Research Report

Group of Twenty

AGENDA ITEM

Measures to combat tax evasion

CHAIRING PANEL

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Contents

Introduction

Taxes have the effect of decreasing a taxpayer's annual income or profit. As a result, sometimes individuals or corporations declare less income, profits or gains than the amounts earned, or overstate deductions, in order to avoid paying or underpay taxes, and thereby increase their income. Either scenario is a case of tax evasion, where individuals or corporations use illegal means to avoid paying taxes.

The issue of tax evasion has become a global one, and poses a serious threat to world economies' development and growth. As taxes are a primary source of income for governments, usually in the form of income taxes, payroll taxes, and corporate income taxes, one of the main direct effects of tax evasion is the loss of government revenue. Government's use their revenue to operate and develop a country by funding for public goods such as education, social care and infrastructure, from which society as a whole benefit. If the government's income is deprived, their capacity to invest in the same becomes limited. It is therefore of paramount importance that countries act together to combat international tax evasion.

Definition of Key terms

Tax
A fee levied by the government on a product, income, or activity.

Common taxes:

> *Personal income tax (PIT)*
> *A direct tax levied on the income of an individual.*
>
> *Corporation tax*
> *A tax levied on companies' or legal entities profits.*
>
> *Inheritance tax*
> *A tax imposed on the money a heir inherits.*
>
> *Capital gains tax*
> *A tax on the profit made from the sale of a non-inventory asset.*

Tax revenue
The income gained by the government through taxation.

Tax evasion
Tax evasion is using illegal means to avoid paying taxes. Typically, tax evasion schemes involve an individual or corporation misrepresenting their income (...). Misrepresentation may take the form either of underreporting income, inflating deductions, or hiding money and its interest altogether in offshore accounts. (Source: https://www.law.cornell.edu/wex/tax_evasion)

Tax avoidance

Tax avoidance is a legal practice used to pay the least amount of tax possible.

Tax noncompliance
A range of activities that intend to subvert a state's tax system, including tax evasion and tax avoidance.

Tax liability
The amount legally owed to a taxing authority from a taxable event.

Tax gap
The difference between total amounts of taxes owed to the government versus the amount they actually receive. (Source: http://www.businessdictionary.com/definition/tax-gap.html)

Offshore account
A bank account located outside the country of residence of the depositor. To avoid tax liability, offshore accounts are typically created in low tax jurisdictions (or tax havens) which provide financial and legal advantages.

Tax haven country
A low tax jurisdiction known for generating little or no tax liability, thereby offering individuals or corporations the advantage of having to pay less taxes.

Subsidiary
Subsidiaries are business entities, fully or partially owned by other companies. In the context of tax evasion, companies may shift their profits to subsidiaries established in tax havens to ultimately pay less taxes.

Beneficial Owner
According to the definition accepted by the EU and its Member States is based on FATF Guidance, a beneficial owner is a “natural person who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted.”

Major Parties Involved

G20
This international forum brings together central banks and governments from the world's 20 leading economies. Most of its member countries including the US, UK and China are having issues with tax evasion and it is therefore important that these countries are involved in discussing resolutions and collaborating.

Organization for Economic Cooperation and Development (OECD)
OECD is at the forefront of efforts to establish international cooperation between governments to counter tax evasion.

Global Forum on Transparency and Exchange of Information for Tax Purposes
This international treaty economic organization works under the auspices of the OECD and G20. Over 100 countries and jurisdictions have committed to their new global standard on Automatic Exchange of Information (AEOI) which aims to reduce the possibility for tax evasion by increasing transparency and cooperation among financial institutions and tax administrations.

Tax Haven Countries
Bermuda, the Netherlands, Luxembourg, Mauritius, Switzerland and Panama are some of the top tax havens existing today. Companies and individuals take advantage of these low jurisdiction countries, as they do not have to pay as high taxes as in their country of residence.

Developing Countries
If companies established in developing countries shift their profits to subsidiaries in tax havens, the governments of those developing countries lose out on potential tax revenue. This is highly problematic as the governments of developing countries are dependent on revenue in order to make the countries progress in basic areas such as education and food.

Timeline of Key Events

2009	**G20 London Summit: Called on all countries to adopt the international standard for tax information exchange.**
2011	G20 Cannes Summit: An agreement to consider the voluntary automatic exchange of tax information.
2012	G20 Los Cabos Summit: Acceptance of the OECD report on automatic tax information exchange.
2013	G20 Finance Ministers and Central Bank Governors full endorsement of the OECD proposal for global multilateral and bilateral automatic exchange of information for tax purpose.
2016	G20 Finance Ministers and Central Bank Governors Meeting in February 2016 where the communique stated "We reiterate our call for all countries to join the Multilateral Convention on

	Mutual Administrative Assistance in Tax Matters [...]"
2017	10th meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes in Cameroon, Yaounde regarding further steps to combat international tax evasion with a focus on developing countries in Africa.

Evaluation of Previous Attempts to Resolve the Issue

There have been several attempts over the past years to combat international tax evasion. The Convention on Mutual Administrative Assistance in Tax Matters is a is a freestanding multilateral agreement designed to establish international co-operation to tackle tax evasion and avoidance. It was initially developed by OECD in collaboration with the Council of Europe in 1988. Having gone through amendments to agree with international standards on exchange of information, the G20 has repeatedly encouraged countries, including developing countries, to sign the convention.

In addition, standards have been developed jointly by OECD and G20 to combat the issue of tax evasion. This includes the recent new global standard on Automatic Exchange of Information (AEOI), which reduces the possibility for tax evasion through improving transparency. To date, approximately 100 countries, including Switzerland, have decided to implement this global standard

Possible Solutions

With the implementation of AEOI by international banks, this is already a step towards combating the issue of tax evasion, as it requires financial institutions to share information regarding accounts held by non-resident individuals and entities to their tax administration. What could further be encouraged, however, is the support to developing countries to transition to AEOI, as these countries are suffering the most from tax evasion.

In addition, the international tax system could consider options for reform. This could include introducing a unitary tax system where the profits earned by a corporation is taxed according to its activities in each country where it operates, meaning that they cannot avoid tax liability by shifting profits of subsidiaries to tax havens.

Furthermore, another possible solution to end tax evasion is that tax evaders could be exposed to harsher penalties. This could be through an increased number of years in prison or greater fines. Harsher penalties could also apply to intermediaries that help the tax evaders.

Finally, in order to further ensure transparency, countries could encourage the disclosure of beneficial ownership, as beneficial owners are often used to hide illegal businesses or to facilitate illegal activities, in this case being the evasion of taxes. Countries should however work on agreeing upon a common definition for the concept of beneficial ownership, as it has different meanings today.

Resources

https://ideas.repec.org/p/pra/mprapa/29672.html
https://www.loc.gov/law/help/beneficial-ownership/chart.php
http://www.thehindubusinessline.com/economy/pm-returns-home-after-attending-g20-summit/article2600474.ece
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