prevent tax base erosion and profit shifting (BEPS). The measures put forward should enable governments to tax corporations adequately according to the economic realities of multinational groups and the actual geographies of production. With this in mind, the project addresses transfer price manipulation, aggressive tax incentives and other devices that make it possible for taxable profits to surface in tax havens or other low-tax jurisdictions in purely artificial ways.

Danger of inertia

Notwithstanding this progress, the greatest concern at this point is that the G20/OECD approach might not be radical enough, and that in just a few years' time the work will have to be done all over again. A similar situation occurred with regard to the G20/OECD's tax information exchange regime. After several years of muddling through on the basis of the suboptimal 'information upon request' standard, recently the G20 and OECD fully embraced the more effective standard of automatic information exchange.

But the new standard at the global level is nowhere close to being implemented yet, and precious years have been lost. In the world of global tax cooperation, policy inertia and conservatism are costly for public treasuries. The BEPS initiative must now ensure that

tax authorities stay ahead of corporations and their armies of tax advisers for a long time, rather than the other way around.

A related concern is that the BEPS initiative may not remove the extreme complexity of the matter. This could be all the more problematic for developing countries, which are likely to continue to struggle with the exact determination of transfer prices for multinationals' intra-firm trade. The 2013 G8 summit at Lough Erne and the OECD have already hinted at this problem.

The fundamental question remains whether developed and developing countries would not be better off with a regime of 'unitary taxation' and the apportionment of countries' taxing rights based on an easy formula, rather than sticking to the current 'at-arm's-length principle', which treats cross-

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border trade between entities of the same multinational group as if this trade occurs between independent parties.

With regard to the second major challenge – cross-border exchange of information on individual taxpayers – work is currently under way on a detailed new OECD standard that countries can adopt for their bilateral dealings. As endorsed by G8 and G20 leaders, this standard implements the principle of automatic exchange of information (AEOI). This is a giant leap forward. The big question now is how this standard will be spread across the world. For now, G20 governments have agreed to apply the standard among themselves, and to promote it vis-à-vis other countries. The latter part is critical for success,



since the problem is not one of hidden billions in each other's countries – it is all about tax havens. So, how are the G7, G20 and OECD to convince dozens of secrecy jurisdictions to implement automatic information exchange? So far, the communiqués produced by leaders and finance ministers remain silent on this crucial question.

Two-way dialogue

In the past 16 years, since information exchange has moved higher up the multilateral agenda, the OECD and G20 have considered concerted 'sanctions' against non-complying jurisdictions several times. But they always stepped back, to give dialogue on an equal footing between OECD/G20 countries and tax havens a chance. In those formats, the tax havens have mostly dragged their feet.



Work is under way on a new OECD standard, endorsed by G8 and G20 leaders, that implements the principle of automatic exchange of information

At this stage, a critical evaluation of these processes would be useful. At present, the international dialogue takes place within the OECD-led Global Forum on Transparency and Exchange of Information for Tax Purposes. Two-way consultations about how to design and implement the new standard are surely preferable to unilateral action, as long as these talks deliver. But if, in a globalised world, secrecy jurisdictions use their sovereignty to undermine the actual tax autonomy of the rest of the international community, the other countries are allowed to use their sovereignty to the full to enforce their own domestic tax rules concerning the worldwide income of their citizens.

Concretely, such an expression of sovereignty can take the form of concerted action by OECD and G20 countries.

Action might include measures that touch upon the financial and economic ties with non-complying jurisdictions. In order to avoid more years lost, at the Brussels Summit the G7 leaders should come up with courageous ideas on this issue. As with the BEPS initiative, a key question about AEOI is what's in it for poor countries not represented in the G7, G20 or OECD? Certainly, it will be possible for them to enter into bilateral treaties with OECD and G20 countries committing themselves to reciprocal AEOI.

Focus on tax havens

But in addition to the huge technical challenge of complying with the standard, this poses the question of how useful all these efforts would be. The overall success of the new standard hinges on compliance by more

sophisticated, but secretive, financial centres – and, to a lesser extent, on 'normal' countries exchanging information. Tax havens should be the focus, and preferably through genuinely multilateral arrangements and instruments. If the G7 and OECD are serious about improving the recently discovered tax-development nexus, they should prioritise the flow of tax-relevant information from tax havens to developed and developing countries alike.

The odd thing here is that the bulk of global taxation governance is monopolised by international institutions that exclude poor countries. Will the G7 Brussels Summit, hosted by the pro-development and pro-multilateral European Union, speak out in favour of a substantial upgrade of the United Nations' tax work in partnership with the OECD and other relevant institutions? ■

Improving tobacco control and boosting government revenues

The World Health Organization's Framework Convention on Tobacco Control (WHO FCTC) has been described as the world's first public health treaty. It has been developed in response to the global tobacco epidemic and contains a set of wide-ranging measures and recommendations that will ultimately lead to governments having better control of the tobacco market. What is less well known is the significant impact this treaty can have on increasing government revenues



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The WHO FCTC, the first international treaty negotiated by the WHO, features an extensive series of measures to combat the health impact of tobacco. Some relate to price levels and taxes; others are non-financial approaches, such as regulating the ingredients, packaging and labelling of tobacco products, and promoting smoking cessation campaigns and research.

The FCTC's governing body, known as the Conference of the Parties, can make recommendations and decisions to promote the implementation of the treaty by adopting a protocol. Added to the FCTC at the end of 2012, the first protocol, Illicit Trade Protocol (ITP), focuses on eliminating the illicit trade in tobacco products. A total of 53 countries, plus the European Union, have now expressed their political approval of the treaty by signing up to implement the protocol, and that number is likely to grow over the coming months.

The ITP is the framework that will help governments across the world control the supply chain more effectively and consistently. A key element of the protocol

is the requirement that a global track and trace system for tobacco products – seen as being fundamental in helping to stop the flow of illicit products – is established within five years of the protocol coming into force.

The problem and the solution

Customs officials across the world face the constant challenge of trying to prevent cross-border smuggling by sophisticated and well-funded criminal operations. The WHO estimates that up to 600 billion cigarettes are circulating in the black market, which represents about 10 per cent of the total cigarette market. This is, without doubt, a global problem.

The illicit trade in tobacco products comes in many forms, from petty criminal activity to the work of highly organised criminal gangs. The activity can be broadly categorised into three areas:

- Smuggling involves moving undeclared products between tax jurisdictions operated on a small scale by individuals or highly organised gangs trading very large quantities;
- Counterfeiting of cigarettes requires access to raw materials and equipment and often involves large-scale manufacturing. The resultant cigarettes have none of the safeguards of legitimate products and often have highly increased toxicity levels; and
- Tax evasion involves the falsification of shipping and taxation documents to allow criminals to take advantage of different tax levels between territories without physically moving the products.

The crimes are similar and interlinked and all have the same outcomes – impacting public health, fuelling criminal activity and reducing government revenues.

The WHO's Tobacco Free Initiative (a WHO programme set up in 1998 to focus

international resources and attention on the global health issue of tobacco) recommends that the most up-to-date technologies should be adopted, wherever possible – in particular, state-of-the-art monitoring of the supply chain, and tracking and tracing systems on products themselves. Introducing track and trace technology would give each pack of cigarettes a unique identity stored centrally on a secure database.

WHO FCTC also requires a unique, secure and non-removable identification marking to be fixed to each pack.

Highly secure labels and printing technologies have been used to great effect in this area, and with the addition of unique, machine-readable barcodes this provides law-enforcement officials with a powerful set of tools.

Customs officials can be armed with barcode scanners and authentication tools to rapidly identify and prosecute illicit trade and facilitate genuine trade.

The challenges for governments are to select and integrate the technology into existing processes, retain implementation independence from the tobacco industry and ensure that taxpayers get value for money.

The benefits

Many countries already run successful tax stamp programmes for tobacco, alcohol and pharmaceutical products. In 2011, more than 80 governments had tax stamp programmes in place and there were over 150 billion tax stamps in use to fight illicit trade and boost government revenue.

That means there are still more than 100 countries that could benefit from implementing a government revenue solution on tobacco products. It is estimated that close to \$33 billion in tax on tobacco products is not being



collected. These countries are missing out on significant and predictable sources of government revenue. As illicit products are blocked from the market, consumers switch to taxed products, which increases tax collections.

The partner: De La Rue

As more countries seek to adopt the WHO FCTC treaty and accompanying protocol, De La Rue's status as a long-term trusted partner of governments in areas of key national interest, such as banknote production and identity systems, means it is well positioned to help governments introduce robust revenue protection schemes. Its Government Revenue Solutions business has introduced schemes in 20 countries across the world.

De La Rue's track and trace system is specifically designed to support government revenue protection programmes. It links secure stamps and unique codes to a central database holding important production and tax data, enabling government officials to track activity and verify products quickly in the field.

Based on De La Rue's experience, introducing unique identifying marks to individual products will enable product verification, significantly reduce illicit trade and boost revenue collected on the sale of high-tax products. Across North America,

Europe, Asia and Africa the implementation of unique code verification systems has led to significant gains, including revenue increases in excess of 100 per cent.

Stemming the huge tide of illicit cigarettes passing through borders and circulating in countries on all continents can only be achieved through coordinated and sustained efforts by police and customs officials, government departments and

industry experts sharing knowledge, best practice and information across borders.

A coordinated approach can deliver a significant return on investment for taxpayers. The benefits to governments are clear – compliance with the WHO protocols, reduced illicit trade and better health controls, which are all funded by the improved collection of existing taxes.

Helen Cochrane is an expert advisor to both governments and global organisations on the critical elements of a successful revenue protection programme to help combat illicit trade. Driving product and market strategy in De La Rue, Helen also manages key stakeholder relationships and works with organisations such as the WHO, WCO, UN and product manufacturers. Helen regularly travels internationally advising clients and stakeholders on strategies to combat illicit trade, protection of revenues and health while maximising genuine trade and cross-border activity.

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