Can Stopping 'Tax Dodging' by Multinational Enterprises Close the Gap in Development Finance?

Maya Forstater

Abstract

International debates on taxation and development have been informed by a popular narrative that there is a large 'pot of gold' for funding which could be released by cracking down on the questionable tax practices of multinational enterprises, and which could bridge the gap towards funding the sustainable development goals. How much of this is wishful thinking and how much really reflects what we know? This paper looks at the 'big numbers' that have shaped this debate and seeks to clarify the emerging evidence.

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Foreword

At the Financing for Development conference in Addis Ababa this past summer, the issue of 'tax dodging' and illicit flows was higher up the agenda than ever before. Credit for this is due in no small part to the various non-governmental organizations that have built up public consciousness through sustained campaigns focused on the tax affairs of multinational companies. In this paper, Maya Forstater finds that estimates of corporate tax dodging are often presented, mistaken, or repurposed in a way that exaggerates potential impacts - for example, large aggregate tax loss estimates are compared with aid revenues or healthcare funding gaps, implying that taxes raised in China, Brazil and South Africa might be available for public spending in Cambodia, Haiti and Malawi. Multi-year tax estimates are compared with annual costs of nurses or teachers. In some cases larger estimates ('trillions') which relate to estimates of corruption, informal sector activities or offshore assets held by domestic citizens are mistakenly repurposed to represent complex tax planning practices of multinational corporations. Forstater argues that much-quoted figures such as "developing countries lose three times more to tax havens than they get from aid each year" and "'60% of global trade takes place within multinationals" or "Zambia could have doubled its GDP" are not likely to hold up to scrutiny. The potential for governments to raise additional revenues by taxing multinational companies is limited by the actual levels of profit generated by foreign direct investment in each country; changes to effective tax rates may also have impacts on investment prospects.

I am pleased to sponsor this paper as part of CGD's work program on financial and tax transparency. Tax avoidance is a serious problem and it is important that we understand the numbers. Forstater's work is by no means an attack on the integrity of researchers or activists who have worked hard to bring attention to the problem of illicit financial flows. Rather, it provides a useful touch of realism to temper excessive claims regarding tax losses to developing countries from behaviors and rules associated with multinational corporations. It flags the problem well: to generate awareness and mobilize support for policy changes one needs "headline numbers" and comparisons, such as with the cost of health provision, that convince people of the need for action. However the same numbers can create false expectations regarding the potential gains. The paper is more on the discussion around the numbers and their use than on the numbers themselves – it does not present new estimates of the likely losses – but is nonetheless valuable.

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Summary

International debates on taxation and development have been informed by a popular narrative that there is a 'pot of gold' for development funding which could be released by cracking down on the questionable tax practices of multinational enterprises.

However, perceptions of the scale of public revenue at stake have become inflated – with available estimates often assumed to be larger than they are; many times more than aid in the countries concerned, enough to close gaps in public funding of healthcare and education, hundreds of billions of dollars in the poorest countries, or trillions overall across developing countries. This narrative has been successful in raising public awareness of taxation for development. However, these inflated perceptions are based on a series of misunderstandings.

Unrealistic expectations cloud the perhaps obvious reality that while businesses should pay tax on the profits they make, the potential for countries to raise more from taxing international business is limited by actual level of activity by foreign companies within each country, and that changes to the effective tax burden may also have impacts on investment.

Estimates by NGOs, academics and international organizations do shed light on the order of magnitude of the revenues at stake, with recent estimates suggesting that tax revenue losses might be in the order of $100-200 billion across all developing and emerging economies. This is by no means an insignificant sum of money, but it is a statistical observation and should not be interpreted as an estimate of the actual amount of money that could be collected in practice. Nor should its scale be exaggerated in relation to poverty reduction and public spending need, when considered in relation to the specific countries where taxes are likely to be collected. Overall any gains in revenue from international policy changes will tend to be higher in middle-income emerging economies, and lower in the poorest countries. However, extractive industry rents offer a significant focus for greater domestic revenues in some countries.

Misunderstandings in the presentation of evidence contribute to a dynamic of polarised attack-and-defense in the debates between NGOs, business, tax experts and policy makers. A common language and understanding of the numbers and issues is a crucial step towards developing a more constructive dynamic, one that can support learning and evidence-based action. The paper does not make specific policy recommendations but offers a framework and a set of process recommendations to enhance shared understanding of the emerging evidence.

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Comments are welcome and should be sent to hiyamaya@gmail.com.

1. Introduction

The ability of states to mobilize and deploy resources to deliver the foundations of infrastructure, rule of law and public services is at the heart of development. Taxation is both the primary means by which they do this, and is critical to the politics of accountability between state and citizen. It provides a predictable and stable flow of revenue to finance public spending, and shapes the environment in which investment, employment and trade takes place.

Issues of international taxation have attracted wider and more intense interest in recent years, in particular boosted by outrage in Europe and in the US over the tax affairs most notably of US technology companies. This in turn has been linked to the search for sustainable sources of finance for development. As the UK Guardian summarised in the lead up to the 2013 G8 Summit:

> *"Western governments, still suffering the aftershocks of the 2008 financial crisis, need money to repair their public finances. Voters are angry that the likes of Google, Amazon and Apple are minimising their tax payments – perfectly legitimately – because the global tax system has not kept up with the times. But it is developing countries that are the biggest losers."*

Work done to date on tax and development by campaigners has had notable success despite the complexity of the topic, and the limited resources and data at their disposal. International NGOs have managed to get a forbiddingly technical topic onto the public agenda in their home countries, and advocate for changes in domestic tax law, and international agreements. This has played a major role in the political momentum for the OECD work on 'Base Erosion and Profit Shifting' (BEPS)

> *"Only after journalists and nongovernmental organizations told the story of BEPS in ways that were understandable by people other than tax specialists did sufficient public interest arise to motivate the analysis that currently is being led by the OECD. Unless countries today put in place understandable means of evaluating progress in curtailing Base Erosion and Profit Shifting, the global public might lose its ability to assess political leaders' progress in achieving international tax reform, endangering the viability of the reform process."*

Michael Durst, former Director of the IRS Advance Pricing Agreement Program

But policy debates about the best way forward following the first phase of the BEPS program remain polarized. In a field that is technically complex, political momentum is often driven by popular narrative. It is commonly believed that there are large amounts of untaxed or under-taxed economic activity in the poorest countries, due to the sophisticated tax planning practices of multinational enterprises, and that addressing this would go a long way in mobilizing the resources needed for countries to achieve key development goals. But there are reasons for caution in accepting this narrative as a self-evident truth, as it is often shaped by misunderstandings and wishful thinking. Numbers used interchangeably have become detached from the explanations and caveats underpinning research, becoming the source of potent myths which lead to polarization and to confusion. The lack of common definitions also makes it difficult for campaigners, researchers, tax practitioners, businesses and policy makers to engage constructively to test assumptions and find common ground for workable solutions.

The aim of the paper is to support the foundations for ongoing research, and for constructive engagement and dialogue between experts, practitioners, researchers and campaigners, by offering a basic framework of language, clearing up some of the misunderstandings around the 'big numbers' and then setting out a basic review of what we know about the issues of concern.

2. Clarifying definitions and context

The issues

This paper is focused on the headline issue of tax losses to developing countries from the behavior and associated rules related to multinational enterprises.[1]

The headlines and debates mainly concern taxes on corporate profits ('corporation tax' or corporate income tax (CIT)). While there are economic trade-offs between taxing profits and encouraging investment, there are several good reasons to tax corporations in this way: a corporate income tax prevents people avoiding or deferring their personal incomes through incorporation. It also does double duty as a tax on location-specific economic rents in the places where a company does business. Administratively taxing company profits, particularly from the largest enterprises, offers an attractive source of revenue, as its concentrated, formalized and accessible making it relatively straightforward to administer. Politically it is popular for redistributive reasons. In particular corporation tax applied to the profits of inward foreign investment are seen as a means to effect a transfer of resources from rich-world shareholders to developing country governments and from there to public service users (Shaxson, 2015). However, in practice as the paper discusses the incidence of the tax can also fall on workers or consumers through effects on investment.

Section 4 of this report provides a short review of the available evidence as to the scale of the problem. Section 3 unpicks some misunderstandings that have built up around this evidence.

One of the challenges in understanding the debate is that there is a tendency to aggregate a wide set of issues and tax payer behaviors into a single bundle – popularly labeled 'tax avoidance', 'tax dodging' or 'tax cheating'[2], or in more formal analysis as 'tax related illicit flows' (Hearson, 2014). The concerns that may be included under this heading in practice range from theft of public assets to legally using tax incentives, while the taxpayers involved include foreign multinationals, domestic multinationals, domestic companies and state owned enterprises. While there are many legitimate questions and debates about the design of tax policy, and about expectations of corporate responsibility, presenting a wide spectrum of behaviors under a single heading presents an unnecessarily blurred target for understanding the issues, the amounts of public revenues at stake, and the potential policies and standards to address them.

[1] Other issues in the headlines concern personal taxes paid by high-net worth individuals, and the potential to evade these through international secrecy.

[2] See for example: http://www.taxjustice.net/faq/

Shades of gray

It is generally recognized that taxpayer behaviors occupy a spectrum between illegal ('tax evasion') and legal ('tax compliance') (See for example Beloe, Lye and Murphy, 2006 and Hearson, 2014). While there is broad recognition of the two ends of the range, the middle section (often described with the broad term 'avoidance') is made up of several distinct categories:

- There are genuine 'gray areas' of **legal uncertainty** where the outcome is not clear until it is decided by a legal authority. This is an unavoidable feature of taxation since it is complex and vulnerable to abuse through the creation of complex vehicles, off-setting transactions, and other elaborate devices to "shelter" income. Therefore courts, tax tribunals or commissions can decide on a case-by-case basis whether a taxpayer is complying with "what the law demands" (Messick, 2014). Where courts decide that tax that has been avoided should in fact be payable this has been termed 'ineffective avoidance' (Devereux et al, 2012). One argument that is made is that responsible businesses should steer clear of any possible tax uncertainty (Quentin, 2014).

- Some argue that there is a broader gray area beyond legal interpretation, which relates to contravening the **'spirit of the law'**. However, there are no clear and agreed standards to define what this means in practice, and descriptors such as 'artificial' and 'aggressive' lack detailed definitions and boundaries (Lewis, 2015). In most jurisdictions courts already seek to give effect to the spirit of the law through purposive interpretation and anti-abuse rules. Devereux, Freedman, and Vella (2012) argue that it is therefore inconsistent with the rule of law to try to invoke a further mystical 'spirit' which is different from the interpretation of legislation by the courts. Where a defect (or 'loophole') in the legislation is found, they argue, the most efficient course of action is to revise the specific legislation or to improve the general anti-avoidance provisions and principles.

- A third set of arguments concern situations where tax behavior is not tested against legal compliance but judged by **moral acceptability**; this is the core of the agenda which has been termed 'tax justice'**.** As Margaret Hodge, then Chair of the UK Public Accounts Committee, told Google's vice president for Europe: 'We're not accusing you of being illegal, we're accusing you of being immoral'. This sense is articulated by Christian Aid: 'we need to consider not just the spirit of the law in its narrow sense, but in its broader sense: the spirit in which taxes are paid to help enrich our societies in more than just financial terms: *Tax for the common good*' (Christian Aid, 2014). The Independent Commission for the Reform of International Corporate Taxation also focuses on this area saying that abusive corporate tax practices can include situations *'where the practices of corporations are within the law.*' (ICRICT, 2014). Clearly this is the least well defined of the gray areas since there is no clear standard for moral tax behavior or outcomes. The Tax Justice

Network offers this criteria for unacceptability: 'If any reasonable person, newspaper or government […] might want to change the law to prevent others acting in the same way in the future.' (Tax Justice Network, 2012). While this definition captures the spirit of demands for tax justice, it also highlights the difficulty of defining practice in this area, since reasonable people can and do disagree on potential legislative reforms.

The concerns in each case are different, and require different remedies. Broadly, the first calls for better enforcement of existing laws, the second calls for tightening of anti-avoidance measures to close down loopholes, while the third might be a case for broader legislative changes.

However often confusion arises because arguments, estimates and examples which relate to one of these areas are elided with others. For example Oxfam argues in their briefing paper, Business Amongst Friends (2014) that multinational corporations *'escape their tax obligations, particularly in poorer countries, […denying] governments the vital revenues that are rightfully theirs to spend on essential services'*. Few would defend companies that seek to escape their rightful tax obligations under the law. However the same paper says that '*quibbling about legality misses the point. It is time to develop rules that are fair and work in the interests of all'*. Again, no one would argue that tax rules should never be reformed. But this slipping and sliding between issues allows revenues which *might* be due under alternative legislation to be presented as if they were *current* legal obligations of companies. As Allison Christians (2014) argues, the conflation of tax evasion, tax avoidance and broader questions of moral outcomes into a single message by activists and the media is counterproductive to coherent debates on tax policy and to the rule of law.

While this paper does not argue for or against particular proposed solutions within any one of these areas, it does argue that they should be the subject of clearer public debate and evidence. The 'right' answer as to the best way forward does not belong exclusively to legal interpretation, economic analysis or moral reasoning, nor can it be read off from popular anger and political pressure. Assessments the practicality, potential benefits, costs and risks of different pathways should involve exchange of understanding between experts in these different domains. This requires some common use of language.

Four categories of taxpayer behavior

The paper offers basic a framework of four descriptive categories to understand how estimates and case examples of types of taxpayer behavior relate to the legal spectrum and gray areas above:

1. **Evasion, illegality or corruption**: For example hiding payments, underreporting revenues and making corrupt side payments.

2. **Potentially ineffective avoidance:** Pursuing opportunities to reduce taxes which are at high risk of falling foul of legislation, such as using marketed tax avoidance schemes or setting transfer prices at barely defensible levels.
3. **Tax planning:** Structuring a business in ways that has tax advantages, but which are commercially justifiable choices and remain low risk in relation to legal challenge.
4. **Uptake of incentives:** Pursuing opportunities to reduce taxation that have been explicitly intended by legislation through undertaking the behaviors encouraged (e.g. using capital allowances or setting up a factory in a Special Enterprise Zone).

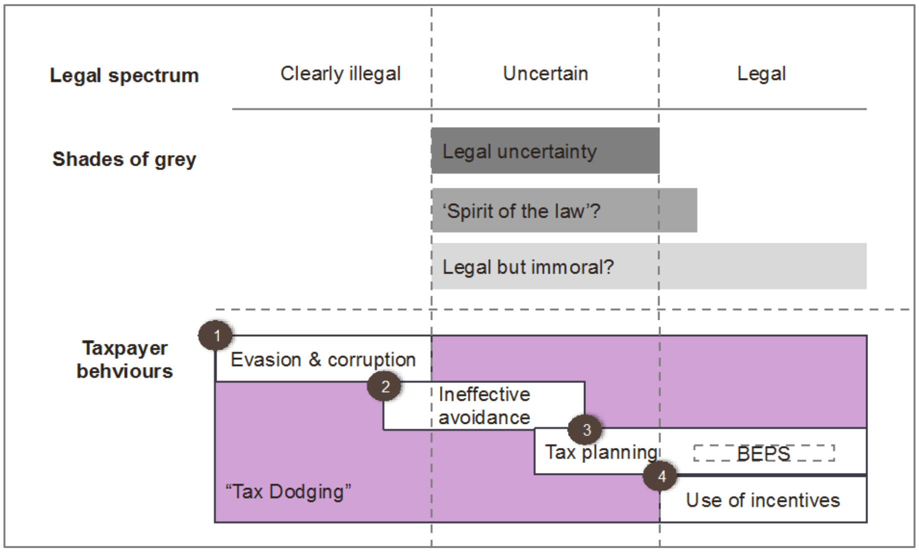
The first category can be defined by its dependence on secrecy; concealing payments and hiding the true nature of business transactions or relationships – businesses may be thought of as 'ghosts' (invisible to the tax authorities) or 'icebergs' (hiding a substantial proportion of their true size). It may involve complex structures and transactions but can involve more straightforward practices such as undeclared cash income, falsified expenses or the complicity of tax officials.

The second category of involves potentially 'ineffective avoidance', which could be tackled by existing laws, provided it is discovered. Such avoidance does not necessarily entail secrecy, but may involve complex structures and legal risk-taking.

The third involves clear compliance with tax rules. However actions that are in line with legislation in one country may have negative impacts in another. The OECD's work on combating Base Erosion and Profit Shifting (BEPS) (defined as "behaviors or arrangements which achieve no or low taxation by shifting profits away from jurisdictions where the activities creating those profits take place") generally concern structures and transactions that are currently in the legal tax planning category, but which could be shifted into the 'ineffective avoidance' category through anti-avoidance measures (Durst, 2015).

The fourth involves taxpayers responding to tax reliefs and incentives that are explicitly offered. The key argument here is that these incentives can be poorly targeted and inefficient. They may have been put in place as a result of corporate lobbying rather than a clear economic cost benefit analysis, and can offer windfalls to companies that would have invested anyway (Hearson, 2013). Reforming tax incentives demand a domestic response (possibly with regional coordination), rather than depending primarily on international tax rules and agreements. Figure 1 describes the overall framework.

Figure 1: A framework for understanding what is meant by 'tax dodging'



Context

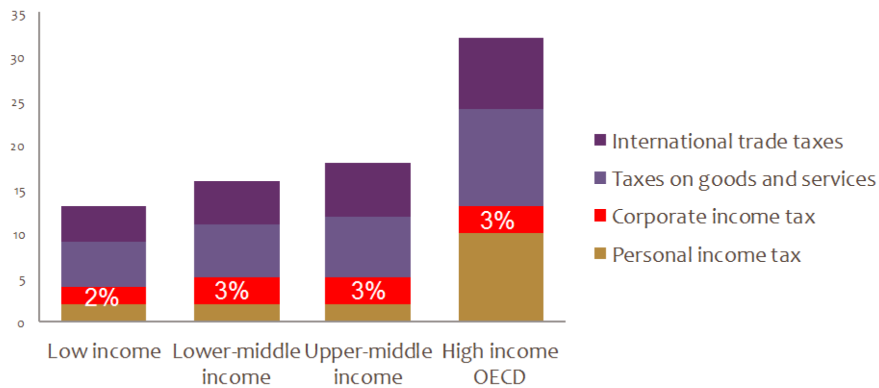
This paper is particularly focused on the 'tax dodging debates' in relation to financing for development.

Overall domestic tax revenues are rising in developing countries (amounting to some $7.7 trillion in total – World Bank, 2015).[3] However for many countries the levels are still far below what would be needed to deliver comprehensive public services (for example annual per capita revenues amount to $32 in Ethiopia and $62 in Bangladesh, rising to $600 in upper middle income countries like China and Colombia).

While the main reason for low tax revenues is low per capita income, developing countries also tend to have low tax-to-GDP ratios (20 percent or less compared to upwards of 30 percent in developed countries), and these have risen only slowly despite economic growth. There is acknowledged potential to raise taxation by several percentage points (Le et al, 2012 and Fenochietto and Pessino, 2013). However, it should not be assumed that this difference is solely, or even mainly, caused levels of corporate taxes collected or not collected. As Figure 2 shows, differences in corporate tax only contributes a small proportion to the overall difference between developed and developing country tax ratios, with the greatest different being in personal taxation (including property taxes).

[3] There is no single established criteria for the designation of "developed" and "developing" countries, but broadly for statistical purposes the UN officially divides the world into developed and developing regions. Developed regions are Northern America, Europe, Japan, Australia and New Zealand, and everywhere else is considered developing. This overlaps with the World Bank categories of low income, low-middle-income and upper-middle income countries.

Figure 2: Taxes as a proportion of GDP



Source: Base on IMF, 2011

It is well recognised that developing countries tend to be more dependent on corporate tax than developed counties, relying on a narrow tax base of a few large formal sector businesses (including multinationals and often the extractive industry). As Action Aid (2013) notes "*In developing countries corporate income tax often represents a high proportion of taxation from a small number of taxpayers: the largest companies."* UNCTAD reports that in developing countries the taxes paid by international businesses (including corporate tax, natural resource royalties, trade and property taxes) represent some 23 percent of taxes on business and 10 percent of total tax revenues, compared to around 15 percent and 5 percent, respectively in developed countries. (Bolwijn, Casella and Rigo, 2015).[4] This pattern is also illustrated by figures reported on an ad hoc basis for example:

- In Zambia a few large enterprises account for the majority of tax revenue (60-70 percent of total tax revenue) (Fjeldstad & Heggstad, 2011).
- In Tanzania the 400 largest taxpayers account for 70 percent of domestic revenues (Katillya, 2011).
- In Rwanda micro, small and medium-sized enterprises make up 98 percent of taxpayers but only provide 3 percent of the revenue. 70 percent of taxation comes from multinational enterprises and 0.3 percent of taxpayers pay 48 percent of the tax authority's revenue (Rwanda Revenue Authority, 2009).
- Nigeria reported that multinational corporations represent 88 percent of the county's tax base (ATAF, 2014).

[4] This overall estimate depends on assumptions about what percentage of individual taxes are paid by multinationals which have been questioned, with the suggestion that UNCTAD may have been overgenerous in their assumptions (Cobham, 2015).

- Burundi has stated that one multinational taxpayer contributes nearly 20 percent of the country's total tax collection (North South Institute, 2010).
- In Uganda less than 1 percent of the population are registered as individual income tax payers. Corporate income tax revenues depend on a few multinational corporations with the top five companies accounting for 40percent of corporate income tax revenues (Oxfam/Tax Justice Network, 2014).

Ensuring that businesses, including international businesses pay tax is clearly an important part of domestic resource mobilization. However it is just one of a number of challenges and limitations to raising the level of tax revenues. Other factors include low absolute incomes, large informal sectors and low rates of collection of tax on domestic incomes such as personal taxes on professionals and property owners (Moore, 2013). Furthermore, domestic tax sources are likely to be more robust, give a wider tax base and links citizens to the political process. However broadening the national tax base depends on a difficult process of building institutions, capacity and trust, and the political will to tax local elites.

3. Unpicking three Sticky IDEAS

Chip and Dan Heath in their book Made to Stick: Why Some Ideas Survive and Others Die (2007) set out six things that together can make an idea memorable and interesting enough to win out in the battle for attention: *simplicity, surprise, concreteness, credibility, emotional resonance* and *specific stories*.

Discussions on policies to enable developing countries to raise greater revenues from taxing multinationals have been shaped by three powerful sticky ideas, often backed by specific stories involving brand-named and familiar companies:

1. **Cracking down on tax avoidance multinational corporations** would go a long way to solving the problem of finance for development in poor countries.
2. **Transfer pricing is a system that rigs the rules** to allow multinationals almost unlimited scope to shift profits and avoid paying taxes.
3. Governments of developing countries could raise significantly more tax at **no cost to ordinary citizens.**

These statements are of course somewhat stylised, although the quotes below illustrate some pithy examples of the viewpoints being articulated, and the cases and data that appear to support them.

While these statements may not reflect the more nuanced opinion of experts (even including those quoted below), nevertheless they are popular received wisdoms which are reflected and reinforced by the overall flow of media reports, infographics, press releases, case studies and campaign publications which shape this debate. Often they are based on basic misunderstandings. They gain credibility because of the apparent corroboration between the multiple presentations of estimates of developing country tax losses, alongside media reporting of individual company tax rates of major companies (sometimes showing tax as low percentage of turnover as self evident demonstration of 'tax dodging') – leading to the perception that it is an established fact that inadequate funding for public services in developing countries is caused by artificial erosion of taxable profits by multinational companies, and could be solved by international policy changes.

This perception is influential enough to require clarification in order to get on to a more robust discussion of the potential for development gains from international tax reforms and responsible corporate tax behaviour.

IDEA 1: problem-solving amounts of money

The amounts of money involved in tax avoidance and exemptions by multinational corporations are huge in relation to the budgets of developing countries, and the development needs particularly of the poorest countries.

"If we tackle tax dodging by big business, we can fund free, quality healthcare & education for all."

Global Alliance for Tax Justice, Share-graphic 2015.

"Clearly, massive reductions in existing human rights deficits could be achieved by allowing poor countries to collect reasonable taxes from multinational corporations and from their own most affluent nationals, assuming the resulting revenues were appropriately spent."

Thomas Pogge (2015) How Are Human Rights and Financial Transparency Connected?

As highlighted in the previous chapter total annual tax revenues in many countries are still far below what would be needed to deliver comprehensive public services (revenues ranging from $32 per person in Ethiopia and $62 in Bangladesh to $600 in upper middle income countries like China and Colombia).

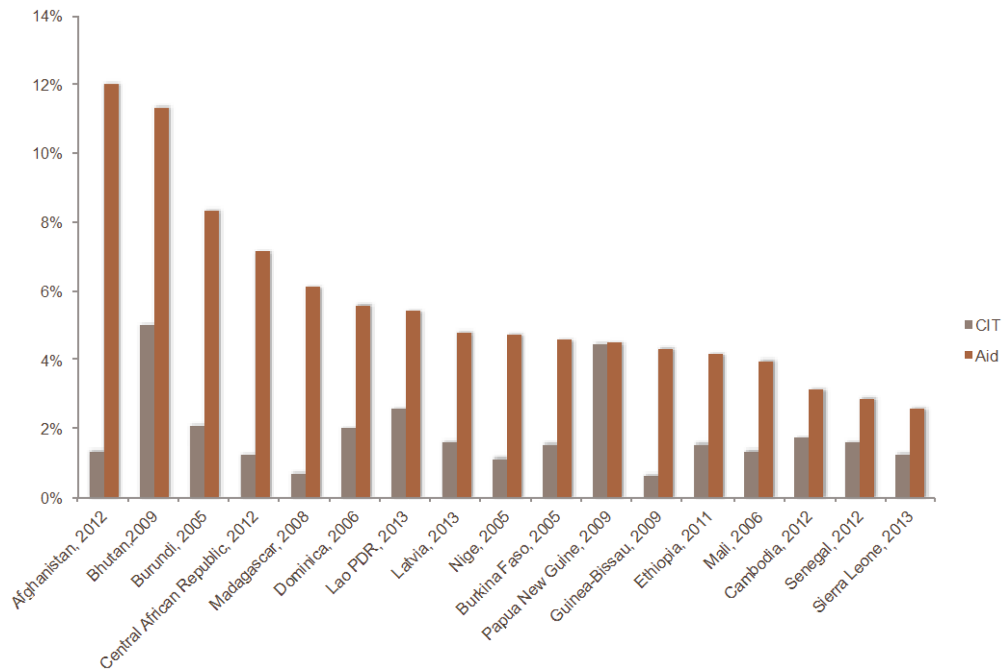
This can be compared with estimates for the amount of funding needed to deliver basic services and safety nets. The cost of very basic healthcare has been estimated as starting at $86 per capita for poorer countries. The cost of basic education starts at around $50 per person. These figures rise as countries become richer and are able to provide more than the very basics. Benchmarks such as 6 percent of GDP for education and 5 percent for healthcare are suggested by international agencies. Overall the Overseas Development Institute estimates that the cost of delivering a basic package of cash transfers and universal basic health and education ranges from around $150 to $480 per capita for low to middle income countries, if services are delivered efficiently (Greenhill et al, 2015). This does not include costs of upgrading transport, energy and water infrastructure and other key areas of public spending, which are also needed.

The problem of financing for development then has been conceived of as the gap between these two sets of numbers – tax revenues (supplemented by aid) on one hand and public spending needs on the other.

The perception that 'fairer' corporate tax revenues could solve this problem of inadequate financing for development in the poorest countries is morally attractive, but mathematically implausible. The world's poorest countries are generally not the home to large and profitable business communities. The difference between total revenues and the cost of adequetely meeting basic needs in the poorest countries is large; current corporate tax receipts would need to be multiplied several times to close the gap.

This is illustrated in Figure 3, drawing available data from the ICTD Government Revenues Database. Current overall corporate taxes (from domestic and multinational businesses) are generally much less, (often several times less) than aid receipts for the most aid dependent countries.

Figure 3: Corporate Income Taxes and Aid as a percentage of GDP



[Source: based on data from ICTD Government Revenues Database]

Where has the assumption that the value at stake from 'corporate tax dodging' could solve the financing gaps for development in the poorest countries come from?

Often simple mistakes have lead to expectations becoming inflated by an order of magnitude. Potential tax gains have been reported as amounting to *several times the value of aid*, and is often assumed to be *hundreds of billions* for Africa alone

Four common mistakes that inflate perceptions of scale

Four common mistakes and misinterpretations tend to encourage, and reflect inflated perceptions of the potential for multinational corporate tax revenues to close development financing gaps:

1. **Wrong countries** – This often arises from a basic mismatch between the popular understanding of the term 'developing countries' and the international bureaucratic one. Estimates of revenue losses attributed to developing countries relate mainly to major emerging economies such as Brazil, Mexico, China and South Africa. However the aggregated totals are often misinterpreted as if they can be ascribed to low-income countries, as the example in box 1 highlights. Often aggregate tax loss

estimates are compared to aid volumes or to calculations of development finance need (see box 3). However, it is unlikely that taxes raised in Mexico and China will be spent in Malawi and Cambodia (examples of such comparisons include Oxfam's statement that corporate tax dodging' amounts to enough to get *'every child into school four times over'*, and the ONE Campaign's statement that *3.6 million deaths could be prevented each year in the world's poorest countries*).[5] The tendency to rhetorically apply estimates of potential tax revenues mainly related to large emerging economies to the public budgets of least developed countries is not confined to NGOs. Most recently the World Bank's Managing Director Sri Mulyani Indrawati presented an estimate of tax avoidance across all developing countries and illustrated it with examples of public service gaps in Haiti, Malawi and Bangladesh.[6] Similar lopsided comparisons are made at a regional level – for example Oxfam calculated tax losses across Africa and compared this to the healthcare funding gap in Sierra Leone, Liberia, Guinea and Guinea Bissau (Oxfam, 2015) – in fact their estimate largely relates to Nigeria, Egypt, South Africa and Morocco.[7]

2. **Wrong numbers** – In some cases the wrong number is used altogether. Estimates of illicit financial flows (IFFs) through trade misinvoicing issued annually by the NGO Global Financial Integrity are often misunderstood by others as an estimate of tax loss (See Annex 1 for more details on illicit flows estimates). One widely reported example is the statement by the Africa Progress Panel in 2013 that $38 billion dollars is lost from tax revenue in Africa due to profit shifting.[8] In fact this was a misunderstanding of an estimate of gross capital flight through illicit flows (Forstater, 2013). Many other reports appear to confuse (or allow for confusion) of such illicit flows with tax revenue losses (For example see Lomborg, 2014, Oxfam, 2015b and Hickel, 2015). Estimates of capital flight are often set against public spending needs, allowing readers to wrongly assume that the estimated amount involved involved would, if illicit channels were closed, translate directly into a public revenue flow.

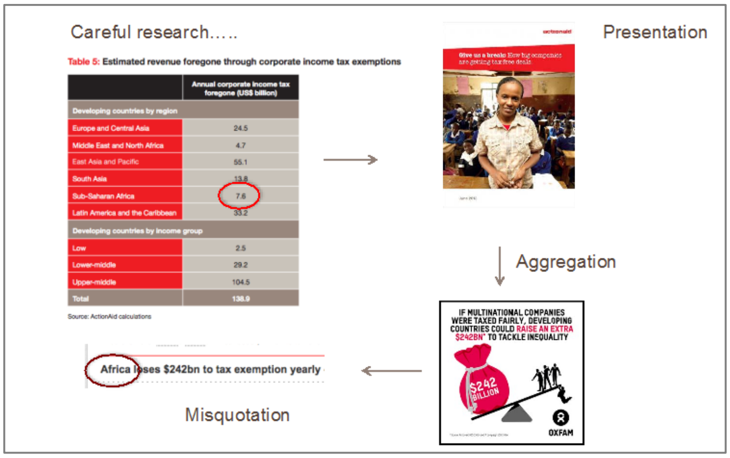
[5] Another methodology which appears to inflate development impacts of projected tax gains, without simply applying sums from larger countries to the budgets of smaller countries, is the child mortality analysis used in Christian Aid's Death and Taxes report (2008), which found that trade related tax evasion 'costs the lives of 1,000 children a day'. The methodology uses a fixed effect regression to calculate the correlation within countries between tax/GDP and mortality rates. However as tax/GDP ratios reflect the general administrative capacity of the state and have tended to rise slowly, at the same time as GDP levels have been rising rapidly it seems a stretch to conclude that this regression captures the impacts of tax/GDP as an independent variable which could be applied to a small tax rise achieved through an international policy shift.

[6] http://www.worldbank.org/en/news/speech/2015/04/17/speech-wb-md-coo-sri-mulyani-event-tax-evasion-development-finance

[7] http://www.cgdev.org/blog/talking-about-tax-taxing-pretending-it-simple-will-hurt-poor

[8] Also see for example http://www.bbc.co.uk/news/world-africa-23965543 and https://euobserver.com/social/122484

Box 1: How 7.6 billion became $242 billion



In 2014 the CEO of a major aid agency told an IMF conference that Africa is losing $242 billion a year to corporate income tax exemption and unpaid taxes by companies annually.[9] This was duly reported by the press. This is just one example of such a misunderstanding, but it is one which is useful to illustrate the cycle of misunderstanding, which resulted in the $242 billion figure.

In 2013 careful research seeking to estimate the annual tax foregone in developing countries through tax exemptions came up with an overall figure of $138 billion, with $7.6 billion of this related to Africa (Hearson, 2013). However the photos and cases chosen to illustrate the report meant that all but the most careful reader might have assumed the larger total related to Africa. Another international NGO used the number as part of a larger total relating to exemptions and avoidance, and their CEO then presented this as a figure relating to Africa alone.

3. **Wrong taxpayers** – Estimates relating to one category of taxpayer behavior on the legal-illegal spectrum, are easy to confuse with others, or to report as arising from a different or smaller group of taxpayers. For example the figure that ***$1 trillion is lost through tax avoidance and evasion in Europe*** has been widely quoted by the NGO Eurodad (2013), ETUC (2015) the European Council (2013) and European Commission President (Euronews, 2013 and European Commission, 2014). It is often used to illustrate the scale of the impacts of complex tax planning, and the unwary reader might therefore assume that this is what it refers to. However the original study from which this number is drawn (Murphy, 2012) mainly relates to *tax evasion* in the shadow economy – such as underpayment of taxes through unregistered cash-in-hand businesses. It only includes a guesstimate of tax *avoidance* by all businesses in Europe at $150 billion.[10] Similarly as mentioned above estimates related to 'trade misinvoicing' (a form of fraud) are often assumed to represent the

[9] https://blogs.oxfam.org/en/blogs/14-05-30-africa-rising-time-fairer-deal-all

[10] The main part of this estimate involves multiplying tax revenue as a percent of GDP by the estimated size of the shadow economy in each country, based on estimates from a World Bank working paper which uses the 'MIMIC' model for assessing the size of the shadow economy. However, the underlying estimates on the shadow economy are not viewed as not robust. Furthermore, estimates of the scale of the shadow economy appear to be gross volumes, rather than value added, suggesting that the tax implications are overestimated by calculations which assume that this whole amount could be added to official GDP and taxed accordingly. What data there is suggests that the shadow economy largely relates to informal sector; unregistered cash in hand activity.

impacts of transfer pricing by multinationals. The recent African Union/UNECA report on the High Level Panel on illicit flows from Africa 'Track it! Stop it! Get it!' (UNECA, 2014) uses an estimate based on trade misinvoicing, which has been widely presented as a figure which points to abuse by multinational corporations (see for example Oxfam, 2015a). A recent report by the Open Society Initiative for West Africa, based on analysis by Dalberg Global Development Advisors also falls into the trap of assuming that tax loss estimates related to trade misinvoicing are measures relate to transfer pricing (OWISA, 2015).

Box 2: An Extractive Affair?

A recent Action Aid report 'A Extractive Affair' on the tax affairs of Australian uranium miner Paladin Energy in Malawi compared an estimated tax loss to the government from reduced royalties and withholding taxes, with the cost of HIV medication and the salaries of nurses, doctors and teachers:

"Paladin – just one company cut its tax bill by $43.16 million in Malawi.
In one year this could have paid for one of the following:
431,000 HIV/AIDs treatments, 17,000 nurses, 8,500 doctors, 39,000 teachers"Action Aid (2015)

These headcounts are arresting; representing some 3 times the current number of nurses and over 20 times the number of doctors in the country according the Action Aid's figure.[11] If taxing 'just one company' more could deliver so much for education and health provision imagine the potential across the whole economy.

However, these comparisons are odd. Firstly because they compare an estimate for *six years* of tax revenues with *annual* salary costs, but also because Malawi needs funding in all four areas; for doctors, nurses, teachers AND healthcare supplies (as well as other areas of public spending). Comparing six years' worth of potential tax revenues with the annual costs of 4 different spending gives an inflated impression of what it could pay for, by a factor of 24 (6 x 4). Notwithstanding the question of whether the $43 million figure is meaningful, more realistically it might potentially support the annual costs of 18,000 HIV treatments, 700 nurses, 350 doctors and 1,600 teachers.[12] Of course 700 nurses and 350 doctors is a significant number in itself, but is significantly less the figures of 17,000 nurses and 8,500 doctors, which give an impossibly exaggerated impression of the potential for increasing social spending from taxing FDI profits in Malawi.

Moreover Paladin's Kayelekera Uranium mine is one of very few large FDI projects in Malawi, rather than the tip of an iceberg. It has been loss making to date and is currently shuttered as unprofitable due to a fall in uranium prices, suggesting that the idea that it could have easily yielded an additional $43 million may be wishful thinking.

[11] Author's calculations based on figures given in the Action Aid report
[12] Author's calculations based on figures given in the Action Aid report

4. **Wrong time period –** Often estimates are aggregated over multi-year time periods to produce large numbers, which are harder to contextualize than annual figures. In some cases these multi-year estimates are then compared to annual spending, creating inflated perceptions of scale. Box 2 describes the recent Action Aid report on Paladin Mining in Malawi.

It is widely accepted that the international tax system is in need of reform, and that the artificial erosion of taxable profits in countries in which companies are operating is unacceptable. But collectively these misunderstandings have the result of exaggerating broad, general and fairly modest economic estimates and presenting them as if they represented specific, large amounts that could be collected from a few foreign investors in the poorest countries. No program of action can deliver against such unrealistic expectations. As mental benchmarks, they undermine the ability of the public, media and civil society organizations to evaluate real proposals and progress in achieving domestic and international tax reforms, as well as in considering implications for other aspects of development finance.

Box 3: 'Three Times More than Aid'

Tax dodging by multinational companies costs developing countries 3 times more than they receive in aid *(Action Aid Fact File).*[13]

Tax loss estimates are often compared to aid volumes or to calculations of development finance needs at an aggregate level. One of the most widely quoted figures on tax and development is that ***"developing countries lose to tax havens almost three times what they get from developed countries in aid."*** This comes from a Guardian op-ed written by the OECD's Angel Gurria in 2008. It is seen as authoritative because of the source, although there are no further details about way that it was calculated. A statement by Jeffrey Owen, then Head of the OECD Centre for Tax Policy and Administration gives some clarification indicating that it was intended to relate to tax losses from citizens holding undeclared assets offshore (evasion), not to tax avoidance by multinationals at all; ***"many citizens of developing countries now have easy access to tax havens and the result is that these countries are losing to tax havens almost three times what they get from developed countries in aid"*** (Owens, 2009).

As with other aggregate figures it appears to be based on a comparison between an estimate of tax avoidance related to all developing and emerging economies, and aid receipts which are concentrated on a subset of these countries (for example China in 2012 received around 1 percent of international aid according to OECD DAC statistics, but as the world's second largest economy will tend to contribute a large amount to any measures based on economic aggregates). It would be a mistake to assume that from this ratio that for individual aid-dependent countries there is a sum that is three times greater than aid at stake from taxing FDI *or* offshore assets of domestic high net worth individuals.

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[13] http://www.actionaid.org.uk/tax-justice/ftse-100-tax-haven-tracker-the-new-data

IDEA 2: Transfer pricing is tax dodging

Transfer pricing rules allow multinational enterprises to import goods at hugely inflated prices and export commodities at a fraction of their true value: Addressing transfer mispricing by multinationals would generate large volumes of public revenues in both their home countries and the places where they do business.

> ***"Many multinational corporations launder profits earned in developing countries by importing goods at hugely inflated prices and exporting commodities at a fraction of their true value. They do this through paper subsidiaries in tax havens, providing them with a significant tax advantage over their nationally based competitors and fleecing governments of tax revenue".***
>
> Christian Aid (2005)

> ***"The most common way multinationals avoid taxes is through "transfer pricing", in which their subsidiaries in tax havens buy goods cheaply from arms in more exacting countries, and then sell them on at a higher price, thereby shifting profits to the tax haven."***
>
> The Economist (2015)

Transfer pricing is perhaps the most widely misunderstood concept in international tax debates. It is often described (perhaps as a shorthand) in a way that makes it appear to be synonymous with *mispricing* or abusive profit shifting. For example Paul Collier (2013) describes it as ***"a well-established method of avoiding paying tax"***, James Boyce and Léonce Ndikumana (2014) define it as "***the manipulation of prices assigned, for accounting purposes, to intra-firm trade in goods and services so as to park corporate profits in low-tax (or no-tax) jurisdictions."*** Tax Justice Network report highlights with concern that in a survey assessing the economic practices of multinational corporations, ***80 percent acknowledge that transfer pricing remains central to their tax strategy*** (Tax Justice Network Africa, 2011).

Engaging in transfer pricing is a compliance obligation for businesses that have branches, subsidiaries or other connected companies in more than one country. Taxation rules in OECD countries, as well as most emerging and some developing countries require that companies apply a fair price for goods, services and interest when making transactions amongst its different entities. Usually the standard applied is some version of 'arm's-length pricing' (i.e. the price that would be paid if the company was buying or selling on the open market).

It is clear that the transfer pricing system is under strain. As global value chains have become increasingly complex, the tension between source and residence taxation (i.e. between taxation accruing to the government in the place of business, or in the source of capital) has multiplied, as many different places of business (R&D, extraction, manufacturing, management, brand management, marketing) contribute to the ultimate realisation of profits (Devereux and Sørensen, 2006). The arm's length price of management services, brand IP and other intangibles can be difficult to determine. Even in a domestic context it is not always easy to price goods and services. Allocating costs across products, or cost centres, is more of an art than a science. There can be considerable scope in practice for companies to structure their operations, management of IP and borrowing costs to allocate costs and revenues in a way that reduces their taxable profit overall (KPMG, 2008). The OECD's Base Erosion and Profit Shifting (BEPS) project has focused on identifying workable ways to better align international taxation to the realities of globalized and mobile business – with a particular focus on transfer pricing, amongst other areas.

For smaller and poorer countries there are additional challenges, both practical and in terms of the pressures for tax competition (Durst, 2015). Many poorer developing countries lack the capacity to undertake transfer price audits, and some do not have transfer pricing rules in place. Even if not actively reducing tax, companies tend to respond to the disparity in transfer pricing expertise and capacity between the revenue authorities of different countries by taking care to avoid the risk of transfer pricing disputes with the most aggressive and powerful revenue authorities, which can lead to companies apportioning greater profits to developed countries, even if it doesn't reduce their tax bills overall.

The OECD BEPs project has created a framework for incremental improvements to regulation of transfer pricing, but questions remain as to what this means for low-income developing countries. Should capacity building programmes concentrate on developing transfer price audit teams, or on the basics of professionalising and tax collection and reviewing tax exemptions? (for example, see Holmes, 2014) Can the arm's-length principle be made to work through reforms such as those undertaken through the OECD BEPS process, or should states 'reject the artifice that a corporation's subsidiaries and branches are separate entities' and replace it with a system of taxing multinational corporations as single and unified firms, as argued by the International Commission for the Reform of International Taxation? (ICRICT, 2015) Is the lack of a UN tax body to address such issues a major limiting factor for developing country taxation, or are demands for such a body a distraction from more practical immediate action? (See Carter, 2015)

Debates about transfer pricing should be based on clear evidence, but here again it appears that expectations of the levels of undertaxed profits are often inflated:

1. **Misinvoicing or mispricing?** As highlighted in the previous section estimates related to fraudulent 'trade misinvoicing' (such as for tax evasion or to pay bribes) have often been assumed to relate to overly aggressive transfer pricing. However the numbers involved are quite different. Global Financial Integrity (GFI) for example estimate that Kenya loses around $435 million a year in tax revenues in relation to trade misinvoicing. PWC in a study for the European Commission estimate that Kenya could gain up to € 4.7 million (around $5million a year) from enhancing its transfer pricing administration. Similarly for Ghana GFI estimate $386 a year of tax revenues to trade misinvoicing,

while PWC estimate a $10million potential gain from strengthening transfer price administration (Clough et al 2014 and PWC 2011).[14]

Box 4: Bananas

*"Let's say it costs a transnational corporation (TNC) $1 to produce a bunch of bananas in Ecuador. It can sell it for $10 in Germany. Here's how the TNC cuts its tax bill. The Ecuador affiliate sells the bunch to an affiliate of the TNC in a tax haven for $1. The tax haven affiliate sells it to the TNC's German affiliate for $10. The German affiliate sells it to a German supermarket shop for $10, the true market price in Germany. So what happened here? The Ecuador subsidiary had costs of $1 and sold at $1, so its profits – and therefore its tax bill – are zero. The German subsidiary bought at $10 and sold at $10, again for zero profits and zero taxes. But the tax haven subsidiary bought it $1 and sold at $10, **for $9 profit**. But the tax haven doesn't tax profits, so the tax bill is zero there too!"*[15]

Griffiths and Lawrence (2007), Action Aid (2009), Sikka and Willmott (2010), Christian Aid (2011), Shaxson (2011), Ruiz and Romero (2011) and also use the banana supply chain to argue that activities carried out by subsidiaries in tax havens, such as financing, purchasing, insurance, management and brand management represent profits shifted out of either producer or consumer countries. They do not assume a 90% profit margin on bananas highlight that for every £1 spent in the UK on bananas, "17p went to a company in Bermuda for 'use of the distribution network'; 6p to a company in Jersey for 'management services'; 4p to a company in Ireland for 'use of the brand'; 8p to a company in Luxembourg for use of 'financial services'; 8p to a Cayman Islands company for use of the 'purchasing network'; and, lastly, 13p remained in the producing country."

Certainly there can be questions about the whether the price for these services is reasonable, and it is clear that the locations chosen for activities are likely to create tax benefits. It cannot simply be assumed that the activities involved in turning crates of green bananas at an export port into bunches of yellow bananas on a supermarket shelf are fictitious 'costs'. Nor is it obvious that shipping, insurance, or branding *should* be (or really are) sources of value located in the producer or consumer country. Ultimately the assumption that there are large secret margins within banana distribution chains, clashes with the investor view that bananas are a low margin product.[16]

[14] NB: GFI do not state that their trade misinvoicing illicit flow estimates relate to transfer mispricing, but they are often misunderstood – for example in reporting on the UNECA 'Get it! Track it! Stop it!' report. Further discussion on trade misinvoicing estimates is included in Annex1

[15] http://www.taxjustice.net/topics/corporate-tax/taxing-corporations/, a similar example is included in 'The Dark Side of Transfer Pricing: Its Role in Tax Avoidance and Wealth Retentiveness (Sikka and Willmott, 2010).

[16] See for example http://blogs.wsj.com/corporate-intelligence/2014/08/11/bananas-a-big-business-and-a-pretty-small-business/

2. **Gains at both ends of the value chain?** Transfer pricing concerns the division of taxation rights between home and source countries. There can be a tendency to assume that gains can be made at both ends. For example the NGO Citizen's for Tax Justice in the US views the low tax rates paid by companies such as Apple, Google, Nike, PepsiCo as taxes lost to the US treasury (Phillips et al, 2014), while those in Europe view them as taxes lost to the source countries (see for example Change to Win, 2015). In the UK Vodafone and Barclays have faced criticism that they are not paying enough UK tax at home on overseas profits while at same time it is also argued that multinationals such as SAB Miller in Ghana and Associated British Foods in Zambia should be paying more tax in source countries. There are legitimate questions about where the profits generated within complex international value chains should be taxed, but it should not be assumed that the profits to be divided amongst these jurisdictions can add up to more than overall economic margin within the value chain.
3. **Is the problem transfer mispricing or transfer pricing itself?** Often arguments slip between concerns about transfer mispricing or abuse (where the prices are not at arms-length or activities charged for are fictions), and the argument that the transfer pricing system itself is unworkable. The cases used to illustrate the argument often assume large scale mispricing simply from the existence of international business structures. For example Action Aid estimates that SAB Miller's use of internal payments for royalties and management fees results in £19 million in lost revenues for African governments. This appears to be based on the assumption that when African subsidiaries pay sister companies £43 million for royalties and £40 for management fees they receive precisely zero's worth of services. This is presented as 'legally permissible, but ethically questionable' behavior -however the practice described of charging for fictitious services would be massive mispricing; effectively tax evasion. Shaxson (2011) argues that because no one can say for sure how much management expertise, branding or insurance contribute to profits and costs the accountants can "more or less, make it up". Thus egregious mispricing is assumed to take place, hiding large profit margins on even basic commodities. The worked example on bananas by the Tax Justice Network in box 4 highlights this thinking.
4. **Do trade statistics really reveal massive transfer mispricing**? Some of the most widely quoted apparent evidence for massive transfer mispricing are estimates based on analysis of bilateral trade data. Notwithstanding that these statistics do not isolate trades involving subsidiaries from trades between unrelated companies, they are highlighted as evidence of transfer mispricing, and seem to indicate that the taxes at stake are several times greater than those that could be levied on the economic profit of the products involved. For example a study by Christian Aid (Hogg et al, 2010) using international trade data on copper exports and imports found that ***"if Zambia had received the price for its copper that Switzerland declared on re-exporting the exact same copper, then Zambia's GDP would have nearly doubled"*** (this was widely quoted and features in the film Stealing Africa). It was seen as an example of the scale of corporate trade mispricing driven by tax avoidance. In fact the calculation extrapolates prices declared on even very small re-exports from Switzerland (such as a single shoe

Box 5: The $973 bucket and the 50 pence fridge

- "Would you buy any of the following? How about plastic buckets from the Czech Republic at $973 each…. you won't find such dodgy prices in your local market, but these are the actual prices charged by some of the world's biggest multinational corporations, all authorised by some of the best accountants, and by political friends in high places. Their game is to shift the tax burden onto somebody else. It is played through 'transfer pricing'" – **Tax Justice Network** (Sikka, 2003)
- "*Transfer Mispricing:* Research conducted by Simon Pak and John Zdanowicz found that US corporations used manipulated pricing schemes to avoid paying taxes. For example, one appeared to import plastic buckets from its subsidiary in the Czech Republic for $ 972.98"– **Eurodad** (Ruiz and Romero, 2011)
- "A 2002 study by Trade Research Institute […] found American firms buying plastic buckets for $973 each and tweezers for $4,896. By overpaying or overcharging its foreign affiliates, a company can spirit losses and profits from one part of the world to another" – **The Economist** (2005)
- "Examples of mispricing are plastic buckets bought by a subsidiary in a developing country for $973 per bucket from another subsidiary in a tax haven. A more realistic price paid on the open market would have been around one dollar. The rest of the price paid is just a way to shift profit to the subsidiary in the tax haven where less tax is paid." – **Forum Syd** (Fröberg and Waris, 2013)
- "African invoice fraud hampers development of poorest nations[….] It means that importers pretend to pay more for goods than they actually pay and the extra money is slipped into offshore bank accounts. In one notable case an American company invoiced for plastic buckets at $972 each." – **The Guardian** (Neate, 2014)

The evidence for the $973 bucket does not come from a particular business that was caught at mispricing, but is based on a line of data from the US's detailed published trade statistics (which list the price and quantity of detailed categories of goods traded with each partner country each month) Pak and Zdanowitz (2002). A more parsimonious explanation of the $973 bucket and the other similar examples is that they reflect mistakes in recording the quantity of items (for example the price of a shipment of toothbrushes being misclassified as the price of a single toothbrush – see discussion in Eden, 2012).

Another example is given by Christian Aid based on Pak's analysis that in 2007, over 60 million fridges were imported from China to Spain at a cost of under 50 pence each. This, they believe resulted in €8.08 billion (£5.53bn) being shifted out of China. [17] Carter (2009) provides a reality check on this case, suggesting that it would be highly unlikely that such a huge jump in the number of fridges bought could go unnoticed, given that usually consumers in a country like Spain buy around 1.5 million fridges a year, while China's main white-goods manufacturer produces around 12 million. He points out that the anti-dumping duties being levied at the same time, on just a few hundred thousand much less steeply discounted fridges from South Korea, are another reason to doubt that such an enormous jump in shipments of massively discounted fridges could go unnoticed.

box full of copper ore) as evidence of the 'true price' of much larger shipments from Zambia at world prices (Forstater, 2014).[18] Other examples of anomalies in the trade data, are the '$973 bucket and the 50 pence fridge' (see box 5) often presented as representing as clear cut cases of tax abuse by multinational firms (for example Sikka, 2003, Baker, 2005, Christian Aid, 2005, Eurodad, 2008 and Somo, 2008, as well as in the media). What is striking about these cases is that they are so different from actual transfer pricing cases that make it to court, and yet they are interpreted as indicators of massive (yet easy to detect) fraud. Trade data is freely available online and anyone can make these calculations. Yet if they reflect real trade volumes rather than data glitches it suggests a total lack of confidence in the ability of national tax administrations to spot and tackle what would appear to be egregious abuse. Furthermore, as with the bananas example above the belief that there are large hidden margins involved in basic commodity supply chains such as copper conflict with what is known about the fundamentals of the business; when world prices falls mines close - suggesting that the large hidden margins assumed are simply imaginary.

5. **How much trade involves multinationals?** Another belief that underpins the perception that addressing transfer mispricing holds out large promise for closing development finance gaps is the much quoted statement that "60 percent of global trade takes place within multinationals". This quote has been repeated so often that it has gained the status of unquestioned truth and appears to suggest a massive shadowy underworld of intra-firm trade, with almost unlimited scope for transfer mispricing. The quote is often attributed to the OECD (who has indeed used it), but it seems to be based on a misunderstanding of an UNCTAD report (Box 6). Actual estimates put the figure closer to 30 percent and note that this is mainly concentrated on trade between affiliates within developed countries. For least developed countries FDI inflows (and therefore associated transfer pricing) continue to be concentrated in the extractive sector (UNCTAD, 2011). However the misunderstandings outlined above, together with the individual company examples chosen to illustrate the issue (such as beverage, sugar and telecoms companies) and the '60% of trade' figure seem to have combined to give an exaggerated impression of the importance of multinational non-extractive industry transfer pricing in the poorest countries (see for example Eurodad's conclusion that the extractive industry is just 'the tip of the iceberg- Ruiz & Romero, 2011).

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[17] http://www.christianaid.org.uk/pressoffice/pressreleases/march2009/revealed-true-cost-global-tax-dodging.aspx

[18] Alex Cobham and co-authors have recognised these problems with the methodology , also used for the wider analysis Swiss-ploitation? The Swiss Role in Commodity Trade (Cobham, 2013). and have withdrawn their initial conclusions from it http://www.cgdev.org/blog/how-much-are-developing-countries-losing-commodity-mispricing-really , however Christian Aid maintain that despite this it 'provides a stark illustration of the potential damage of mispricing' http://www.christianaid.org.uk/pressoffice/pressreleases/comment/christian-aid-research-on-commodity-trading-via-switzerland.aspx

Box 6: 60% of Global Trade is Within Multinationals

UNCTAD's 1999 World Investment Report states that 'TNCs account for two thirds of world trade'. This includes *both* intra-firm trade, and trade with customers and suppliers – however it has been widely misquoted and repeated as indicating that 60 percent of global trade is intra-firm trade *within* multinationals.

Patterns of intra-firm trade (i.e. which would involve transfer pricing) are closely linked to patterns of foreign direct investment (since it must involve an affiliated company at both ends of the trade), and mainly take place within the OECD where multinational companies' affiliates are concentrated. Sourcing along supply chains such as in the food, apparel and electronics industries is generally not intra-firm trade, since production is carried out by independent suppliers (intra-firm trade *does* take place in these supply chains between the sourcing and distribution hubs of the firm; such as from a production office or sourcing hub in the Netherlands to a retail operation in the UK– but this does not impact on the taxable profitability of garment manufacturing in Bangladesh or coffee growing in Kenya for example).

A recent report by the OECD says that intra-firm trade accounts for 30 percent of trade in goods and services in the US and France, mainly with other OECD countries. Canada, Poland and Sweden also have a high share of intra-firm trade (Lanz and Miroudot, 2011). UNCTAD also puts the global share of intra-firm trade at 30 percent (some $6 trillion). Major sectors include pharmaceuticals, automobiles and transport equipment (UNCTAD, 2013).

Emerging economies have lower, but rising levels of intra-firm trade both through foreign invested exporters, inward investment to serve domestic consumers and their own multinationals. In lower income countries intra-firm trade tends to be concentrated in the natural resources sectors such as oil, gas and mining, forestry and in some cases agriculture where there is investment by vertically integrated multinationals.

Clearly there are strains and difficulties in applying transfer pricing rules, and questions remain as to the best way to address these, but many of the examples and cases that have driven transfer pricing into the limelight should be handled with care to avoid a distorted picture of the potential gains.

IDEA 3: Money for nothing

Multinational corporations could easily pay more tax at no cost to ordinary citizens either in developed or developing countries.

> *"The Tax Hoax: Tax-sensitive investment is by definition the least useful stuff: accounting nonsense and paper shuffling that does not involve very much employment creation at all."*
>
> Tax Justice Network (2015)

A focus on the unfairness of multinational taxation, in the face of the perception of massive potential gains, and large-scale exploitation of loopholes generates understandable anger. Taxing multinationals more has popular appeal as a means to transfer money from rich-world shareholders to developing country governments (Shaxson, 2015).

However academic peer-reviewed analysis such as Cobham and Lorentz (2014) recognize that it is not so simple, and that there are likely to be behavioral responses by companies shifting real investment in response to tax changes. This would then lead to associated losses of wages and overall taxes. This point is also raised by UNCTAD (Bolwijn, Casella and Rigo, 2015). However such considerations rarely make it into the public debate where estimates of tax losses are presented as if they are the same as potential amounts which could be recovered in practice, and that this can be translated directly into doctors, nurses or lives saved (as in the case of Paladin in Malawi, outlined in Box 2 above).

While a proportion of tax costs are passed on to shareholders, they can also impact on workers and consumers through the impact of effective tax rises (or uncertainty about taxation) on investment decisions. If higher profit taxes deter investment this reduces wages for workers and potentially also raises prices for consumers where markets are protected. We do not know the exact balance of tax incidence between shareholders, workers and consumers, but estimates suggest that, because capital tends to be more mobile than workers or consumers, a significant portion is shifted to domestic factors – and especially labor, and that this effect is more pronounced for smaller economies (Gentry, 2007; OECD, 2010). Like other aspects of the investment climate, the level of sensitivity to tax rates will likely varies between firms, industries, and locations (World Bank, 2005). Certainly the prospect that effective tax rises will have behavioral effects should not be dismissed out of hand as a hoax, even if there are large uncertainties in assessing them.

Corporate income tax is generally seen as amongst the most damaging taxes for growth. Looking at the new International Centre for Tax and Development dataset, McNabb and LeMay Boucher (2014) find evidence of negative impact of corporate tax on economic growth in developing countries. Djankov et al (2010) also find a large adverse relationship between corporate tax rate and aggregate investment. Indeed, it has been argued that access to tax havens may have a protective effect, allowing governments to effectively differentiate tax treatment between mobile and immobile activities and allowing them to access international capital at lower cost (Blanco & Rogers, 2011). As the UNCTAD study emphasises, corporate income tax is only one portion of the overall contribution of companies to public revenues – in their study they find that for every $1 of corporate income tax paid by multinationals in developing countries there is an additional $3 in other taxes and revenues. In seeking to tackle tax avoidance they argue policymakers have to take into account the value of productive investments and the total revenue contributions they generate (Bolwijn, Casella and Rigo, 2015).

Empirical research and ongoing policy debates (such as those surrounding the OECD's Action 11 on improving the analysis of BEPS) attest to the difficulty of disentangling tax planning from artificial profit shifting. Provisions to defend against profit shifting may deter not only abusive schemes but also real economic investment by raising the risk of double taxation, increasing compliance costs and raising uncertainty. At the same time however, tax rates are not the only factor influencing investment decisions. Infrastructure, law and order, and the education of the workforce can be even more influential, and depend on an adequate tax base (World Bank, 2005). These arguments then, are not reasons to give up on taxing corporations (since there are good reasons to) or necessarily to lower corporate tax rates, but underline the need for tax policy to be supported by economic analysis, rather than based on the assumption that there is 'money for nothing'.

Box 7: Extractive Industries – a particular case

Taxation of the extractive industry is distinct from other sectors, because it involves the exploitation of immobile, non-renewable sovereign natural resources. While investors should be able to make a fair profit for the risk they take in finding, extracting, refining and marketing minerals and hydrocarbons, the 'rents' associated with the value of the underlying resources should go to the country in which they are found.

This is easy to state in principle, but harder in practice, where fiscal arrangements also have to take account of administrative capacity and political pressures. Extractive fiscal regimes tend to involve some combination license sales, royalties on production volumes, taxes on profits and public equity stakes in joint ventures.

As an immobile source of value, natural resources can sustain greater taxation levels without deterring investment. However, both governments and investors face uncertainty about the economic outcomes of extractive industry investments, particularly at the exploration stage. There are many projects that never pay off, and successful projects require many years of large capital investment before profits are returned. Commodity prices are also volatile. Therefore extractive industry revenue systems must be tailored to respond to both good times and bad times of profitability over the lifetime of a project.

A large part of the problem which deters investment and raises the cost of capital is regulatory uncertainty, coupled with market uncertainty. There is a well-known ownership cycle where countries nationalize resource industries when prices are high (or revise taxes) and re-privatize them when they are low. Companies recognize this risk; lobbying for tax arrangements that offset this risk, and appear unfavorable to countries.

While questions about the right level and structure of taxes are matters for political decision-making informed by economic analysis, it is clear that *uncertainty* in taxation has a disproportionately negative impact on investment (see for example OECD, 2005 and Edmiston et al, 2003). There is a danger that public rhetoric about huge tax gaps drive taxation away from the rule-of-law into capricious reputation and political pressure based approaches. This could raise unmanageable tax risks for companies, raising the cost of capital, discouraging investment and perversely increasing the pressure for inefficient tax holidays to offset the risk. The risk of public 'tax shaming' might even become an additional factor deterring companies with reputations vulnerable to pressure at home from investing in long-term capital-intensive projects in poor countries, which could generate low tax bills for many years. Box 7 describes the particular case of extractive industries.

Summary

This section has argued that these three sticky ideas are both caused by and the cause of misunderstandings which risk undermining the debate on domestic resource mobilization, and further polarising debate between business, civil society and government.

Figure 4: Summary of sticky ideas and more complex truths

The sticky ideas	The complex truth
The **huge amounts of money** involved in tax avoidance by multinational corporations are problem-solving in relation to the budgets of developing countries.	Revenue lost through 'base erosion and profit shifting' and tax exemptions for FDI are relatively modest in relation to development needs, with the largest sums concentrated in the biggest emerging economies.
Transfer pricing rules allow multinational corporations to import goods at hugely inflated prices and export commodities at a fraction of their true value: Addressing transfer mispricing by multinationals would generate large volumes of public revenues in both their home countries and the places where they do business.	There are real tensions and dilemmas in where to tax profits in complex value chains, where design, production, marketing, management, financing and currency hedging, transport and insurance are managed in different locations. The challenge of international tax collaboration is that there is no single clearly 'right' way to do this; countries at each point in the value chain have an interest in maximising their own tax revenues.
Multinational corporations could easily pay more tax at **no cost to ordinary citizens** either in developed or developing countries.	Tax policy has impacts on the incentives for investment and employment and therefore on growth and jobs. Policy makers have to pursue not only revenue mobilization, but also efficiency, distribution and growth-oriented objectives in their tax reforms.

None of this is to deny that tax avoidance goes on, that additional revenues could be collected, or that the sums involved are non-trivial (estimates of the amounts involved are reviewed in the next section). But the exaggerations distort understanding of the potential benefits, and may divert effort from areas where it is most needed to areas that are most fashionable.

In short; a lot of confusion clouds the perhaps obvious point that the potential to raise more from taxation of multinational corporations is limited by the amount of actual activity by multinational companies in a country (through FDI and distribution networks) and that this will come from the pockets of workers, consumers, capital owners or from taxpayers in some other part of the supply chain. Assessing potential policy responses demands a cautious and evidence-based view, not one driven by the stickiest ideas that can sustain the greatest anger. Figure 4 summarizes sticky ideas and more complex truths.

4. Looking beyond sticky ideas: what do we know?

What do we know about the scale of tax avoidance and evasion?

Estimates of the scale of the tax loss ('tax gap') associated with different types of evasion and avoidance are one part of the evidence base needed in considering the potential costs and benefits of different proposed solutions. The previous section largely focused on how such estimates are often misunderstood. This section seeks to look at how available estimates can realistically be interpreted.

Most existing studies focused on 'base erosion and profit shifting' (BEPS) by multinational companies (spanning elements of the **ineffective avoidance**, and **tax planning** categories) based on data from developed countries. OECD (2015), Dharmapala (2014) and Reidel (2014) provide recent reviews of the literature. Riedel reports that existing studies unanimously report evidence in line with tax-motivated profit shifting. However there are significant uncertainties and methodological difficulties in assessing the amounts involved. Estimates range from 5-30 percent of income earned. Dharmapala stresses that more recent literature gives lower figures than earlier studies, as access to new and richer sources of data has enabled more precise analysis. Tax sensitivity estimates from the 1990s are three times the current accepted estimates. The OECD BEPS paper on Action 11 notes that one key challenge with currently available data sources is that it is difficult for researchers to disentangle real economic effects from the effects of BEPS-related behaviors.

A recent study for the European Commission analyzing tax rules and incentives for large and small companies finds that inbound multinationals using the most tax efficient financing structure and location have effective tax rates that are between 5 percentage points higher to 6.5 percentage points lower than domestic SMEs, however this does not take into account existing anti-avoidance provisions which would reduce the ability to minimize taxes on one hand, or transfer pricing which could increase it on the other (Valdini Vacari Association/Centre for European Economic Research, 2015). The OECD BEPs report estimates that the effective tax rates paid by large MNE entities are 4 to 8½ percentage points lower than similar enterprises with domestic-only operations, and that global corporate income tax (CIT) revenue losses from BEPS behaviour amount to some 4% and 10% of global CIT revenues, or between US$ 100 and 240 billion annually (OECD, 2015).

These studies confirm that base erosion is a significant issue, but do not match the perception that paying tax is a voluntary endeavour, or the popular view that the effective tax rate of multinational corporations is something close to zero. Nor should they be interpreted as estimates of the amounts of tax that could be recovered in practice.[19]

Where data and estimates do more closely reflect the popular perception of extremely low effective tax rates it is largely in relation to US multinationals, particularly in the technology and information sector. Zucman (2014) estimates that some 40 percent of the foreign earnings of US multinationals are retained abroad each year, having paid tax rates as low as 3 percent.[20]

It is thought that developing countries are more vulnerable to profit shifting than developed countries due to lower tax inspection capacity, as well as greater dependency on corporate tax revenues. The IMF (2014) study on international tax spillovers uses a rough comparison of corporate tax efficiency, which suggests that revenue losses as a percentage of CIT revenues in developing countries could be several multiples of those in developed countries, due to weaker enforcement resources.

A few studies have developed estimates of the scale of the tax loss associated with BEPS behavior in developing countries. They tend to cluster around $100 -200 billion for developing countries as a whole.

Janský and Prats (2013) look at company-specific data from India. They find that multinational companies with links to tax havens had an effective tax rate 30 percent lower than multinational companies with no links to tax havens (domestic companies however paid the lowest tax rate). A recent study by UNCTAD (Bolwijn, Casella and Rigo, 2015) estimates that tax avoidance enabled by one kind of tax avoidance (thin capitalization) through offshore hubs resulted in $100 billion of annual tax revenue losses for developing countries. A new study by the IMF (Crivelli, Mooij and Keen, 2015) looks at data on tax rates and corporate tax revenues from 173 countries over 1980–2013 and finds that spillover effects, operating through both real investment shifts, and profit-shifting effects (as well as domestic tax competition policy measures affecting the domestic tax base such as special incentive schemes) matter at least as much for developing countries as for advanced. They make an indicative estimate that developing countries lose somewhere around $200 billion of tax revenue through base erosion, profit shifting and tax competition to tax havens. They

[19] Tax gap estimates generally do address the question of how much would be practically collectable, but one example illustrating the potential difference comes from the UK where candidate for leadership of the Labour party Jeremy Corbyn highlighted an unofficial estimate of the UK tax gap as £120 billion in his manifesto, promising to address it and saying it would be 'enough to double the National Health Service Budget'. When the basis for this was questioned he later clarified that he only believed that £20 would be actually recoverable http://waitingfortax.com/2015/08/03/what-use-the-tax-gap/

[20] The US has a global system of taxation in which earnings from international subsidiaries are taxed at US rates, less any taxes already paid. Earnings reinvested outside of the US are able to defer this tax.

find that developing countries appear to be two-to three times more vulnerable than developed countries.

These studies provide initial indications of scale but should be treated with care, as there are wide uncertainties in their assumptions and data. Furthermore they should not be assumed to be measures of the potential for recoverable taxes. Nevertheless they confirm that developing countries are vulnerable to tax losses through profit shifting and seem to indicate that revenue losses could range from upwards of 10 percent to 100 percent of current corporate income tax.

Box 7: $160 billion?

One of the most often quoted and influential numbers is $160 billion, developed by Christian Aid in 2008, and which they present as an estimate of the amount of tax lost annually to the developing world from tax evasion by multinationals and other businesses through false invoicing between unrelated parties and transfer mispricing. The number was one of the first estimates in this area and served a role in raising awareness of the issues, and making the case (including within the development community) for greater attention to be paid to multinational taxation issues. However it is clear that it should not be taken as evidence, but as a first attempt at a very rough approximation which hinges on the single estimate that 7 per cent of reported trade volumes are the result of mispricing (based on interviews carried out by Raymond Baker in the 1990s, concerning trade mispricing between unaffiliated companies).

In light of later estimates it appears to be the right order of magnitude for the overall amount at stake, but an overestimate of scale of tax avoidance associated with transfer mispricing of goods specifically.

Tax exemptions are a separate channel for tax loss (although may also be partly captured in some of the BEPS calculations above), and one that can be directly targeted through domestic policies. Both developed and developing country governments award tax exemptions to individual companies, industrial sectors or companies located in a specific geographical areas. While tax exemptions may be economically justified as part of economic and industrial policy they should be clear, transparent and assessed. Often they are instead politically motivated and opaque, and may be granted in exchange for broad political support, personal or political funding. Conversely, the threat of a special tax audit can be used as political tool to intimidate actual or potential political opponents and those unwilling to provide political contributions.

A tentative study suggests that tax exemptions amount to an average of 24 percent of current corporate taxes or 0.6 percent of GDP, indicating that potentially $138 is 'given away' in tax exemptions (assuming that none of them are effective or justifiable as part of industrial policy) (Hearson, 2013). Action Aid also quote a more conservative overall total of $100 billion based on the ICTD Tax Revenue database, and assuming a 22 percent "corporate tax gap" through profit shifting ($49.8 billion) and 24 percent of revenue foregone revenue due to tax breaks ($55 billion) (Action Aid, 2015).

How 'big' are these numbers?

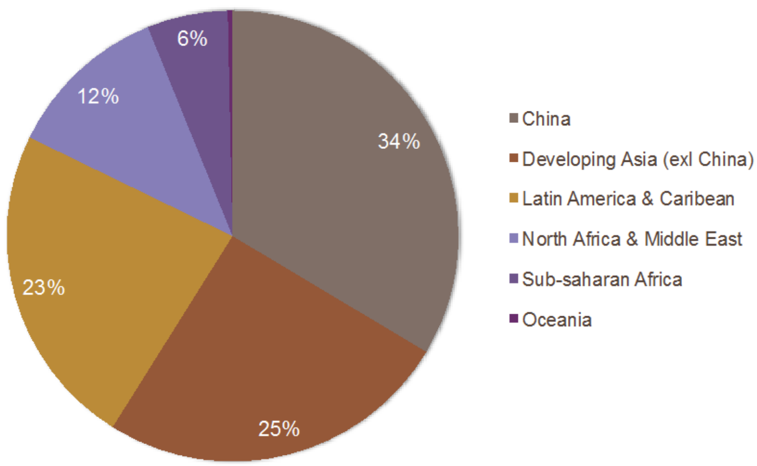
Sums in the region of $100-200 billion are not small. There is a tendency therefore to assume that they are consistent with sticky idea they are huge, problem-solving amounts. The Independent Commission for Reforming International Taxation (ICRICT, 2015) for example say that $100 billion per year is an astounding number and that *'the loss of these revenues may be a matter of life or death for many people across the globe'*.

However, as previously noted there is no suggestion that this is a collectable amount. Moore (2013) cautions that 'it is not clear that specific tax innovations could lead to short-term major increases in revenue collection in low income countries'.

As a very rough gauge, shared between 5 billion people $100-200 billion amounts to $20-40 per person per year, with some fraction of that being actually collectable. This fraction then could be spent, more or less efficiently, across the full range of the government budget resulting in some increase in public services valued by users (as well as some degree of wastage and extracted rent - see Aiyar and Pritchett, 2015). Certainly small amounts of money can be life saving, particularly in a very poor country. The Hep B vaccine costs less than 20c per dose for example. However it should not be assumed that the BEPs estimates will fund a large shopping list of potential public services. Furthermore the potential amounts are likely to be lower in least developed countries, and higher in middle income emerging economies, in line with levels of FDI per capita (UNCTAD states that least developed countries are home to around 1% of global FDI stocks) Larger economies are also likely to benefit more from international cooperation as they have a wider range of specialist staff, and greater economic clout to take advantage of new information flows.

One response to the recognition that one or two hundred billion US dollars is not as much as it sounds, is that the estimation methods are still in their infancy, and overall amounts of profit shifting could turn out to be higher. There are two reasons to be cautious of this hope: firstly, for developed countries the experience has been that as data and estimation methods have improved the estimations of the amounts at stake have gone down (Reidel, 2015). Secondly, there is the ratio between the tax gap estimates and existing corporate tax revenues. A $200 billion rise in the taxes paid by multinationals in developing countries represents almost a doubling of current levels of tax paid by multinationals (UNCTAD, 2015). While the relationship between tax and investment is not clear-cut, at some point seeking to extract more revenue from the same base of taxpayers is likely to become unsustainable.

Box 8: Distribution of FDI stocks amongst developing countries



[Source: based on data from UNCTAD (2015) World Investment Report]

Estimates of overall tax potential suggest that greater revenues *can* be collected, but from a wider tax base, with potential for some 2-4 percent of GDP additional overall. For example UNESCAP (2014) estimates that 17 countries in Asia could raise an additional $440 billion in tax revenues across their whole tax base – (a rise of 70 percent) of which $306 billion would be raised in developing countries. The tax base that is fundamental to increasing tax-to-GDP ratios in a sustained manner is formal sector employment and earnings and private sector spending, while at the same time productivity enhancing investment is critical to raising overall levels of economic output and welfare. As UNCTAD highlight, this creates a dilemma for policymakers; how to "ensure that multinational enterprises (MNEs) pay "the right amount of tax, at the right time, and in the right place" while avoiding excessive tightening of the fiscal regime for MNEs which might have a negative impact on investment" (UNCTAD, 2015).

Other areas, outside the scope of this paper but with high potential, are domestic personal income taxes for professionals and property owners. Legal provisions to tax large-scale agricultural income and personal income from abroad as well as real estate are suggested as underexplored ways to ensure that domestic elites are taxed, but ultimately this is not just a technical but a political question (IMF, 2011). International financial transparency and measures such as automatic exchange of information may help, but ultimately there needs to be the consent and support from amongst the influential elite to both pay more in taxes themselves and to broaden the tax base, which implies more accountable institutions (Everest-Phillips, 2009).

That the numbers are not as huge as sometimes imagined does not mean that corporate tax avoidance should be excused or ignored, or that the numbers are trivial. Certainly improvements in taxation of international business needs to be pursued as part of an overall approach to economic policy and enhanced tax administration, focused on national priorities. Yet the reality that the numbers are not as big and the solutions not as simple as the public narrative has assumed creates a real dilemma and danger for continuing to mobilise public attention and support for the long-haul.

The following two sections dissect the issues, problems and potential solutions in relation to the two headline issues of transfer (mis)pricing and taxation of the extractive industry.

What do we know about the problems with transfer pricing?

Transfer (mis)pricing has been a particular focus of concern. Examination of the case studies, revenue potential estimates and arguments reveals that this headline often covers a wide range of issues and tax-payer behaviors which span all four categories of the spectrum.

> **Type 1: Evasion/corruption** – Fake or egregiously mispriced trade shipments, or service transactions used as a cover to illegally shift capital out of a country, attract subsidies, pay a bribe or kick-back into a foreign account and/or avoid taxation (in some cases these are not transfer mispricing since they involve unrelated entities but 'trade misinvoicing'). This can include misreporting of quantity or quality of the shipment to hide the misreported price: For example in Venezuela fictitious import business have been found to be used to exploit currency controls by obtaining US dollars at official rates from the government to be sold on the black market for a large profit (Neuman and Torres, 2015).
>
> **Type 2: Potential ineffective avoidance** – There is considerable scope for choosing an arm's-length price which is favourable to the company, but which can be defended on some basis as being within the arm's-length standard. This can extend into aggressive avoidance. The basis of these transfer prices may be challenged by revenue authorities based on existing laws, and if found to be an overgenerous interpretation can result in significant adjustments. Examples of this type are seen in the transfer pricing cases that make it to court, such as over the pricing of brand-name pharmaceutical ingredients.
>
> **Type 3: Tax planning** – these are cases where a company's transfer prices appear to be within the limits of the arm's-length standard but nevertheless are seen by some as unacceptable profit shifting and are the focus of reputational challenges and calls for legislative change. Examples here include the SAB Miller case where NGOs believe that the company has unacceptably shifted profits out of Ghana into the Netherlands through charging of royalties for trademarks.
>
> **Type 4: Incentives** – these are cases where the controversy does not concern whether the transfer price itself is at arm's-length, but whether the profits it generates are undertaxed through a tax incentive used to attract the mobile part of

the business. Examples here include the advance pricing agreements agreed with financial hubs such as Luxembourg, as well as the use of tax incentives such as the UK's 'patent box' scheme.

These four sets of cases, although there is some overlap in the situations, highlight different concerns that are likely to require a different type of solution. The first set involves the hiding of aspects of transactions and ownership (or at least the hiding of them in plain sight, taking advantage of situations of lax enforcement). Although they can have tax loss consequences they are often not motivated primarily by tax evasion, but by theft of public assets, the avoidance or exploitation of capital and currency controls, or to divert funds to pay bribes. The case studies used to illustrate this type of behavior tend to involve individually privately owned companies, and linkages to state owned entities, officials and politicians. Although there are also cases involving multinational companies (such as BAE and Siemens), this not the core business of transfer pricing departments in large and well scrutinized publicly listed corporations, but indicates a failure of controls. These are illicit transactions, which if brought to light result in prosecutions that carry not only financial and economic penalties, but criminal penalties. International companies involved in such actions face prosecution under anti-money laundering rules and anti-corruption rules, not only under tax laws. Measures likely to be most relevant to combat this kind of behavior overlap with those for stolen asset recovery including requirements on collection of beneficial ownership information and whistle-blower protection.

The second set involve cases where the company has structured its operations for business reasons, including consideration of tax advantages, but where there is a difference of opinion with the tax authority over interpretation of the transfer pricing rules. They do not involve the kinds of illicit behavior illustrated in the first set of cases, but genuine technical questions of how to apportion profits along the value chain. These instances of potential mispricing can be challenged. However, disputes are expensive for both companies and revenue authorities and many revenue authorities of poorer countries do not have the resources to pursue them. Companies tend to err on the side of caution in relation to the end of the transfer price calculation with the strongest enforcement. A key measure proposed here is for developing countries (with donor support where necessary) to establish transfer pricing rules and build capacity to enforce them. However full implementation of OECD principles, and undertaking transfer pricing audits, is complex and resource-intensive for the tax authority. Other approaches include using simpler alternatives to the standard arm's-length pricing methodologies such as 'safe harbour' benchmarks. Another proposal that has been made is for companies to adopt an active policy of treating transfer price determinations with absolute good faith in relation to the developing countries, even if no challenge is expected (Lewis, 2015). Country-by-country reporting to tax authorities has been proposed here as a risk assessment measure to enable countries to more easily identify potential transfer mispricing.

The third set of cases involves controversies and concerns over the fairness and economic efficiency of outcomes of transfer pricing that are within the current rules. In particular this relates to the ability of companies to legally use IP, marketing and financing hubs to buy and sell commodities across their worldwide operations, manage intellectual property or administrate inter-company loans in lightly staffed offices in low-tax jurisdictions. These effects can be controlled through thin capitalisation and hybrid mismatch rules to some extent – and are the focus of the BEPS reforms. In the last two decades, advance pricing agreements have also been increasingly used to reach agreement with the tax administrations on either side of a cross-border transaction about a fair principle to allocate income and expenses between related parties. Withholding taxes on royalties, interest and dividends are also commonly used to tax these outflows, although companies can often find ways to structure their business through favourable treaty networks which reduce these (and countries might even encourage this by taking a 'most favoured nations' approach to attracting investment through international tax treaties with hub nations). Even where prices are deemed to be at arm's-length, some argue that the transfer pricing system is no longer fit-for-purpose because it does not reflect the true nature of multinational corporations (Spencer and McNair, 2012 and Devereux and Vella, 2015). Renegotiation of tax treaties is a further area of policy focus here. Alternative proposals include unitary taxation/apportionment (where profits are allocated according to a simple key based on factors such as sales and staff numbers), or an overall shift in the underlying basis of source vs residence taxation. 'Tax shaming' of individual companies through public campaigns has tended to be focused on this type of case where transfer prices are within the rules, but the outcome is seen as morally unacceptable. Public country-by-country reporting has therefore also advocated here as a means of public scrutiny and pressure of companies and governments (Ruiz and Romero, 2011).

The fourth set involves companies acting in line with legislation, where the legislation itself may be deemed harmful. In this case what is in question is not the transfer price itself, but the tax rate payable on the profit from it in the marketing or finance hub. Questions here concern the role of corporate lobbying in securing preferential tax regimes. However it is important to note in these cases in terms of tax losses it is not the source countries paying interest or royalties that are losing out on tax revenues (as long as the prices are at arm's-length) but the host country of the hub itself, and other countries that it is competing with it to host R&D, high tech manufacturing or finance activities. A distinction is drawn here between tax incentives that aim to attract real investment, and those that only attract 'letterbox' operations, with tax incentives to attract real investment seen as 'fairer' (although the loss of real investment is more damaging to competitor countries).

This is, of course, only a brief discussion of some of the potential policy solutions to addressing problems that come under the broad umbrella of trade mispricing and transfer pricing issues – what is clear however is that different types of problem require different solutions, and therefore case examples and estimates should not be used interchangeably in assessing and debating policies.

What Do We Know About Taxing The Extractive Industry?

In many cases, the largest flows of FDI (and therefore intra-firm trade and lending) relate to the extractive industry. Extractive industry-related revenues are significant for many countries and potential gains from better governance can be hugely significant in some countries. For example national oil sales provide over 60 percent of government revenues in Nigeria, Equatorial Guinea, Angola and the Republic of Congo (Gilles et al, 2014).

Many of the issues of concern outlined have particular features in relation to the extractive industry because of its relative scale, the relationship between natural resource governance and corruption, and the need for specific fiscal regimes which balance risk between government and investors and can respond to the price volatility and the long investment cycles of extractive projects (energy, telecoms and other utility projects operated as public concessions also share some of the same issues). Again, this is a specific area of policy making with issues that go beyond the scope of this paper, but it is worthwhile to highlight how they relate to the spectrum of taxpayer behaviors:

> **Type 1: Evasion/corruption** – Extractive sectors tend to come under high-level discretionary political control and as such, are particularly prone to secrecy and blurring between public, political and personal interests within governments and state companies. Underreporting of the volume or quality of resource produced (such as through biased oil volume measurements or misreporting of ore grade) is recognized as common and is a major concern in many countries, including such high-profile cases in Iraq and Nigeria (McPherson and MacSearraigh, 2007). Corruption can also be involved in the awarding of contracts with advantageous fiscal terms, which may then use misinvoicing to hide the payment of direct bribes or lucrative service contracts (Le Billion, 2011). These issues affect not only the direct tax and royalty revenues that governments receive but also the important revenues they get when selling products on their own account. For example, several reports, including two commissioned by the Nigerian government, found its national oil company mismanages parts of the oil sales process and has failed to remit billions of dollars in crude sale revenues to the national treasury. In Switzerland, the trading company Gunvor is under investigation for money laundering related to its purchase of $2 billion worth of crude oil from the national oil company of the Republic of Congo at a discounted price of $4 per barrel. These illustrate classic cases of 'trade mispricing' where public assets are sold off at low price to companies controlled by politically exposed persons who "flip" cargos on to international companies after capturing a margin (Gillies et al, 2014).
>
> **Type 2: Potentially ineffective avoidance** – Transfer pricing is often highlighted as a particular problem for taxing extractives, with the perception that companies are selling commodities too cheaply to their affiliates (such as in the Zambia copper case outlined earlier). However, while regulating transfer pricing is a technical challenge for countries switching from a royalty-based system to one where profit taxes play a greater role, often transfer price abuse is used as an explanation for low

taxable profits which are in fact due to large capital expenditures. In Chile for example, six of the ten top foreign owned mining companies paid no income tax from 1991 to 2003, and two only began to pay income taxes in 2003. This was largely because they subtracted accelerated depreciation on new properties. Once the period of accelerated depreciation ended, taxes rose substantially. Similarly, in Peru the new Antamina copper mine paid no more than $20 million in taxes in 2004, the last year of accelerated depreciation, but paid $319 million in 2005 (Moran, 2011). These revenue structures, if not well explained and justified by and to parliamentarians and the public can lead to perceptions that mines must be selling off commodities 'for a fraction of their true value' and pocketing the difference; exacerbating policy uncertainty.[21]

Regulating transfer pricing of commodity exports is technically relatively straightforward, compared with the more difficult situations involving intra-firm trade in goods and services with no comparable arm's-length products. While there are administrative challenges in ensuring that amounts and grades are correctly reported, this would also be the case in royalty-based systems. Minerals and agricultural products are easily measurable physical quantities with standardized grades and readily available comparable market prices, including in many cases exchange-based reference prices, so the arm's-length principle is not in itself hugely problematic. For example in Liberia a mineral development agreement initially negotiated by Mittal Steel did not have include requirements for arm's-length pricing, potentially depriving the government of substantial revenues. International experts brought in by President Ellen Johnson Sirleaf amended the contract to reflect the arm-length rule, leaving taxation to be based on the international market price of iron ores of the same grade (Global Witness, 2007).

Type 3: Tax Planning – Another taxation concern in relation to the extractive industry (as well as other key sectors such as telecoms) is about the taxation of capital gains when assets are transferred from one company to another. It is common practice for these to be structured using offshore entities to ensure that no capital gains tax is paid (in some countries these transactions are specifically exempt)(Hearson, 2014).

Type 4: Incentives: Extractive industries generally operate under a separate fiscal regime laid out in legislation and through individual contracts. There is extensive literature and experience of the dilemmas, challenges and best practices in establishing these terms (See for example ICMM, 2009). Incentives include accelerated capital allowances, resource depletion allowances and tax holidays, as well as usual provisions for interest deduction and carrying forward of losses. These incentives combine with the tax rate, other payments such as royalties and license

[21] For example see the discussion of Transfer Pricing in the Zambian Copper Industry in ICMM (2014).

payments to determine the overall level of revenue due to the government and the extent to which it is front or back loaded in relation to the production cycle. A key area of concern is that governments are giving too much away through a combination of generous incentives and reduced royalty rates, leading to loss of public revenues (and ultimately to instability for investors). Deals may in some cases be arrived at through a process of political and economic brinksmanship. At worst, concessions can be hastily sold off without knowledge of their value or legislative oversight, with deals facilitated through bribery and collusion, conflicts of interest, bid-rigging and trading of influence (Moran, 2008). Even where contracts are agreed in good faith, there are distinct trade-offs between different approaches to the design of the fiscal regime, and the choices can be challenging to explain, and to understand. There is growing recognition that both host country and international investor interests would be served by more active multilateral assistance in the design of extractives legislation and negotiation of contracts. Transparency in the contracting process, to allow for parliamentary and civil monitoring of extractive industry agreements is one key solution to allow trust to develop on all sides and minimize opportunities for corruption. However, this demands capacity building to understand the issues and finances.[22]

Summary

International taxation and policies for domestic resource mobilization pose complex problems in which public perceptions and debate has become somewhat disconnected from research findings and policy questions. This section has provided only a brief overview of some of the issues and options for action both internationally and domestically.

This chapter has provided a basic map of areas of concern that are laid out below as a framework for discussion (Figure 5). The aim is not to provide a single solution, but to offer a way of unpacking the issues and solutions and exploring the connections between international concerns and national priorities, and the role and potential for collaboration between different stakeholders in regularizing expectations in different areas.

While there is of course some overlap and potential for synergy between them, different problems are likely to require targeted approaches. For example proposals for unitary taxation of a companies global operations do not target the immediate core issue of extractive industry taxation where the aim is precisely to tax the value of local natural resources. If the problems in this case are weaknesses in negotiation of contracts or inadequate systems for basic reporting of commodity exports, they are more likely to be addressed through domestic administrative strengthening than a root-and-branch redesign of

[22] There are several initiatives in this area. For example http://www.resourcecontracts.org/ and http://www.open-contracting.org/

the international tax system. Similarly anti-secrecy measures are likely to have limited impact on legal tax avoidance, which is not dependent on subterfuge.

Within such a framework specific solutions may be identified which are easier or harder (both technically and politically), well-established or subject to experimentation. Some involve legislation; others might rely on corporate responsibility, good practice principles and the power of reputation. Some involve host country measures, or measures by capital-sending countries, or a combination. Some areas lend themselves to transparency measures, public engagement and oversight, where others depend mainly on the development of stronger administration capacity. There are areas where campaigners, tax practitioners, businesses and policy makers might work together (and indeed already are; such as the long standing Extractive Industry Transparency Initiative) as well as areas where there are different priorities, divergent interests and disagreements about the best way forward.

Figure 5: Areas of concern and types of solution: a framework for discussion

Areas of concern	Taxpayers			Types of solution
	Domestic business (including high income citizens)	International business	Extractive sector	
Evasion/ corruption	Hiding the business Hiding income (offshore) Inflating deductions Not passing on taxes collected Corrupt side payments to reduce taxes Misapplication of tax exemptions (e.g. through bribery, closing/reopening to get new tax holiday)	Misdeclaring trade Invoice fraud Carousel Fraud (VAT) Offshore abusive tax shelters Not declaring taxable offshore income Misapplication of tax exemptions (e.g. through round-tripping)	Bribery and corruption to win concessions Misdeclaring trade Invoice fraud Theft/oil bunkering	**Law enforcement measures and anti-secrecy** **Adequate resources for tax authorities**
Potential ineffective avoidance	Use of marketed tax avoidance schemes	Overly aggressive transfer prices Thin capitalization/ excessive interest deductions Treaty shopping Using hybrid mismatch arrangements Artificial avoidance of permanent establishment	Transfer mispricing? Thin capitalization/ excessive interest deductions	**Anti-avoidance and BEPs Measures** **Adequate resources for tax authorities**
Tax planning	Captive real-estate investment trusts Employee share options 'Carried interest' (Private equity) Accelerating/deferring income	Centralised IP and treasury operations by MNEs - transfer pricing, service fees, interest deductions etc.. Advanced pricing agreements with tax authorities	Offshore ownership to avoid capital gains tax on restructuring/sale	**Updating domestic legislation?** **Changes to the basis of international taxation?** **Adequate resources for tax authorities**
Negotiation /Uptake of incentives	Use of general deductions e.g. capital allowances Use of specific incentives e.g. sector based tax holidays	Use of specific tax incentives for FDI – e.g. negotiated tax holidays Advanced pricing agreements with tax authorities known to be generous	Demanding/negotiating overly generous fiscal regimes (including through corruption and secrecy)	**Targeting and transparency of incentives**

5. Conclusion

Effective taxation depends on both robust technical design and broad consent, scrutiny and support from across society. In a globalized world this negotiation must take place internationally as well as within individual jurisdictions, and must find ways to enlist domestic elites in support of institutions which broaden national prosperity, despite the unprecedented options for international mobility. This historic challenge is taking place through a patchwork of domestic political and judicial processes, business and interest group lobbying, voluntary guidelines, academic and other research, bilateral tax treaties and co-operation through international organisations, and through debates, and public understanding enabled by the media, NGOs (and their funders) and corporate communication.

Important areas of policy should not simply be 'left to the experts'. But maintaining public and corporate engagement on such complex cross-jurisdictional challenges depends on the debate developing through stages of maturity and learning – from initial campaigns based on weak evidence, met by defensive responses, through messy and difficult processes of organisational learning and collaboration towards more effective problem solving across sectors and national boundaries (see for example Zadek, 2004).

The first phase of the BEPS process has involved a massive and welcome widening of attention and engagement on taxation issues and brought a wider sphere of academics, civil society organisations and tax experts into dialogue and engagement. Campaigners have succeeded in getting the complex and difficult topic of international taxation onto the public agenda, and have advanced progress on previously 'impossible' solutions such as automatic exchange of information. But in the process they have also contributed to, and perhaps become dependent on maintaining unrealistic public expectations about a corporate tax 'pot of gold' which may become a liability to future progress.

For citizens in developed countries the behavior of well-known consumer brands has been salient, but as international NGOs move to convening civil society networks in developing countries it is becoming clear that issues arising from local discussions and scoping studies do not align neatly with international perceptions of priorities.[23] However, for governments of developing countries the current high level of attention being paid to BEPS in the media and by international organisations might lead to expectations of unrealistic returns from efforts to implement BEPS-related reforms (See Durst, 2015).

Perhaps a reason why there seems to have been a tolerance for exaggerated interpretations and misunderstandings is that the estimates which do exist are seen as the tip of an iceberg.

[23] For example there is barely a mention of tax issues involving international non-extractive industry companies as a key focus of local concern in the report of CRAFT stakeholders' strategy meeting involving NGOs starting to work on tax justice in Uganda, Mali, Senegal, Nigeria, Egypt, Ghana, Bangladesh, Niger, Morocco, Tunisia and Pakistan, (Mugambi, 2014).

There are many areas of fraud and corruption which are not covered by existing estimates – such as oil theft, outright smuggling, rigging of forex trading and so on. Trade in services is not covered in trade statistics and often have less clear benchmark prices to compare against. Nevertheless, lack of information in one area cannot be mitigated by errors and misunderstandings in another. Furthermore, exaggerated expectations of the scale of commercial illicit flows risk make efforts in areas such as recovering stolen assets (where amounts recovered are in the hundreds of millions, see Gray et al, 2014) appear to be paltry, and allows discussion of aid commitments to take place against a background of expectations that there is a much larger sum of money just around the corner.

This does not mean that multinational corporate taxation is unimportant for development. It contributes non-trivial revenues, and is accessible to support through legislation in capital sending and financial center countries. Developed countries therefore have a moral responsibility to ensure that the 'spillovers' from their tax policies to not undermine development prospects elsewhere. Corporations have a responsibility to act responsibly in relation to taxes, and a need to be able to demonstrate that to their stakeholders. They might also contribute to the development tax capacity as part of their commitment to supporting the rule of law and an enabling environment for business, in a similar way that some companies are working in partnership with NGOs and host governments to strengthen environmental health and safety capacity.[24] But corporate tax is only one part of a domestic revenue mobilization strategy.

Moreover a narrative that depends on casting multinational corporations, international financial centers and the accountancy profession as always the 'bad guys' ignores the common interest that responsible companies, jurisdictions and the tax profession have in the development of broad, stable tax regimes, enforced through the rule of law; where tax risks are manageable and compliant businesses are not out-competed by those practicing tax evasion and corruption in negotiation of contracts. Business people argue that investment structured through offshore financial centers can be a legitimate part of this (for example because they offer a tax-neutral site for combining investment from different countries, and well established legal systems); this has the potential to put pressure of financial centers to demonstrate that they contribute to, and do not detract from broad-based development. This suggests a potential alignment of interests between development-motivated campaigners and tax experts and business.

Ways forward

There will always be a difference between the kinds of mass-communication statements used to raise awareness of issues, and more in-depth analysis. However the gap between these two forms of communication in this case appears to be widening. Closing it may be difficult, but

[24] See http://www.isc-ehsplus.com/

it offers the potential for finding ways forward for effective progress beyond the first wave of campaigns:

- **Building understanding**. Continued research is critical to developing policies with theoretical rigor and empirical support, and which are able to win international agreement and broad consent. Concepts, issues and evidence should be commonly understood, even where there are differences of opinion on the best way forward. At the very least, broader peer review of relevant publications between experts from development, campaigning, taxation and business would allow basic mistakes and misunderstandings to be identified early in a collegiate rather than an antagonistic process.

- **Developing coalitions.** There is much emerging common ground between campaigners and business (for example see Lewis, 2015). However, the division of the tax debates into competing sides and movements with unassailable beliefs and advocacy positions precludes more constructive engagement. In particular, confusion and conflation of illicit financial flows and legal tax planning (in particular using estimates drawing on trade statistics) contributes to a toxic debate in which corrupt behavior and legal compliance are presented as roughly similar morally, technically, and economically.

- **Translating transparency into change.** Transparency measures are a key hope for improving the integrity and management of tax payments and public revenues. For example, in the area of extractive industry revenues, hard fought for 'publish what you pay' regulations have been enacted. Data on revenues are published by governments as part of the Extractive Industry Transparency Initiative; and laws are being amended to enable civic monitoring of contract awards and implementation through 'open contracts'. However, experience to date is that transparency in itself has had less impact than hoped, and that the critical work of enabling constituencies to use the data to influence reforms is still to be done (O'Sullivan, 2013). Paul Collier highlights the risk that transparency alone, if not combined with a well-informed public debate can lead to an 'explosion of expectations' and imprudent public spending.[25] Unrealistic expectations and polarised debate could put at risk the potential for meaningful public scrutiny to improve accountability and revenues.

As the transparency movement comes of age, facing up to the practicalities and dilemmas of tax policy is just one test case. Can it support people to engage honestly with debates over economic trade-offs and widen and deepen the conversation between tax campaigners, tax

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[25] See discussion of this danger between Paul Collier and Jonas Moberg of the EITI https://eiti.org/blog/transparency-building-block-not-stumbling-block

experts and practitioners, development agencies, the business community and policy makers? Or will the gulf between data and perceptions continue to widen?

One parallel example of development NGOs facing up to the tension between popular narratives and their long-term objectives is in the use of images. Codes of conduct have been drawn up by international and national associations of NGOs committing them to refrain from using 'pathetic images' or 'images which fuel prejudice' and giving guidance about how to use images of people which respect their dignity and autonomy, and do not confirm prejudices amongst audiences.[26] It might be useful to institute similar processes within and between NGOs around communication about tax. Organizations could individually and collectively set simple guidelines and review their research and communication processes to make sure they:

- **Highlight data weaknesses** in any estimates used.
- **Be clear on the policy challenges** with raising revenues that are estimated to be lost.
- **Use photographs and case studies which reflect the basis of the geographic and economic basis of the estimates**
- **Be clear on where revenue losses are emerging** from and avoid aggregating estimates between countries and over years in ways that make them harder to understand in context.
- **Consider the area of taxation with the most potential** for mobilizing revenues with minimum negative effects.
- **Use broad peer review processes**

Wider collaborative processes could also help to strengthen understanding and to create the space for more constructive engagement between campaigners, tax experts and those concerned with finance for development – both internationally and domestically in individual countries:

- Establishment of broader multi-expert, multi-sector networks to **debate issues** and strengthen research by **identifying new data sources, collaborating on projects** and undertaking **peer review** (this could include campaigning reports which have largely been the subject of this paper, but also other relevant publications – such as

[26] See for example the European NGO Code of Conduct on Images and Messages http://www.concordeurope.org/publications/item/115-code-of-conduct-on-images-and-messages

PWC's 'Total Tax Contribution' report, or the work of business organisations) to consider estimates and other research findings.[27]

- Collaboration between tax and development experts to develop **common basic resources of definitions and knowledge** on key issues such as transfer pricing.
- **Teach-ins or seminars** involving tax experts to raise levels of understanding of tax issues amongst development advocates (within NGOs, development organizations and funders).
- **Collaboration to assess the individual clusters of potential solutions** in light of clearer articulation of the evidence of the nature of the problems.
- Establishment of **common principles**
- Collaboration in **piloting the use and understanding of data from country-by-country reporting in the extractive sector**.

The challenge now is in moving beyond the early-stage attack-and-defense mode to a conversation focused on collaboration, understanding, experimentation and learning about what works in practice. Positive signs include new research by international organizations, the tentative collaboration between NGOs, tax experts and business representatives (including, for example, the Martin's in the Fields Group convened by Christian Aid with business representatives from the UK's CBI, the involvement of tax practitioners in Christian Aid's 2014 report on 'Tax for the Common Good', and Denmark's 'Tax Dialogues') as well as on the discussions that have gone on in the advisory group to this report. Further research will of course be needed, and is welcomed, and can only be strengthened by ongoing conversations and collaborations.

[27] The work by COVI in the UK (http://covi.org.uk/project/2015-an-important-year-in-the-responsible-tax-journey/) and IBIS in Denmark (http://thetaxdialogue.org/articles/important-milestones-tax-and-corporate-responsibility/) to initiate such a dialogue is a welcome sign.

Annex 1: what to make of 'illicit flows' estimates?

It is difficult to talk about estimates and expectations of tax gains from tackling multinational tax dodging without talking about the much larger estimates of illicit flows since the two are often confused and conflated.

The most important thing to note in relation to this discussion is that illicit flow estimates based on **trade misinvoicing** such as those published by Global Financial Integrity and by High Level Panel on Illicit Flows from Africa is that **these are not estimates of tax loss, and they do not specifically identify flows related to tax avoidance by multinational companies** (i.e. transfer pricing or mispricing). Rather they seek to measure 'trade misinvoicing' – a fraudulent practice whereby trade quantities, values or quality are being inaccurately reported by exporters and importers. This can be used for capital flight, tax evasion, bribe paying or money laundering.

These are gross flows, and there have been some efforts to estimate the associated tax loss implications. However there are serious methodological difficulties with both the overall and the tax loss estimates.

This annex provides a short outline of some of the methodological issues

Measuring Illicit Flows – methodological issues

Trade statistics on the declared price of goods imported and exported and are a vast stock of freely accessible data which have held out great promise as potential sources of primary evidence of where and A number of researchers including Pak (2009 and 2012) Kar & Cartwright Smith (2010), Ndikumana & Boyce (2012) and Mevel, Ofa & Karingi (2013) use anomalies in reported international trade data to come up with large numbers (over $700 billion in 2012 according to Global Financial Integrity) for laundering of illicit flows through trade misinvoicing.

Trade statistics are notoriously prone to errors in reporting and there are significant concerns with the reliability of estimates of illicit flows, and the resulting tax revenue implications based on them.[28] Methodologies struggle to differentiate between mispricing and gaps in the data or legitimate price deviations due to exchange rate fluctuations, forward contracts, triangular trade or difference in quality.

It should be noted that this methodology is not designed to deliver plausible estimates of scale as with the BEPS estimate methodologies reviewed in the report, but to aggregate forensic evidence of individual scams in specific industries, in specific countries and specific years

[28] See Feust and Reidel, 2012; Eden, 2012, Nitsch, 2012 and Henry, 2012

A major determinant of aggregate estimates is the methodological decision of how to deal with apparent inflows as well as outflows, since trade records tend to show both under-priced and overpriced flows of both imports and exports and it is impossible to tell which country is losing out on any apparently mispriced trade. Methodologies tend to be applied one-sidedly to generate results of interest. For example when looking for profit shifting out of the US Simon Pak assumes *overpriced imports* and *under-priced exports* but when looking for evidence of profit shifting *into* the US from other countries he assumes *under-priced imports* and *overpriced exports*. The GFI methodology 'gross excluding reversals' methodology only looks at mispricing out of developing countries (i.e. under-priced exports and overpriced imports) and discounts any apparent inflows, on the basis that there is no such thing as 'net crime'. In Pak (2012) the implied capital inflows and outflows from mispricing in all four directions are added together to arrive at a total of over $110 billion which has 'disappeared' in the international oil trade.

The **'price filter'** methodology used by Simon Pak in the False Profits report for Christian Aid (2009) tests whether monthly imports and exports between pairs of countries (e.g. tonnes of wheat, dozens of men's shirts, kilogrammes of copper wire) are over or under-priced against a benchmark range. It assumes that the cheapest and the most expensive products are mispriced, irrespective of quality. As in the case of the $973 bucket, simple misrecordings of quantities are sometimes counted as evidence of egregious mispricing. Also, when commodity prices are volatile or seasonal, there can be months where the value of trade at world prices is counted as 'overpriced' or 'under-priced', because it diverges from the annual middle range.

A second set of methodologies uses **'mirror data'**; comparing the exports declared by one country with the corresponding imports by another. This includes the regular assessments of global and country level illicit flow by Global Financial Integrity[29] as well as slightly different methodologies by Ndikumana & Boyce (2012) and for the High Level Panel on Illicit Flows from Africa.[30] A key challenge with this methodology are gaps or errors in the data, and the effects of volatility and forward contracts which can be impossible to differentiate from genuine misinvoicing.

Despite the difficulty of constructing aggregate estimates it is clear from individual cases, big and small, that misinvoiced trade *is* one means used for paying bribes, misappropriating public money and money laundering (alongside other methods such as simple wire transfers, and old fashioned suitcases of money or gold). This is also confirmed by smaller studies. For example Andersen et al (2013) find that when political institutions are poor, windfall gains from petroleum extraction translate into larger stocks of hidden wealth. They look at BIS bank data and petroleum rents and estimate that around 1.5 percent-2.5 percent of petroleum rents in autocracies are transferred to bank accounts in tax havens, with additional funds

[29] For example Kar & Cartwright Smith, 2010, Kar and Spanjers, 2014

[30] Mevel, Ofa & Karingi (2013)

likely to be stored as other assets such as property. However many (including the Tax Justice Network – see Henry, 2012) say that the large numbers here should be taken with a pinch of salt. Reuter and Truman (2005) conclude that "It is fair to assume that money laundering is in the hundreds of billions of dollars annually but probably only several, and it is unlikely to be a trillion."

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