জনগণের জন্য সার্ক
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SAARC for People

Mass Awareness on Black Money and Illicit Financial Flow

Understanding Tax Justice

1. Tax Justice

The sustainability of any modern economy requires the state to have sufficient revenue for funding the physical and social infrastructure essential to economic welfare, and also to enable a degree of wealth distribution between rich and poor in order to promote equity and security. The main components of the Tax Justice comprise both the duty of the taxpayers and the duty of the state.

For the taxpayers, tax justice means that they accept their duties to the states in which they reside (as a citizen or for the business purpose) to fairly declare all of their income and to pay the taxes they owe as defined by the law of that country.

For state, it has to create a system of taxation that requires each person (whether a real person or a corporate entity or trust) to pay tax according to their means like i) imposes no undue cost on them to comply with that law, ii) provides them with reasonable certainty as to what is due, iii) provides a system of access to information and arbitration when the law is not clear, iv) State expenses are budgeted and accounted for through democratic and transparent processes, v) imposes a duty to ensure that taxes are applied fairly.

In addition a state has to avoid regressive tax systems that charge people on lower incomes to a higher proportional rate of tax than those on higher incomes. Taxes should promote on the basis of equity and redistributive justice. It means those who have more income (and assets) should give more. Those who have the same level of income of should be taxed in the same level. Most importantly, taxation should not be an additional burden to those who do not earn enough or earn just to meet their basic needs and live a decent and humane life.

2. Illicit Financial Flow

Illicit Financial Flows (IFF) is the illegal and unexpected flow of money across the borders by hiding the nature and source of the fund and/or evading duties and accountabilities.

In a broader definition, IFF includes activities that are technically legal but are, however, illegitimate from the point of view of justice and democratic principles because they deceive people and evade public revenues that can potentially improve people's well-being and their future.

Global financial Integrity (GFI) stated in their report that, it estimated that the developing countries lost roughly US$ 5.9 trillion in illicit financial flows during the period 2002 to 2011. Globally, Asia has the largest share of IFF among the regions.

3. Capital flight

Capital Flight is a process whereby wealth holders deposit their funds and other assets offshore in stead of in the banks of their country of residence or business. The result is the assets and income are not declared in the country in which a person resides or running a business.

In case of business, as the person is drawing the profit from a particular country, s/he owes the people or the country to pay the due taxes of the income and assets.

4. Double Tax relief

Tax relief is given by a country in which the taxpayer resides for the tax is paid in another country on a source of income arising in that of other country.

5. Double Tax Treaty (DTT)

DTT is an agreement between two sovereign states or territories to ensure, as far as possible, that the income of a person or a business entity arising in one and received in the other is taxed only once.

It includes rules to define Residence and Source, and limits on Withholding Taxes. It also usually includes provisions for cooperation to prevent avoidance of information exchange.

6. Income Tax

Income Tax is a charge upon the income of an individual. It can also be extended to companies. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.

7. Loophole

A technical opportunity found off the language and design of a particular law that allows a person or business to avoid the scope of a law without directly violating that law.

8. Money-laundering

The process of 'cleaning' money earned through criminal or illicit activities and to provide an appearance of originated from a legitimate source.

9. Profit laundering

It is a process of transferring profits from a territory where that would be taxed to another where there is either no tax or a lower rate of tax is offered.

Mechanisms of achieving this opportunity include transfer-pricing, re-invoicing, licensing, thin capitalization, corporate restructuring and inversions.

10. Progressive taxes

A tax system where the amount of tax increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as graduation.

11. Regressive taxes

A tax system in which a person's income from all sources rises but the amount of tax to paid reduces disproportionate to their income, even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up.

12. Tax Evasion

Tax evasion is the illegal non-payment or under-payment of taxes, usually by making a false or no declaration to tax authorities. It entails criminal or civil legal penalties.

13. Tax Base

The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.

14. Tax haven

Tax haven are the country or jurisdictions that exempt taxes which are legally due in other countries. According to OECD (Organization for Economic Cooperation and Development) tax havens as jurisdictions where:

- Non-residents undertaking activities pay little or no tax;
- There is no effective exchange of tax information between countries;
- Lack of transparency is legally guaranteed;
- No requirement that local corporations owned by nonresidents to carry out any substantial domestic activity. Indeed, such activities might have been prohibited in the jurisdiction in which they are incorporated.

Not all of these criteria are required for a territory to be a tax haven, but a majority must.

15. Transfer Pricing

Transfer pricing is a setting under what commodities and services are sold or money are transferred between a controlled (or related) legal entities within one enterprise or a group of business companies.

For example, if a subsidiary company sells goods to a parent company, the cost of those goods is the transfer price. Legal entities considered under the control of a single corporation include branches and companies that are wholly or majorly owned ultimately by the parent corporation.

There is no problem in transfer pricing as it is a legal process. However, it can be used sometimes for profit allocation to attribute a multinational corporation's net profit (or loss) before taxed in the country it operates.

16. Transfer Mis-pricing

Transfer mis-pricing is also known as Manipulation of Transfer Pricing refers to trade between parties under same parent business entity at the prices meant to manipulate markets or to deceive tax authorities.

For example, if company A, a food grower in Africa, processes its products through three subsidiaries i.e. X (in Africa), Y (in a tax haven, usually offshore financial centres) and Z (in the United States). Now, Company X sells its product to Company Y at an artificially low price, resulting in a low profit and a low tax for Company X based in Africa. Company Y then sells the product to Company Z at an artificially high price, almost as high as the retail price at which Company Z would sell the final product in the US. Company Z, as a result, would report a low profit and, therefore, would pay a low tax to US.

About 60% of capital flight from Africa is from improper transfer pricing. Such capital flight from the developing world is estimated at ten times of the size of aid it receives from and twice the debt it pays to the developed countries.

17. Over and Under Invoicing

Trade mis-invoicing (over and under invoicing) is a method for moving money illicitly across borders which involves deliberate false reporting in the invoices to hide the real value of exports and imports in order to justify moving money out of, or into, a country illicitly. In the form of trade-based money laundering this kind of over or under invoicing is the largest component of illicit financial outflows measured.

18. Base Erosion and Profit Shifting (BEPS)

Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

In context of developing countries BEPS is failed to deal with how the tax base from multinational companies is shared out between countries – Residence versus Sources taxation. The distinction between residence and source taxation can be defined as whether you tax money where it is earned (source taxation) or where the person or company earning the money is based for legal purposes (residence taxation).