

**Submission to the Financial Accountability Transparency and Integrity Panel,**  
coordinated by the Independent Working Group on Illicit Financial Flows, a project of the  
Financial Transparency Coalition

May 22<sup>nd</sup>, 2020

On behalf of the Financial Transparency Coalition, we wish to share our considerations on several key issues discussed in the three clusters as agreed upon by the panel. These are 1) improve cooperation in tax matters, 2) accountability, public reporting and anti-corruption measures and 3) cooperation and settling disputes. These issues consciously build on previous input related to the FACTI Panel activities to the G77 Group of Nations in the run-up to the FACTI Panel consultation with member states.<sup>1</sup>

The Financial Accountability Transparency and Integrity (hereafter FACTI) panel represents a vital opportunity to move forward the stalled debate around defining and tackling illicit financial flows (IFFs), an issue whose importance has never been greater given the ongoing COVID-19 pandemic. The pandemic's social and economic consequences are exacerbated by the deep inequalities between and within countries, of which IFFs are a major driver. The FACTI Panel has the potential to push forward important components of a global agenda to 'build back better'.

While we mainly input into the cluster on 'tax matters', we would like to highlight that we observe that tax matters are intrinsically linked to other subject areas of the Panel.

The following points by the FACTI panel must be taken into consideration:

**Cluster 1: Improve cooperation in tax matters**

The current institutional architecture for global economic governance is fragmented into multiple international financial institutions that frame or revise rules on tax, transparency, anti-money laundering, anti-corruption, etc. - affecting all countries.<sup>2</sup> Developing countries are systematically under-represented in most of these bodies, and their interests and priorities are diminished or subordinated to those of developed countries. The bodies also under-represent the interests of people living in poverty that are also marginalised by the same system of global economic governance. This especially pertains to women who are disproportionately affected by the dysfunctional tax system at all levels; global, national and local. The principles which govern governments necessity to cooperate in tax matters is founded in a critical and well documented need to address social and economic intersectional inequalities. These are clear commitments for signatories to the Sustainable Development Goals 2030. Moreover, signatories to the International Covenant on Economic, Social and Cultural Rights (ICESCR) should be cognizant of their obligations to progressively maximise resources in their commitment to realise the full range of human rights and substantive equality for all. We emphasize the observation made by the G77

<sup>1</sup> See here: <https://financialtransparency.org/financial-transparency-coalition-submission-g77-countries-consultation-un-member-states-facti-panel/>

<sup>2</sup> Financial Transparency Coalition (2017). *Who Makes the Rules on Illicit Financial Flows*. Available at: <https://financialtransparency.org/reports/who-makes-the-rules/>

countries in the past year that there is still no global platform for international tax matters at the intergovernmental level and reiterate our support to their call for the UN Committee of Experts in Tax Matters to be upgraded into an intergovernmental funded body.

The debate around harmful and wasteful tax incentives has resurfaced amid COVID-19 responses. Tax incentives and other forms of tax relief, including reduction of corporate tax rates, are being included in fiscal responses<sup>3</sup> by governments. CIT rates in Kenya and the Republic of Congo were reduced from 30 to 25% and 30 to 28%, respectively while Indonesia and the Philippines are looking do the same. Relying on tax incentives to spur investments and stimulate economic recovery is apparent will fuel the race to the bottom. Essentially used to attract foreign investments, tax incentives are prevalent despite mounting evidence that most of these are wasteful, often are misused and abused<sup>4</sup>. Multinational corporations that do not need or are not qualified for tax breaks can abuse incentives regimes for tax avoidance through profit shifting and corporate layering. These abuses have dire developmental consequences<sup>5</sup> for countries in the Global South – they deprive governments of much needed tax revenue and drain the economy through capital flight. The extraordinary impacts of COVID-19 pandemic have prompted governments across the world to devise fiscal plans amounting to trillion of dollars to deal with the subsequent health, economic and humanitarian crises. Corporate bailouts have been a common feature in these fiscal responses to save enterprises from bankruptcy and stimulate the economy, with the US allocating as much as half a trillion dollars. Bailouts come in the form of grants, credits, loan guarantees and tax breaks. Both bailouts and tax incentives share a susceptibility to similar misuse and abuse. Therefore, both must be well targeted, have evident links to socio-economic policies and should be offered only after determining that other policy alternatives will not deliver the same desired results. The conditionality agreed for bailouts must be sufficiently robust to anticipate and counter misuse and abuse. Financial transparency must, therefore, be at the heart of criteria. We recognise that taxation is a sovereign decision and rests with national governments, but the international community has a role to play in enabling effective measures to prevent abuse and misuse of bailouts and tax incentives, or a race to the bottom that benefits no nation. Efforts to narrow bailout eligibility criteria by countries in the Global South will be futile if they do not have access to necessary information that are beyond their borders, jurisdiction and reach.

The implications of the lack of international tax co-operation are wide-spread in countries designing tax loopholes that allow to report revenue from other countries, and the governance concerning these rules and norms are severely harming revenue capacity of developing countries. In an extensive research of case-studies of transactions, it is these diverging legal norms, and lack of a terminology of identifying ‘tax abuses’ that deprive revenues domestically or internationally by going against the intended purpose, spirit or international norms that govern international law and justice such as human rights frameworks, Sustainable Development Goals (SDGs) or indeed the Addis Ababa Action Agenda on financing development. We find that it is often the case that even if a transaction is determined as taxable in a developing country based on domestic law, courts and jurisprudence, it is then intermediary jurisdictions (often tax havens), and headquarter jurisdictions (often OECD countries) that undermine the domestic legal systems, and domestic tax systems in developing countries and thus do immense harm towards the very principles of an international society that is based on law and justice, mutual respect and solidarity by creating loopholes that allow ‘offshoring’, abusive interpretations of investment, financial secrecy, and tax treaties, that deprive billions of revenue from developing nations. This is exemplified in the figure below that summarises a number of case-studies analysed in a report titled ‘trapped in illicit finance’.

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<sup>3</sup> IMF (2020). Policy Responses to COVID-19. Available at: <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>

<sup>4</sup> Financial Transparency Coalition (2020). Use and abuse of tax breaks: how tax incentives become harmful. Available at: <https://financialtransparency.org/reports/31710/>

<sup>5</sup> AA, CBI, Christian Aid and Oxfam (2018) Tax Incentives in the Global South: A Business and civil society briefing’ Available at: <https://www.christianaid.org.uk/resources/about-us/tax-incentives-global-south-business-and-civil-society-brief>

Figure 1: legality, illegality and abuse of tax treatment of MNC transactions

Transaction studied	Host country position	Intermediary jurisdiction position	Headquarter country position
Ncell in Nepal	Illegal after Parliamentary Accounts Committee and Supreme Court case	Legal	Legal and challenged through investor-state dispute settlement mechanism
FQM in Zambia	Illegal after audit or investigation that concluded smuggling had taken place	Legal	Legal
Tenchint in Argentina	Legal until challenged by authorities	Legal	Legal
Outokumpu in Finland	Most likely illegal in Russia if proof of mispricing found	Legal	Legal, and unsuccessfully challenged by prosecutors
Football related commercial rights in Argentina	Legal until challenged	Legal	Legal
Individual wealth of Argentinians held in British Virgin Islands	Illegal tax evasion	Legal, information requests considered to prevent international tax evasion	N/A
Oil mispricing in Ghana	Illegal but not discovered initially	Legal	Legal
Mauritius–India trade and investment under a tax treaty	Legal	Legal	Legal
Ireland–Ghana trade and investment under a tax treaty	Legal unless challenged by tax or other authorities to be illegal or harmful	Legal	Legal
Amazon deforestation in Brazil	Legal unless breaking rules on tax, capital gains or moratorium on deforestation	Legal	Legal

International cooperation is necessary to democratise access to information on corporate global footprint, public beneficial ownership, public country by country reporting, links to tax havens, and participation in past or on-going tax avoidance schemes.

## **Cluster 2: Accountability, public reporting and anti-corruption measures**

There is a need to integrate tax transparency measures like automatic information exchange, public beneficial ownership of legal entities, instruments and arrangements and public country-by-country reporting. In addition, mechanisms exist to document flows of finance and could underpin the accountability of financial flows, for example an over-whelming majority of IFFs are cross-border in nature and are channeled via the SWIFT financial transaction messaging system – a valuable source for countries and UN agencies to access<sup>6</sup>. SWIFT provides financial institutions with information on financial transactions, sent and received. This information can play an important role in the statistical compilation of illicit financial flows. While the EU and the US have access to this information on regulatory grounds, Southern countries or even the UN institutions do not<sup>7</sup>. We also find that corruption, bribery and tax abuse pass through the mainstream banking system, where large international banks provide banking services without adequate due diligence or know your customer checks.

FTC recommends that bank transfers using the SWIFT messaging system must also incorporate beneficial ownership details along with account holder information.

On financial and beneficial ownership transparency, the background document recognizes the “critical gap in international access to beneficial ownership information. Civil society groups for long have advocated that beneficial ownership (BO) information must be published in an open data format for all legal entities, instruments and arrangements – including but

<sup>6</sup> SWIFT data can be a global vantage point for tackling global money laundering July, 2019. <https://financialtransparency.org/swift-data-can-global-vantage-point-tackling-global-money-laundering/>

<sup>7</sup> See The Politics of Defining Illicit Financial Flows. Available at: [http://www.cbgaindia.org/wp-content/uploads/2020/02/Module\\_1\\_Politics\\_of\\_Defining\\_Illicit\\_Financial\\_Flows-1.pdf](http://www.cbgaindia.org/wp-content/uploads/2020/02/Module_1_Politics_of_Defining_Illicit_Financial_Flows-1.pdf)

not limited to companies (listed/unlisted companies), limited liability partnerships, associations (unincorporated/incorporated), trusts, foundations and cooperative societies for state and public scrutiny alike. Further, to reduce errors in the data and increase the possibilities of verifying data, it has been argued<sup>8</sup> that even for developing countries who may have to endure limited human resources or financial constraints an open national registry of beneficial owners over a closed or restricted one is more preferable for law enforcement agencies. For example, “In the UK, data use has grown exponentially, to 10 million searches a day, since the data was made free and open”<sup>9</sup>. Countries should ensure that they include “proper definitions of beneficial ownership, details on the ownership chain to be collected, regulations in relation to bearer shares and nominees, and sanctions (as incentives) to ensure that registered information will be registered and updated”<sup>10</sup>.

Due to the UK’s public BO registry, Global Witness, a civil society watchdog and FTC member, was able to identify circular ownership in 328 companies. More importantly, a public register on beneficial owners is a concrete effort towards improving global cooperation on tackling all types of illicit financial flows. Additionally, companies must publish their corporate structures and provide subsidiary accounts openly free of charge so that they can be held accountable for their activities, in view of preventing any forms of tax abuse, money laundering or corruption.

### **Cluster 3: Cooperation and settlement of disputes**

Cluster 3 on settling disputes requires more clarity – in particular the framing of this issue is highly significant. The role played by international Investor-State Dispute Settlement (ISDS) mechanisms\* included in Bilateral Investment Treaties (BIT), or at times in trade treaties is a source of concern if proposed as a viable mechanism as these often violate State sovereignty and threaten social, economic and political rights. In March 2019, seven UN Independent experts published a letter<sup>11</sup> to the Working Group III on ISDS Reform highlighting the ISDS mechanisms’ well-established incompatibility with international human rights law and asymmetrical system that encroaches upon the States’ fiscal space. Any dispute resolution mechanisms must be public, transparent and accountable to all parties, and resist capture by one interested group of actors, public or private.

Asset recovery remains a major component of policy debates around anti-corruption and transparency measures. However, systematic processes of prompt return of assets from countries that benefit from the purchase of property, art, or other high-value items are absent and/or slow.

We especially emphasize the need to base asset recovery not on lengthy processes that are about Stolen Asset Recovery investigations, where one has to prove a crime before asset ownership information can be accessed. Often this is the wrong way, as it is vitally important to have knowledge of the beneficial owners in order to understand if a crime took place in misappropriating assets in one way or another. This is why a focus in this Panel’s inputs on the need for public registries of beneficial owners is important, and this policy shift has already been implemented in some jurisdictions that have decided to make beneficial ownership registries public (including the Netherlands and the UK), but in many jurisdictions beneficial owners are kept on a secretive registry, and they are thus not made publicly available for wider scrutiny even though company and trust ownership is not a private asset – as company ownership is a share in owning a legal entity which itself comes with a number of privileges (such as bankruptcy legislation, other public protection in company law and company regulation), that make it a matter public interest rather than a matter of purely private interest.

Additionally, the Panel should interrogate the role of the facilitators of these losses to taxpayers and domestic revenues, including audit, advisory and legal services providers.

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<sup>8</sup> Open Ownership: The case for beneficial ownership as open data. Available at:

<https://www.openownership.org/uploads/briefing-on-beneficial-ownership-as-open-data.pdf>

<sup>9</sup> Ibid

<sup>10</sup> Beneficial ownership verification. See here: [https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification\\_Tax-Justice-Network\\_Jan-2019.pdf](https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification_Tax-Justice-Network_Jan-2019.pdf)

<sup>11</sup> OHCHR (2019). UN experts send letter to UNCITRAL Working Group III on ISDS Reform urging systemic changes to the ISDS system. [https://www.ohchr.org/Documents/Issues/Development/IEDebt/OL\\_ARM\\_07.03.19\\_1.2019.pdf](https://www.ohchr.org/Documents/Issues/Development/IEDebt/OL_ARM_07.03.19_1.2019.pdf)

We would be happy to provide further inputs on the same. Please reach out to Laura Diez Ron at [ldiez@financiamtransparency.org](mailto:ldiez@financiamtransparency.org).

**Resources for further reference:**

1. Guidance for people with significant control over companies, societates europaeae, limited liability partnerships and eligible Scottish partnerships (Department for Business, Energy and Industrial Strategy, 2017)
2. Tax Justice Network (2020). Tax-responsible rules for Corona Bailouts. Available at: <https://www.taxjustice.net/wp-content/uploads/2020/04/Tax-responsible-rules-for-Corona-Bailouts-Tax-Justice-Network-April-2020.pdf>
3. Saila Stausholm (2017). Rise of ineffective tax incentives: New empirical evidence on tax holidays in developing countries. Available at: <https://osf.io/preprints/socarxiv/4sn3k/>
4. CBGA, Christian Aid, FTC and Fundacion SES (2019). 'Trapped in Illicit Finance' <https://www.christianaid.org.uk/resources/about-us/trapped-illicit-finance-report>
5. Transparency International (2017). Sao Paolo: Does Corruption Live Next Door? Available at: [https://knowledgehub.transparency.org/assets/uploads/kproducts/2017\\_SaoPauloRealEstate\\_EN.pdf](https://knowledgehub.transparency.org/assets/uploads/kproducts/2017_SaoPauloRealEstate_EN.pdf)
6. Common African Position on Asset Recovery (2020). Available at: <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7159683/>

## Annexe:

### \*Case study on Ncell

The transaction regarding the sale of Nepal's main telecoms company Ncell from a Swedish company Telia to a Malaysian company Axiata, where capital gains tax was initially not paid by Telia on the capital gains made in the transaction despite this being due under Nepal's Income Tax Act. They argued the transaction took place in St. Kitts and Nevis (a low-tax jurisdiction, without a capital gains tax), and also benefited from treaty provisions under a Norway-Nepal Double Tax Treaty (to find a second rationale for not paying capital gains tax) which contradicts with the previous argument that the transaction took place in St. Kitts and Nevis. They also argued that the further holding company in the structure based in the Netherlands allows for exempting from Capital Gains Tax (CGT) in Nepal.

The Multinational Corporations in question were backing their arguments on interpretations done in their professional circles, which rest mainly on UK law where 'tax avoidance' as it is called (a legally ambivalent term elsewhere), is considered as always legal on the basis that it is not explicitly outlawed in this given territory. The very same transaction can be seen as tax evasion (as in the case of Ncell sale in Nepal) by a court of law in Nepal. International dispute settlement in this case has to make a rather complicated decision on which jurisdiction is right, and which jurisdiction is wrong. Arbitrators are used to resolving commercial disputes on contract law, not disputes that have wider human rights implications or indeed wider constitutional implications, or jurisdictional preferences. Arbitrators on international tax matters are overstepping their authority in deciding whether Nepal or the UK jurisdiction has preference.

Axiata ended up having to pay part of the tax charge to date is now suing the Government of Nepal under the UK-Nepal Bilateral Investment Treaty (BIT) as Axiata has a UK subsidiary which it argues was party to the sale. They have taken the case at the World Bank arbitration court, and the case is currently pending. This is yet another attempt by the MNCs to undermine tax laws, and for State agreements (in this case the Bilateral Investment Treaty) providing a platform to use Investor-State Dispute Settlement (ISDS) clauses to challenge a legal decision in a developing country. The international tax system is putting in danger years and decades of judicial reform, strengthening of judicial systems and anti-corruption systems by completely undermining the very basis of Nepal's law, including its constitution as interpreted in this matter by the Nepal's Supreme Court.

#### Box 1: Example of the Tax Abuse in Ncell Transactions between Telia and Axiata

