



Title

Facilitator's Guide: Tax Injustice in the Global South - Causes, Consequences and Solutions

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Overview

The purpose of this guide is to provide an overview of tax for educators and facilitators who wish to provide training to adult learners or school-leavers on the subject of tax justice. The overall purpose is to show the numerous methods by which countries in Africa, Asia and Latin America are 'short-changed' by the global governance rules which underpin today's global tax structures, and outline some solutions to change this situation. It is structured in four parts.

- 1. Tax: A Short Introduction for Adult Learners**, a two-page introduction to tax and tax justice, which can be used as a handout or introductory reading for adult learners.
 - 2. Tax: A Deeper Guide for Facilitators**, an in-depth look at the main issues and debates relating to tax and tax justice, in the Global North & the Global South. This is intended to strengthen the confidence and knowledge of facilitators who wish to carry out workshops or training about tax with adult learners.
 - 3. Tax: Suggested Activities for Adult Learners**, a series of activities to be used together over a full day or as standalone sessions, which introduce adult learners to the topic of tax & tax justice, using a range of active learning methodologies.
 - 4.** Finally, a **glossary of key terms** is provided at the end of the resource.
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Tax: A Short Introduction for Adult Learners

Tax is a crucial part of the story of injustice in the world. Unfortunately, many people hear the word tax and recoil - it seems dense, boring and perhaps a topic best left to the 'experts'! This guide will help you as a facilitator understand just what tax is, why it is so important, what global trends threaten fair tax collection, and what might be done to help solve tax injustice globally. Read on for the short version, and keep note of the sentences written in red. These are questions or reflective prompts to help you dive deeper into what you're learning about!

So what do we mean by tax? A tax is a compulsory contribution made by people in a country to the state of that country. Taxes are also paid by businesses, again to the state. In general, the state then decides how to use the tax to 'defray' or mitigate some of the expense of running the country. Importantly, tax isn't a transaction. One person or business cannot say to the government, "I gave you ___ in tax, and I now want a road/hospital/street light in return". It is not an exchange, rather it is a duty that we all pay. It has even been described as the price paid for having a government!

Specifically though, tax has a number of functions, and surprisingly, not all are directly related to the impact of the extra money or revenue that the state has at its disposal. These functions can easily be remembered with the handy mnemonic - 'the 4Rs of taxation'. Firstly is **revenue**. This funds essential public services that are critical for the smooth functioning of a country, like education, healthcare, transport infrastructure etc. This revenue allows governments to plan into the future, something not always possible with aid or grants. The second function of tax is to **redistribute** wealth in order to reduce inequality in society and protect those most vulnerable and in need. However, redistribution can be done in more or less just ways, and this depends on how progressive or regressive the tax system is. The third function of tax is in the **repricing** of goods, whereby social 'bads' might have an extra tax put on them, and social 'goods' might get tax relief. **What might an example of a social 'bad' be? And a social 'good'?** Finally, tax can actually increase the extent to which citizens feel **represented** by their elected representatives, and so can actually encourage democratic participation. Think about it; if you pay tax to an authority, but that authority does not listen to your views about what is needed in your community, what might happen...? That's right, they may not get your vote again! It's in their interest to listen to you, and one of the reasons you get a say is because you pay tax. This unwritten agreement between citizens and elected decision-makers is what's known as the **social contract**. **Finish the anti-British slogan at the time of the American Revolution sentence, "_____ without _____ is tyranny!"**

Tax is a key tool for ensuring what is known as 'distributive justice', meaning that the benefits and burdens of social cooperation (e.g. tax) are shared fairly. But why is *this* important? Distributive justice is important because ensuring global justice requires that all states have the capacity to secure a *just* distribution of advantages between their citizens. However, as will be

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shown, many governments are prevented from having enough revenue to meet the needs of their citizens, and one key reason for this exists in the global tax rules we are living under today. And it's not just that the tax rules prevent many governments from receiving their fair share of tax, it is also that the lack of tax revenue triggers a self-reinforcing cycle, whereby state institutions such as those to collect tax are degraded so much over time by insufficient tax revenue, that the task of collecting tax becomes increasingly difficult! This has knock-on effects on all of the public services that governments need to provide to their citizens in order to ensure human rights are not breached. **Can you think of some human rights that could be negatively impacted without sufficient revenue to provide public services?**

The story doesn't end there however. **Reflect on what governments might do if they foresee a deficit in their balance sheet.** In these situations, they may continue to cut their spending on public services, or even increase taxes on the everyday person, for example Value Added Tax or VAT which is the same for everyone regardless of their incomes. **Now consider who may be more impacted by cuts to public services, and by increases in 'flat' taxes?** That's right; those already poor and vulnerable, and even women and girls, especially if extra VAT is placed on sanitary products, something which has happened frequently.

It does not stop there however. We must ask, what role does the global financial system have to play in this scenario? You may think that in situations where human rights are at risk, global organisations would swoop in to support countries in need. Well many 'International Financial Institutions (IFIs)' do, such as the WB and IMF. **Can you find what these acronyms stand for?** Individual countries can also help. However, most of this financial support is given in loan format, rather than as grants, or aid, or even interest free loans. **What is the difference between a loan and aid or grants?** And with the IFIs, they have actually used the threat of withholding financial support in the form of loans as a way to promote certain ways of doing things economically around the world. For example, 'tied' to this support are conditions around removing trade barriers, increasing VAT, reducing taxes on foreign investors and more. There are some reasons for this; such as remaining neutral towards business, not hindering competition, and leaving companies with as much profit as possible so that this profit either flows down into our pockets or is transformed into higher wages, better machinery etc. As shown in the long version, these assumptions do not hold when put under the microscope. This suite of policy 'recommendations' is called the **tax consensus**. And this is one intersection where debt avenue meets tax lane; read more on debt justice in the FreshUp article!

The fundamental problem is that our global financial system is replete with loop holes and escape hatches, like a giant game of snakes and ladders. Not even 100 years ago, companies were fixed to where they had a factory, their raw materials, their employees. But today, companies are complex, with many tentacles stretching out all over the world. A company's headquarters might be in country A while raw materials accessed from countries B and C and manufacturing happens in country D. The world is not a single country, and tax laws differ across borders. 'Aggressive' tax planners and 'creative' accountants exploit these mismatches

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in rules to allow companies to shoot up a ladder, bypassing fair rules, or to use an escape hatch (**research what 'capital flight' means**), leaving to somewhere more favourable when the rules no longer suit them. As a result, instead of *companies* competing for market share, we increasingly see *countries* competing with one another on tax laws in order to attract investment, resulting in a '**race to the bottom**' on corporation tax.

This tax dodging can be legal (called tax avoidance) or illegal (called tax evasion). **Do you think something that is legal is always ethical or moral?** This tax dodging costs developing countries more than they receive in aid. Corporate tax is more crucial in these countries than Global North countries because in the Global South, a large portion of the population don't make enough money to earn tax. If multinational corporations paid their fair share of tax in these countries, it could make a huge difference.

There are some solutions however, which if implemented would make a significant difference and help to alleviate global poverty by giving **fiscal sovereignty** back to developing countries. One solution is for tax authorities around the world to automatically share information about what's in bank accounts in their countries with other relevant countries. This prevents companies and wealthy individuals from hiding their money in tax havens, where tax rates are very low. Another solution is to uncover the person at the head of companies that actually benefits from owning the company. Many people are surprised to learn that companies can actually pay people to be the public face of their company, so that the real owner stays hidden. This needs to change, and the names of the beneficial owners (who have to be human!) need to be made public. Next, companies with many tentacles (subsidiaries) should be taxed as if they're one company, not many. Finally, the UN should be responsible for global tax regulation, not the OECD. This is because the OECD is actually more so a club of rich countries, whereas the UN is the only global institution where governments participate as equals. Surely this is then the best forum with which to determine global action to reduce inequality. Read on for a more detailed and deeper dive into the causes, consequences and solutions of tax injustice in the Global South.



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Glossary

Ability to Pay Principle

Arm's Length Principle

Beneficiary-pays Principle

Capital Flight

Cost-of-service Principle

Consumption tax (e.g. VAT, GST)

Direct tax

Elasticity

Effective Tax Rate

Equal Sacrifice Principle

Excise Tax

Horizontal equity

Incentive (of tax)

Incidence (of tax)

Indirect tax

Nexus

Marginal tax rate

Multiple taxation

Marginal Utility

Policy Space

Principle of Economic Allegiance

Progressive taxation

Proportionate Principle

Regressive taxation

Residence country

The investor's country of residence. The residence country is also sometimes referred to as the capital-exporting country.

Revenue (of Government)

Sales Tax

Source country

Special Economic Zone (SEZ)

Sudden Stops

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What is tax?

“Taxation is key to the character and functioning of the state, the economy and society as a whole.”

- Solomon Picciotto¹

Before facilitating any session to do with tax, it is important to ensure a common understanding in the group of what is meant by ‘tax’. Taxes have been described as the price paid for having a government, paid by anyone who benefits from the existence of the state and the public services it provides. The formal definition of a tax is “a compulsory contribution levied upon persons, natural or corporate, made to the public authorities in order to generate revenue to help the government defray the expense incurred in conferring common benefits upon the residents of the state²”. In more simple terms, a tax is compulsory, increases government revenue (also known as government income), is placed upon those *incorporated* which means both people *and* corporations (note the existence of “corp”, in Latin meaning anything to do with the body), and is used for the purposes of offsetting some of the costs that are incurred by governments in the process of providing public services to their population, like healthcare, education, and public transport for example. Tax is a core element of what is known as fiscal policy, or government policy concerning in particular public revenues and taxation.

Importantly, even though it is a payment from one party to another, tax is different to a regular transaction in the sense that it is not paid with the expectation that a specific item or output is given on payment, in the way that we may exchange money for food or clothing. In other words, there is no *quid pro quo* (direct return) in the case of a tax. Instead, taxes are paid to the authorities and it is they, along with councils etc. (depending on the decision-making structure of the country’s public institutions) who ultimately decide, with more or less input from and responsiveness to the population, what tax revenue should be used for and how it should be apportioned between services.

In contrast however, many people argue that tax is just a way for governments to deprive citizens of their hard-earned money. However, this analysis of tax ignores the reasoning behind tax systems, namely that their existence supports the fulfilment of economic, social and human rights. How so? The human rights legal framework states that the minimum requirements needed to fulfil economic and social rights include providing sufficient foodstuffs, essential primary healthcare, basic shelter and housing, and the most basic forms of education³. Tax is

¹ Lecturer, author (book *International Business Taxation*, 1992, and *Regulating Global Corporate Capitalism*, 2011) and co-founder of the Tax Justice Network

² Investopedia

³ Unicef



crucial for ensuring that these rights are fulfilled. Without adequate taxation to ensure the provision of basic services, states are undermined from meeting their human rights obligations.

What does tax do, or, what are the purposes of tax? 4Rs &? 2Ss.

Revenue

Tax has four key purposes, which are often referred to as 'The Four Rs of Tax'. The first of these is generating revenue, also known as government income. This revenue provides three functions:

- 1) It is used to fund **essential public services** like education and healthcare, as well as infrastructure like roads, street lights, and bins for example.
- 2) It is also related to the **strengthening of the democratic process**, because when governments receive revenue via tax, it places the citizens of that country in a position whereby they can demand to have an input into how the revenue is spent. Tax is therefore related to democracy, and we will see some evidence of this shortly when we move onto 'representation'.
- 3) It provides governments with the **predictability** needed to be able to make financing decisions into the future. For example, if a government was using only aid to pay the salaries of all nurses, doctors and teachers, what would happen to the country if that aid were to be removed?

Redistribution

The second purpose of tax is to support the **redistribution** of wealth. Redistribution refers to redistributing the country's resources from the wealthy towards the poorest and most vulnerable people, a strategy which can help to reduce inequality in society.

However, redistributing wealth via tax can be done in a number of ways, and not all are equally just. In fact, the way a country's citizens are taxed can either lessen or increase equality. Therefore the already existing income inequality means that it is not solely enough to increase the *amount* of tax, instead governments must decide *how* to tax its population in order to ensure an equitable burden that does not worsen existing inequality.

Specifically, there are two ways in which tax can be applied on individuals in society that can lessen or increase income inequality. These two ways are **progressive** or **regressive**. A reliance on consumption taxes like sales tax or value added tax (VAT), for example on food, fuel and other goods is seen as regressive as everybody is taxed the same amount regardless of their



financial status. In contrast, an example of a **progressive** tax is income tax in some countries, as index bands change the tax rate based on how much income is earned, and the more people earn, the more tax they pay (to a point). This is because the marginal utility (i.e. the usefulness of the surplus) is lower as one earns more money. For example, when a person has less money, each unit of that money becomes more valuable. Think about it; the marginal utility of €10 to a person earning €4,000 per month is much greater than to a person earning €10,000 per month.

Repricing

The third purpose of tax is the **repricing** of certain goods. This means that items may be taxed according to whether they constitute a public 'good' or public 'bad'. Tax can be applied in order to create a price that accurately reflects the benefits and costs to society. For example, higher taxes on cigarettes and alcohol may discourage smoking and drinking of alcohol, both of which are negative for people's health, while tax breaks on the price of bicycles or electric vehicles may incentivise people to choose these modes of transport that are better for the environment and for human health. In this way, tax can be used to deter behaviours that are considered socially undesirable, and can be used to incentivise behaviour that is considered desirable to society as a whole.

Representation

The final R of taxation is **representation**. Citizens and other entities are generally only required to pay taxes if the taxing authority provides them with a political voice through elected representatives. The relationship of taxation to representation goes back to the time before the American Revolution. At the time, the anti-British slogan "Taxation without representation is tyranny" reflected the resentment of American colonists at being taxed by the British parliament, a political body to which they elected no representatives. Tax can therefore build healthier democracies, because as populations are taxed, they tend to demand stronger political representation and governance. This dynamic has contributed to the emergence of what is known as the '**social contract**' or '**fiscal contract**', whereby tax-paying members of society vote for certain candidates and in doing so expect them to raise and spend the taxpayer's revenue in a way that benefits the voter. A striking study found that in 113 countries between 1971 and 1997, introducing or increasing taxes without simultaneously increasing or improving service delivery led to citizens demanding their rights, and to subsequent democratic reforms⁴.

This trust given to authorities by citizens when paying tax is important for building a shared accountability between citizens and governments. However this trust is threatened by a perception of unfairness, which tends to increase when ordinary citizens feel that they are paying too much, while the richer players are not contributing their fair share.

⁴ Ross (2014)



Stability

Another purpose of tax in addition to the 4 Rs is **(macroeconomic) stability**. Tax provides macroeconomic stability by being used as a fiscal lever in times where there is too much demand and not enough supply of certain goods or services in the economy. This situation can increase inflation, defined as the general price of goods and services as measured by the Consumer Price Index (CPI). Imposing a tax on the scarce goods or services can reduce demand, and therefore reduce inflation.

Sustainability

Finally, tax is a more **sustainable** source of finance for southern governments. This is for a few reasons. Firstly, it is less likely to be vulnerable to the sudden removal of money or capital from a country, so called '**sudden stops**'.

Secondly, tax from revenue isn't subject to interest repayments, unlike debt. Financing projects via debt can result in the tax raised domestically going towards paying off the debt, reducing the revenue available for public services. Debt servicing can thus swallow tax revenue. For example, in Nicaragua in 2008, debt servicing swallowed one quarter of the entire annual tax take, which was equivalent to 36% of total public spending and was more than the country's entire health budget that year. Another example can be found in the Philippines where the debt service from 1986 to 2008 for interest payments averaged just over 25% of the country's national budget. This was without paying off any of the principal of the loan; it was solely paying the interest. More recently in 2010, just under 25% (24.34%) of the Philippines' budget was spent on interest repayments and just under 30% (28.95%) went towards paying off the principal. In contrast, 28.5% total was allocated to public services like health, education and housing⁵.

The third reason that tax may be preferable to debt as a financing tool is that with loans, external donors (that don't necessarily understand the needs of the country) can dictate how the loan is spent, rather than the domestic government. Increasing the domestic tax take reduces a country's reliance on external loans and the debilitating repayment of these loans into the future, and affords them increased agency and space to determine their own national policies rather than having them dictated by donors.

What about aid?

There is a role for foreign aid, however there are a number of issues attached to relying on aid rather than tax revenue as a source of finance for societal well-being. Firstly, aid can encourage

⁵ All examples cited can be found in Action Aid, Tax Justice Advocacy Toolkit (2011)



rent-seeking behaviour in the political elites in the country receiving aid, an economic concept referring to when an entity seeks to gain wealth without any reciprocal contribution of productivity.

Secondly, it can make rulers accountable to foreign donors rather than their populace, increasing government responsibility to donors, while sacrificing their ability to be genuinely responsive to their citizens⁶.

Thirdly, aid is volatile, as its amounts can change rapidly over a short period of time. This reduces the ability of the government in the aid-receiving country to plan accordingly into the future.

Finally, aid is unable to match the revenue-generating potential of tax. In fact, some have estimated the revenue loss of low-income states to be greater than the combined foreign aid budgets of high-income states⁷. Tax allows countries to be self-reliant, and to plan into the future. This is something inherently absent with foreign aid.

Framing: What is distributive justice and what does it have to do with tax?⁸

This facilitator's guide to tax approaches tax from the perspective of distributive justice. Distributive justice is an approach to justice that concerns the fair distribution of the benefits and burdens of social cooperation, such as taxation. Global justice requires that all states have the capacity to secure a just distribution of advantages between their citizens⁹. States must, therefore, have the capacity to design their legal and economic institutions in such a way that they reflect the concepts of distributive justice. Distributional justice also means an ability to determine the size of the government budget and the level of redistribution, important elements of fiscal policy¹⁰. However, many low-income countries face difficulty in raising revenue which affects their ability to pursue redistributive programmes, a core component of fiscal self-determination. This guide will outline some of the ways that this happens, and some of the policies that have been offered as solutions.

Tax is a key tool used to redistribute resources, and so the tax policy debate is one of the few areas of law in which discussions of distributive justice are considered appropriate. The reality is that most other economic regulation is oriented towards *maximization* of wealth, rather than its

⁶ The concepts of responsibility and responsiveness in politics can be attributed to the political scientist Peter Mair

⁷ Death and Taxes (2008)

⁸ Content in this section is sourced from the book Tax Justice, the Ongoing Debate (2002)

⁹ Appeldoorn (2016)

¹⁰ Dietsch (2015, p.35)



distribution. What is different about discussions of tax in the law is that tax is a tool used *after* productivity has been maximized. Tax comes in afterwards to set about rearranging the wealth distribution in society.

How is tax an issue of Global Justice?

Tax is necessary to fund essential services. This is particularly relevant to countries in Africa, Asia, and Latin America (Southern countries) for a number of reasons. Firstly, Southern revenue authorities already tend to be under-resourced, for many reasons but one of which is the issue of sovereign debt (see FreshUp guide on Debt for more on this). This creates a vicious cycle whereby with less revenue, the tax authorities struggle to improve their capacity to collect tax with which to facilitate their improvement.

A key issue found across the board is the association between tax justice and development. In the 2000s, the organisation Christian Aid began to link tax to global inequality and development issues by publicising the fact that developing countries lose more money through the tax evasion practices of large corporations than they receive through official aid¹¹. Global tax rules that facilitate tax dodging are exploited by corporations and wealthy individuals to deliberately deprive countries of the resources they need to meet their country's needs and fulfil human rights obligations. Tax justice advocates frame tax malfeasance or bad practice as an issue of concern to human rights. This is because without government income (called revenue) from tax, it is much more difficult for a government to fulfil obligations relating to health, education, security, climate change and other issues.

Additionally, insufficient tax from corporations and wealthy individuals has knock-on effects domestically regarding the burden of ensuring sufficient tax revenue is generated, as when governments don't have sufficient tax revenues from a variety of sources to meet the country's needs they are encouraged to place the tax burden on the everyday person.

Furthermore, when governments cut public spending or increase everyday taxes to plug the revenue gap, this burden falls disproportionately on certain social groups. One of the ways they do this in the absence of corporation taxes is by increasing indirect taxes such as Value Added Tax. This disproportionately affects women and girls¹² because they spend most of their income on household goods. Additionally, flat-rate personal taxes are more likely to increase the tax burden on those with lower incomes. In many countries, this is disproportionately women.

What's more, according to the International Labour Organisation (ILO), women perform more than 76.2% of the total hours of unpaid care work, so when governments cut public services

¹¹ See report, 'Death and Taxes' (2008)

¹² Details found on Global Alliance for Tax Justice website



through austerity measures and budget deficits, policies chosen to increase revenue, women act as 'shock-absorbers', taking on the care and education work that must be done regardless of public support.

The tax consensus: How have tax-policy recommendations impacted developing countries?

Some would argue that taxation without representation still occurs today, as global tax rules are developed without input from impoverished countries, making them by definition unrepresentative. Rather than being accountable to their citizens, many southern governments are in fact more accountable to donors and international financial institutions (IFIs) that provide them with aid and debt, especially as many southern country governments depend on aid and debt for a high percentage of their revenue. Donors and IFIs can impose conditionalities with their aid (called '**tied aid**') or conditions with debt (i.e. loans). The policies demanded by these conditions can actually make it *more* difficult for the government to raise revenue via tax.

The 'tax consensus' refers to this general set of principles which multilateral donors in particular, have adhered to in their tax-policy recommendations to developing countries¹³. Christian Aid examined the role of the IMF in promoting particular tax policies in 18 Sub-Saharan countries to find patterns in their recommendations, and found that the IMF tries to impose a 'one-size-fits-all' tax policy on countries, regardless of their specific situation¹⁴. For example, a key element of the tax consensus has been the focus on indirect taxes – in particular a shift toward a Value Added Tax, which is a regressive tax as it is applied equally to everyone regardless of their income, and as aforementioned, can disproportionately impact on women and girls.

Debt was used as a vehicle for this conditionality throughout the Debt Crisis in the 1980s and 1990s in the Global South. This debt crisis led to more loans towards the Global South from IFIs such as the World Bank and IMF [See FreshUp article on Sovereign Debt]. The conditionality required to access loans included minimising the taxation of foreign investors and reducing trade tariffs to increase free trade. However prior to this, taxing foreign investors and placing tariffs on imports were important levers for increasing government revenue.

The use of 'sin' taxes has proved popular in the tax consensus. However, this strategy can have negative impacts on both poor consumers and producers. An example is in India, where regressive kerosene and paraffin taxes targeted poor Indians.

¹³ See Cobham (2007)

¹⁴ See Marshall (2009)



A study exploring IMF recommendations for 18 Sub-Saharan countries between 1992 and 2008 found that two of the most heavily recommended tax changes were to increase trade liberalisation (via import-tariff reductions and lowering export-tax rates) and to introduce VAT.¹⁵

The consensus has also supported trade liberalisation, in other words the reduction of both export and import taxation.

What is the logic behind the tax consensus?

Tax neutrality

A key principle of the tax consensus is **tax neutrality**, which means trying to avoid changes that may distort the market. As a result, tax neutrality manifests in an increase in consumption taxation over trade taxation or direct taxation on income. The key issue with tax neutrality is that it assumes that as long as distortionary taxes are absent, for example taxes that would affect business practice, the economy will deliver an efficient and optimal allocation of resources in society.

Tax neutrality also assumes that governments have a range of other instruments at their disposal to tackle inequality, however in the case of many countries but in particular developing ones, these assumptions do not hold. This is because due to already weak tax collection systems, weakened by the global debt system for example, the pre-tax economy will *not* be efficient, and governments typically will *not* have available to them a range of instruments to mobilise revenue and redistribute wealth.

Trade Liberalisation

The reasoning behind trade liberalisation is to increase market efficiency. The logic behind import-tariff reduction is that if a small economy reduces its tariffs, it increases the flow of imports, and then these impacts that have domestic consumption taxes placed on them. An accompanying well-administered rise in the consumption tax that is equal to the drop in the tariff will therefore leave prices at the same level while raising greater revenue from a broader tax base, and a broad tax base is more sustainable in terms of risk reduction and longevity.

What's more, it was rationalised that the investment would help to develop the country, bringing jobs, infrastructure etc. and that the resulting competition with European imports would be best for consumers.

¹⁵ See Investopedia, 'Supply-side Economics'



However, the revenue response has proved to be very weak, particularly so in the poorest countries where trade taxes constitute a significant proportion of revenue. Many southern countries rely heavily on the taxation of imports, as these taxes are relatively easier to collect and less costly to administer than other forms of taxation, in particular tax on informal economic activity which is prevalent in southern countries. Removing this option has meant the removal of a key method of generating tax revenue for many countries.

Despite this situation, many countries have progressively lowered trade tariffs during the last few decades because of World Bank and IMF conditionalities.

Supply-side fiscal policy

Another reason for lowering taxes and enacting the policies of the tax consensus is that by doing so, the economy is stimulated. The argument is that by being 'pro-business' (i.e. by lowering corporate tax), the financial benefit will trickle down to all individuals in society. This theory is known as supply-side economics or supply-side fiscal policy. The theory is as follows¹⁶: By lowering individual tax, people will have more money in their pockets and therefore more money to spend, which will encourage production and economic growth. By lowering corporate tax, businesses have more profit, and then they will have more funds to hire more labour and invest in improving their service, which will benefit society as a whole. As they employ more and increase wages, they continue to add more money to the pockets of consumers. This cycle continues (it is surmised), resulting in more economic growth which will compensate for the lost tax revenues. Supply-side economists believe that high tax rates strongly discourage efficiency of resource use. Regarding tax, supply-side theorists have historically focused on promoting corporate income tax reductions rather than personal.

This theory does not always hold however, as history shows. For example, Bill Clinton's tax increases on top earners caused economic growth to *increase* for 8 years and created over 20 million jobs. In contrast, in 2001 and 2003 George W. Bush lowered the top tax rate and cut top rates on capital gains and dividends. Despite the forecast in line with supply-side economics, the economy *barely grew*¹⁷. More evidence contradicting supply-side tax cuts exists. In Kansas in 2012, tax cuts on top earners and business owners were drastically cut, while in California taxes were raised on top earners to the highest rate in the USA. Kansas has now fallen behind most other states in terms of economic growth, while California has progressed in the rankings. Supply-side fiscal policy is evidently risky as it can result in reduced tax revenue, resulting in less revenue for public services. However, that said, there are many related factors and it can be

¹⁶ See Investopedia, 'Supply-side Economics'

¹⁷ See video, The Failure of Trickle-Down Economics | Robert Reich, 2017



difficult to pinpoint effects with a high level of confidence and to determine the exact outcome of any one theory or set of policies.

A further argument against supply-side fiscal policy is that there is a growing trend among corporations to engage in stock buybacks rather than reinvesting in line with the theory's assumptions. Buybacks occur when companies place the cash they may gain from lower taxes back into the pockets of their shareholders rather than investing in new plants, equipment, innovative ventures, or their workers. According to the Tax Policy Center, in 2018, US corporations spent more than \$1.1 trillion to repurchase their stock rather than invest in new plants and equipment or pay their workers more.¹⁸

Competition is good for the economy

Further rationale for the tax consensus policies is that increased competition is good for the economy as it encourages companies to make better products and drives the cost of goods down to attract consumers. However, in recent decades there has been a shift from *companies* competing, to *countries* competing. The globalised nature of mobile capital means that tax systems that exist in one part of the world can influence economic activity in another. The result of this is that even if sovereign tax laws tend to be within the remit of one country, the tax laws that exist in country A can influence the economic activity that takes place within the borders of country B. This has manifested in governments competing with one another to attract private investment. There are many ways governments compete; via reduced regulations so that companies can operate more freely without so-called 'red tape'. Specifically, tax concessions, tax breaks and tax 'holidays' are used to attract investment. For example, 'maquilas' in Latin America can, in some countries, be exempt from import duty, income tax, taxes on the repatriation of profits, VAT, asset taxes and municipal taxes.

The logic behind cutting corporate tax rates is that in a globalised world, countries are competing for productive capital. By cutting corporate tax rates, it is surmised that countries can attract capital, which therefore will make workers more productive because of the increase in machines, plants and equipment. This will result, it is theorised, in increased wages for workers. As a result of this logic, between 1985 and 2018, the global average statutory corporate tax rate fell from 49% to 24% (Tørsløv et al.). The logic and laws which initially were used to attract investment in order to develop certain countries have now transmogrified into mechanisms firms can exploit to avoid paying taxes. In Guatemala in 2005 for example, the fiscal losses due to the existence of maquilas was almost 16% of total tax collected that year.

In an effort to attract more investment than the next country, countries have also been competing with their corporate tax rates. Since the 1980s, the corporate income tax rate, the

¹⁸See CNBC (2018)



top inheritance tax rate and the top personal tax rate have all been in decline. Examples abound globally of corporation tax being reduced. For example in the UK, the rate dropped from 28% in 2010, to 19% in 2017, to 17% in 2020. In the US, it dropped from 35% to 21% with the Tax Cuts and Jobs Act of 2017. This reduction has been even more significant in southern countries. As a global trend, when corporation tax decreases, VAT increases, which as you'll recall is a regressive tax which tends to impact women and girls quite negatively. In low-income countries, two thirds of tax revenue is raised through indirect taxes like VAT.

Despite arguments for tax competition that claim that lower tax regimes are essential for attracting investors who will in turn provide jobs, revenue, technology transfer, and infrastructure, and ultimately increase wages, a number of cross-country studies have in fact concluded that the costs of tax incentives in terms of lost revenue frequently outweigh the benefits in terms of increased productive investment. The winners of tax competition are the MNCs that can play governments off one another as they vie for investment by continuously lowering their tax rates. Those who ultimately lose in this dynamic are the ordinary citizens whose governments are deprived of vital revenues with which to fund public services.

While high-income states have by and large been able to protect their revenue flows by shifting the tax burden to relatively immobile economic factors such as labour, income and consumption (with predominantly regressive effects), low-income states have generally been unable to offset the decrease in corporate income tax revenue¹⁹. This is also compounded by the developments in how the global economy operates which we have seen over the last number of decades.

How is the world different today than when the dominant tax rules were created?

Most of the existing country-to-country tax rules were created in the 1920s, in a world where tangible capital was paramount: factories, warehouses and physical goods. Two major developments combined with a situation whereby the current tax rules have not kept pace with said developments, have meant that companies can take advantage of global tax rules in order to minimise how much tax they pay and maximise how much profit they earn.

The first development was the removal of capital controls in the 1970s and 1980s which allowed corporations to easily move their operations and capital between countries. For the first time after WWII, corporations could threaten sovereign nation states with their departure if the terms were not favourable, threatening a sudden stop to that flow of revenue and the associated employment etc. They were able to hit two birds with one stone; they could get the highest profits possible without regard for the needs of the country in which they were based,

¹⁹ Avi-Yonah 2000, Dietsch 2011a, as cited in van Apeldoorn, 2016



and they could dictate the terms of their investment to the nation-state. This reduced and continues to reduce the state's policy space, a strategy that has resulted in diminished revenue via corporation tax for the nation-state.

The removal of capital controls also sparked the emergence of what is now known as the 'race to the bottom', or competition between countries on the rate of corporation tax they charge corporations. Since capital became more mobile, nation states have engaged in efforts to attract Foreign Direct Investment (FDI) through low tax rates, financial incentives and in some cases, financial secrecy. The IMF, the WB, regional development banks and the EU have all been part of promoting this developmental strategy known as the 'tax consensus' [see earlier section]. It has also contributed to a situation where corporations can threaten to leave the country if the corporate tax rate is not seen as favourable.

An outcome of capital mobility is a phenomenon called **capital flight**. Capital flight denotes money leaving a country rapidly, and is defined as the transfer of assets abroad to reduce loss of principal, loss of return, or loss of control over one's financial wealth due to government-sanctioned activities. This can be in response to many stimuli; and is not always illegal. However one key reason capital flight takes place is for the asset-holder to escape paying tax. As Nicholas Shaxson summarises "To *escape* rules you don't like, you take your money *elsewhere*, offshore, across borders."²⁰

The second development is that today in our highly digitised and financialised world, MNEs can conduct their business, often at a large scale, in a jurisdiction in which they have little or no physical presence. The existing rules say that the profits of a company can only be taxed in a country different to that in which it is headquartered, if the company has a *physical* presence there, but of course this is often not the case when it comes to intangible items, for example software owned by technology companies. What's more, a country which headquarters a particular company, for example country A and the global headquarters of Tech Company Inc., does not tend to tax the income on *foreign* activities of that company, as it assumes that the country in which the company is operating, i.e. Country B will receive the tax. However that is not the case, in particular for intangible goods..

Corporate tax dodging in the Global South

Calling countries that suffer from tax dodging 'poor' does not adequately reflect the situation. These countries are often rich in resources, but poor in revenue by virtue of harmful practices of MNCs and global rules that facilitate tax dodging. They are not inherently poor; instead they have been *made* poor.

²⁰ <https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/tackling-global-tax-havens-shaxon.pdf>



The OECD report in 1998, 'Harmful Tax Competition: An Emerging Global Issue'²¹, is credited with first putting the issue of tax avoidance on the political agenda. By showing how wealthy individuals and multinational corporations (MNCs)²² are facilitated by states that are competing for foreign direct investment (FDI) and mobile capital, the OECD was prescient in its warning that this may affect states' fiscal sovereignty. It may 'erode national tax bases', 'alter the structure of taxation' and 'hamper the application of progressive tax rates and the achievement of redistributive goals'.²³

Corporate tax dodging is a major obstacle to fighting poverty. In fact, tax dodging costs developing countries more than they receive in aid. The IMF estimates of long-run revenue loss for developing countries from corporate tax evasion is \$200 billion²⁴. Corporate tax is more crucial in these countries than Global North countries because in the Global South, a large portion of the population don't make enough money to earn tax. If MNCs paid the tax in these countries, it could make a huge difference. For example in Zambia, public services have lost an estimated US\$27 million as a result of Zambia Sugar's tax avoidance schemes and the special tax breaks given to it. This is enough money to put 48,000 Zambian children in school. In 'lower income countries' tax losses are equivalent to nearly 52 per cent of their combined public health budgets²⁵.

What are the impacts of tax dodging?

Tax dodging increases regressive taxation in the Global South

The current global tax system which facilitates corporate tax dodging pushes southern governments towards regressive taxes on broad swathes of the populace, and most often the poorest people in society. The consequent reduction of tax from corporations, combined with weak tax collection systems (which are themselves further weakened by inadequate revenue) means that southern countries have limited options with which to raise revenue. One of the only methods left to generate revenue is therefore to tax their population. Due to the nature of many southern societies in which the informal sector is large and the rural populations also tend to be significant, hindering smooth collection of tax, governments implement regressive taxes on the population via VAT in order to ensure maximum revenue-generation. This is the case even though the rural populations and those in the informal sector are those least able to afford to pay VAT. This means that it is those populations that end up spending a much higher

²¹ See OECD (1998)

²² Also known as MNEs

²³ OECD (1998), p. 14)

²⁴ See Shaxson (2015)

²⁵ Mansour (2020)



percentage of their minimal incomes on essential goods and services that carry VAT than those with much larger disposable incomes. It is important to note that this situation is because **policy space** has been diminished due to inadequate corporation tax as well as sub-standard tax collection systems which are hard to improve due to the lack of revenue.

A combination of factors results in a situation whereby low-income countries may use regressive taxes to generate revenue. A **regressive** tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases. Progressive property and other wealth taxes are difficult to implement for political reasons²⁶; whereas progressive income and capital gains taxes are relatively easy to avoid or evade²⁷. Because of the lack of revenue in the country due to corporate practices, low-income countries then predominantly rely on indirect taxes such as value-added or sales taxes, which generally have a regressive effect on income equality²⁸.

Tax dodging reduces revenue predictability

In countries that don't have a stable tax base, tax revenue is diminished and unpredictable, making it difficult to carry out the functions mentioned in part one, as well as having the revenue required to spend on infrastructure and public services. Without this predictability of revenue into the future, the capacity to plan for the future development of their country is somewhat eroded. For example, issues such as tackling HIV, responding to malaria, and addressing high maternal and infant mortality rates all require reliable long-term funding from governments. This principle has been displayed in Bolivia since 2005, where since 2005 the Bolivian government has been reversing a privatisation policy contained within an IMF-imposed structural adjustment programme (loans with conditions). The government sought to change the royalties and tax structure applied to multinational corporations (MNCs), a move which generated increased government revenue from oil and gas extraction. This gave the government increased fiscal space and allowed it to increase spending on social services including pensions, healthcare and education.

Tax dodging affects domestic compliance on tax

Tax dodging can also influence tax compliance. This is because the perception that the taxes of citizens are being put to good use and that other economic actors aren't unfairly dodging their tax responsibilities is crucial to ensuring tax-paying compliance.

Classic studies on tax compliance found that compliance depends positively on (i) the perceived or expected level of redistribution, and (ii) individuals' expectation of others' compliance

²⁶ Ahmad and Stern, 1989 (as cited in van Apeldoorn, 2016)

²⁷ Bird and Zolt (2005, p. 933)

²⁸ Ahmad and Stern, 1989 (p. 1021, as cited in van Apeldoorn, 2016)



levels²⁹. It has already been shown that tax dodging reduces available revenue in Global South countries, reducing the capacity for redistribution, and then likely influencing the tax compliance in affected countries. Additionally, levels of compliance are dramatically weakened by the absence of international measures to tackle evasion through tax havens and by multinational firms. This highlights a flaw in the existing tax consensus that does not allow for direct redistribution of wealth, and so promotes a self-reinforcing cycle of diminished tax compliance. Indeed, evidence exists to show that the size of the shadow economy depends directly on the level of 'tax morale' - that is, the belief in contributing to society by paying taxes³⁰.

What strategies are used to avoid paying tax?

We'll now move into a number of strategies that are used by MNEs to exploit loopholes and mismatches in tax policies worldwide in order to dodge paying tax.

Base Erosion and Profit Shifting (BEPS)

Base erosion (referring to the tax base) and profit shifting (BEPS) refers to the suite of tax strategies used to exploit mismatches and gaps in tax systems between countries. Profit shifting refers to shifting profits to low or no-tax jurisdictions or where there is no or little economic activity by that company, by using strategies such as trade mispricing, which will be explained later. The erosion of the tax base refers to diminishing the amount of government revenue accrued via tax by using deductible payments such as interest or royalties, in other words, the payment of interest or royalties is deducted from the overall taxable profits, reducing the corporate income, and therefore reducing the taxable income. Developing countries' higher reliance on corporate income tax means that they suffer disproportionately from BEPS.

The first comprehensive view of the cost of profit shifting for governments worldwide found that governments of the EU and developing countries are the prime losers of this shift³¹. Over \$200 billion of the \$500 billion lost globally due to BEPS is lost from the Global South. Crucially, this is more than those countries receive in aid from the Global North.

Close to 40% of multinational profits (more than \$700 billion in 2017) are shifted to tax havens each year. Based on reports filed by the biggest multinationals to OECD members, the tax lost each year to international corporate tax abuse and private tax evasion costs countries altogether the equivalent of nearly 34 million nurses annual salaries every year – or **one nurse's annual salary every second**. The OECD estimates conservatively that 4–10% of global corporate

²⁹ Bosco and Mittone (1997)

³⁰ Torgler and Schneider, 2009.

³¹ Tørsløv, Wier and Zucman (2020)



income tax revenue (100–240 billion USD annually) is lost to BEPS³². The OECD has said that this is a conservative estimate.³³

More recent figures from the Tax Justice Network analysing OECD data track US\$467 billion worth of corporate profits shifted into tax havens, leading to a loss of US\$117 billion around the world annually³⁴. However this is only a collation of data from just fifteen countries. By using higher quality data from 2017, the Tax Justice network has estimated that actual profit shifting for US data is likely in the region of \$US840 billion, and by extrapolating to the global picture they arrive at a figure of US\$1.3 trillion a year. Including indirect effects from the race to the bottom, the overall annual losses imposed by the use of tax havens by MNCs is likely in excess of US\$500 billion. This estimate was arrived at by using a methodology created by researchers at the International Monetary Fund.

Transfer (mis)pricing, or ‘Creative Accounting’

International regulation requires companies to price goods and services as if they were selling them in the open market and as if they are not selling between subsidiary companies. This is supposed to ensure that they are taxed accordingly. This rule is called ‘**arm's length principle**’ i.e. goods and services should be sold ‘at arm’s length’.³⁵ There are valid reasons why transfer pricing exists, for example if a company has a subsidiary in France that makes vinegar and a branch in Ireland that bottles it, then there are good reasons you want to be able to sell between different ‘sister’ companies. However, when this doesn’t take place using the arm’s length principle and leads to a reduction in the company’s declared profits and therefore taxable income, it is called transfer mispricing.

Transfer mispricing is when MNCs sell a resource or item to a subsidiary company at a price different to the market price in order to report lower profits and therefore pay lower tax. Companies with multiple subsidiaries operating in different countries are able to easily manipulate their taxable profits by manipulating the prices that are charged for goods and

³² OECD (2015, P.4)

³³ See OECD (2017)

³⁴ See Tax Justice Network (2021)

³⁵ The OECD article which refers to this principle is as follows:

Article 9 of the OECD Model Treaty Provision:

“Where A) an enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other contracting state, or

B) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state,

And in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

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services traded within the company but across borders. In doing so they reduce the declared income that is taxable by governments. They then may sell this item or resource on to another country, inflating the price and making higher profits.

Let's take an example. Imagine a company's headquarters is in country A where the corporate tax rate is 35%. This company may not want 35% of their pre-tax profits to go to the government. So what they may do is set up a subsidiary or 'sister' company in country B which has a lower tax rate, for example 5%. The company may then tell Country A that their pre-tax profit is lower than Country A thinks it is because in fact, they need to pay the sister company to use the intellectual property. For example, on US\$1 million pre-tax profits, the company may send \$800,000 to the sister company in royalties and licensing. This drastically reduces the amount of profit on which the higher (35%) corporation tax may be charged; US\$200,000 instead of US\$1. Thus by moving pre-tax profit offshore to a lower tax rate jurisdiction via an intellectual property subsidiary, the company pays significantly less tax overall than it would have done had it not had the option of creating offshore subsidiaries in lower tax rate jurisdictions.

For tangible goods for which competitors exist, it is very possible to monitor and regulate transfer pricing. However, less so for intangible items. For example, what happens in a scenario where the item(s) traded between subsidiaries have no easy comparison on the market, and so the price can't accurately be determined? Think of a logo, for example the Apple logo. How can the worth of this logo be determined? It can be powerfully argued that much of Apple's value comes from its reputation, so it does not make sense to compare the value of the Apple intellectual property to that of a brand new company that has no societal reputation. So then the question arises, at what price should Apple sell their intellectual property to Apple subsidiary companies? This question is becoming increasingly relevant in today's digitised world, however the rules for monitoring and regulation transfer pricing in the realm of intellectual property (IP) have not kept pace with global technological developments. Since for many such transfers no comparable market transactions exist that would allow for an accurate price determination, MNCs will likely continue to be able to manipulate the system for tax purposes³⁶ until a system for accurately determining market prices in IP exists.

The victims of trade mispricing are often poorer countries where the revenue authorities are often under-resourced and unable to monitor or prove what is happening. The Mbeki Report revealed that African countries lose over \$50 billion annually in illicit financial flows (IFFs), transfer mispricing being a significant cause of this revenue loss. According to research by Action Aid International, twenty developing countries could be missing out on as much as \$2.8bn in tax revenue from Facebook, Alphabet Inc. (parent company of Google) and Microsoft due to unfair global tax rules. This is unfair especially considering how developing countries

³⁶ Avi-Yonah (1995, as cited in van Apeldoorn, 2016).



offer tech businesses new markets, increased global brand recognition and billions of new users' data, which translate into continuing revenue growth.

Ironically, some of the methods that countries are taking to regain lost revenue are in fact affecting the use of apps such as Facebook. In 2018, the Ugandan, Zambian and Benin governments announced or imposed new taxes on mobile internet customers to use 'over the top' (OTT) mobile communications apps³⁷. These revenue-garnering taxes, (which are also an effort to protect national telecom industries), are partly a result of the diminished tax base due to the activities of corporate actors.

Secrecy Jurisdictions

The impact of transfer mispricing is compounded by global secrecy and lack of transparency in financial reporting. Secrecy jurisdictions, more commonly known as tax havens, facilitate the opacity of financial holdings and transactions. They allow companies and wealthy individuals to hide assets and so avoid paying tax. Their refusal to share information on these holdings with other countries prevents other countries from knowing if their residents or companies which operate on their shores are holding more assets than declared. In 2015, close to 40% of MNC profits made outside of the country where their parent company is located were shifted to tax havens.

Aggressive Tax Planning

After four decades of economic globalisation whereby companies have increasingly been facilitated to operate across borders, it is evident that many of these companies have adopted what are known as 'aggressive tax policies' in order to avoid paying tax. This has allowed them to lower their **effective tax rate** to jurisdictions with very low rates and sometimes 0%. These companies are allowed to move their operations, but the citizens of the countries which they deprive of tax are unable to move, and are burdened with consumption taxes to plug the '**tax gap**'.³⁸

What can be done?

Principles underpinning solutions

³⁷ Uganda has since rescinded the OTT tax (2021) and the tax in Benin was revoked shortly after its introduction due to popular protest.

³⁸ OECD Podcast (2021)



As the world has become increasingly globalised economically, certain principles have emerged to explain the fiscal relationship of corporations to nation-states, and these have inspired policy proposals to help ameliorate the situation. The **principle of economic allegiance**³⁹ requires anyone that obtains significant benefits from an economic community to pay tax to that community⁴⁰. Dietsch terms this principle the ‘**membership principle**’ because it determines in which country or countries an individual or corporation is liable to taxation and thus a ‘member’. The membership principle states that ‘individuals and companies should be viewed as members [and pay tax] in those countries where they benefit from the public services and infrastructure’⁴¹. The principle of economic allegiance, if followed logically, should rule out tax competition as Multinational Corporations (MNCs) are prevented from conducting economic activities in a high tax country while shifting profits to low or zero-tax jurisdictions or ‘tax havens’. However, as we have seen, that is not always the case because of mismatches and loopholes in tax systems between countries, and so concrete policies rather than solely philosophical theories are more effective in practice at changing the global tax rules.

The second principle is the **national rental principle**⁴². Since, on the internationalist position, states are entitled to the productive economic factors they control (such as capital, natural and technological resources), they are then logically also entitled to benefit from the productive use that is made of those economic factors. They may do this by charging rent, in other words by taxing individuals and MNEs who create value by making productive use of the economic factors in their territory. By this logic, profit shifting by MNEs, for instance by means of transfer mispricing, prevents states from taxing the economic value derived from the resources to which they are entitled according to this principle.

Finally, there is a principle that says that taxes should be paid where value is created. However, it is not enough to say that activity is taxed where value is added. Due to the nature of global value chains, the distribution of value-added in GVCs is skewed against low-income countries. If MNEs are taxed where they create *value*, they will mostly be taxed in high-income OECD countries where *manufacturing* takes place, rather than sales. Low-income countries, generally engaging in low value-added economic activity, are only then allocated a small share of the tax base if any, while high-income OECD countries, generally engaging in high value-added economic activity, are allocated a large share of the tax base⁴³.

Solutions

Three of the key solutions to global tax dodging are the ‘ABCs’; Automatic Exchange of Information, Beneficial Ownership and a Common Consolidated Corporate Tax Base.

³⁹ OECD (2013, p. 8).

⁴⁰ Pinto (2003, p. 196), in van Apeldoorn (2016)

⁴¹ Dietsch (2015, p. 82,83)

⁴² Musgrave and Musgrave (1972, p. 73) in van Apeldoorn (2016)

⁴³ van Apeldoorn (2016)



Automatic Exchange of Information (AEI)

Automatic exchange of information (AEI) is a method of data-sharing that prevents both corporations and individuals from using bank accounts they hold abroad to hide the full and true value of their wealth. By obscuring the extent of their wealth, they pay less tax at home. With AEI, country A will take all of the information it has on person A and corporation A, and if they are normally resident, i.e. living or headquartered in country B, then country A will automatically exchange information on their financial holdings with country B. This allows country B to know the full extent of their wealth and so tax the individual or corporation accordingly.

The goal of AEI is to increase tax transparency. However many solutions attempt to do this, so AEI is not unique in that regard. The crucial element of AEI however is the *automaticity* of it; if in place, information is exchanged with the 'home' country automatically. This means revenue authorities are alerted immediately about their residents' (individual or corporate) financial holdings in other countries, and don't have to engage in lengthy and sometimes expensive negotiations with other countries regarding the release of the financial information.

Today, nearly 100 countries are automatically exchanging information with each other. The information shared covers over 84 million accounts containing a total of \$11 trillion. Unfortunately this does not cover all countries. This state of affairs means that money is still flowing to secretive jurisdictions that continue to withhold information on the financial holdings in their country. Tax transparency is therefore only as strong as its weakest link. This is aided by the banks that assist in this process; banks that have historically been based primarily in the United States, the United Kingdom and Switzerland.

Interestingly, countries that are seen as debtors are actually creditors when capital flight and tax flows are taken into account. Nigeria is classified as a 'debtor' country as on aggregate it owes the rest of the world more money than it is owed. However, when the capital outflows from Nigeria are scrutinized, it becomes clear that it is actually a net-creditor; it is owed more money than it owes. 'The Price of Offshore, Revisited' report looked at 139 low and middle income countries to find details on their unreported capital flows. It found that roughly one third of offshore financial assets can be attributed to so-called 'developing' countries; countries in the Global South.

What's more, the lack of complete AEI increases capital flight, as banks in the 'away' country are not required to share information with the 'home' country on the asset holdings of the individual. The 'Capital Flight from Sub-Saharan African Countries, 1970 – 2010' report found that the 33 Sub-Saharan countries covered by this report lost a total \$814 billion dollars of taxable income from 1970 to 2010, for an accumulated capital stock of \$1.06 trillion in 2010. This far exceeds their external liabilities of \$189 billion, also making the region a 'net creditor'



to the rest of the world. This elucidates what was until now perceived as an issue of debt into its modern form; an issue of tax.

Global Asset Register & Beneficial Owners

A Global Asset Register has been touted as a tool to create a comprehensive registry of all international wealth and assets and their real 'beneficial owners'. A beneficial owner is the human that ultimately benefits from the profit accrued due to the ownership of a company or legal body. The legal owner of a company could be another company (like a 'shell' company), or it could be an accountant, or somebody else altogether. This *legal* owner generally must be registered, however the *beneficial* owner usually does not have to be registered. Oftentimes, the legal owner may not even know who the beneficial owner is!

Most countries already have national registries, however these in isolation cannot account for the assets held abroad. By providing a public and centralised global resource showing who owns what and where they own it, the register would provide a way to record, measure, and understand the distribution of global wealth. This would increase global wealth transparency, and give regulatory authorities the power to develop effective taxation policies to reduce the exploitation of secrecy jurisdictions, tax havens and tax conduits.

Financial globalisation has made this process opaque, as one company can have another company as its legal owner, and that company can have even another company as its legal owner, and so on, obscuring the beneficial owner(s) via a long and complex chain of legal ownership. This makes it very difficult to track and tax profit, and ensure that no laws are broken throughout the chain.

The crux of beneficial ownership is that the beneficial owner must be a human. By requiring beneficial owners to be registered just like legal owners, beneficial ownership registration laws make sure the wealthiest are held to the same level of transparency and accountability as everybody else. However, because of the nature of global capitalism and the ability of capital to move freely across borders, this won't work for everyone unless *all* countries register beneficial owners. Until that happens, profits will continue to be able to be relocated to the place most amenable to paying low or no tax by those who wish to hide their identities from the rule of law globally. In order for this to work effectively, governments must drop the threshold from owning 25 percent of shares to owning at least one share in a company, so that true beneficial owners cannot escape being categorised as beneficial owners.

Common Consolidated Corporate Tax Base (CCCTB)

There are two ways to approach the taxing of a company that operates across multiple borders with subsidiaries nested under a parent company. The first method is via the 'Arm's Length Pricing Principle' is what is actually used today, although it has already been shown the issues

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that emerge with applying this principle to intellectual property. The principle assumes that every company within a group is separate and independent and should be taxed as such (however, the reason these companies exist in a group in the first place is because that is the most profitable option, so there will always be some free-floating non-taxable profit in this scenario, even if the subsidiary companies are treated as independent and separate).

The EU is in the process of creating a single set of rules called the 'Common Consolidated Corporate Tax Base' (CCCTB) to calculate the taxable profits of companies within the parameters of the EU. With the CCCTB, cross-border companies would only have to comply with one, single EU system for computing their taxable income, rather than many different national rulebooks. In other words, the profits are consolidated across the EU. The CCCTB seeks to apply a universal tax code for all multinationals operating inside the EU earning in excess of €750m. Companies earning above this threshold will file one tax return for all of their corporate EU activity. The EU says that the CCCTB will contain robust anti-avoidance measures in order to prevent base-erosion and profit-shifting to non-EU countries. If implemented, it will eliminate mismatches between national systems, preferential regimes and hidden tax rulings which those seeking to avoid paying tax exploit.

Unitary Taxation

A similar method of allocating pre-tax profits is called 'Unitary Taxation', and it suggests that governments treat a multinational corporation (MNC) as one group made up of all its local subsidiaries. This is instead of treating each subsidiary as an individual entity separated from the global chain, which as seen in the transfer pricing example, allows a company to apportion some of its profits to an offshore subsidiary in a lower tax rate jurisdiction.

With unitary taxation, the countries in which sales take place are identified, not just the location of manufacture or company headquarters. The pre-tax profits that the multinational corporation declares as an entire group are then apportioned to each country where it operates, based on how much of its *real economic activity* took place in that country. The apportionment formula looks at where the sales take place, where employees are, and where the physical assets are. The pre-tax profit is then split into thirds between these three categories; where the sales are, where the employees are, and where the physical assets are. This profit is then taxed in the respective countries accordingly depending on the percentage of the overall sale which that country accounts for. For example, if a company's pre-tax profit is \$1 million, then one third of this will be allocated to 'where the sales takes place; sales'. This is \$333,000. If country A accounts for 30% of the sales, it will tax 30% of \$333,000. If country B has 60%, it will tax 60% of \$333,000 and country C will take 10% of \$333,000. This same process takes place for apportioning the pre-tax profit assigned to 'employees' and 'assets'. With unitary taxation, countries have the ability to set the tax allowances or credits as well as the tax rate and have full transparency over the profits a company makes and in what countries that



profit-making activity is supported. All of this greatly increases their national agency over tax collection.

Multilateralism at the OECD

Capital mobility and the structure of modern-day corporations with their wide-ranging subsidiaries means that governments must work together to tackle BEPS. The primary goal of institutional reform is to protect fiscal self-determination⁴⁴, or ‘the effective fiscal sovereignty of countries over the design of their tax systems’⁴⁵. However, currently there is no international body governing the rules of tax, although moves have been made in this direction. In 2013, the G20 maintained in its Saint Petersburg Declaration that

“profits should be taxed where economic activities deriving the profits are performed and where value is created”⁴⁶.

The principle that taxes should track value creation has since been almost universally endorsed. The G20’s Saint Petersburg Declaration is at the very core of the OECD’s BEPS initiative which is an effort to align the taxation of corporate profits with value creation and economic activity. The following are two developments to the OECD’s initiative to tackle BEPS, introduced in 2021.

Tax rates differ between countries, and this is called the ‘tax rate differential’. Generally, companies are not taxed on their profits made in a country different to where they’re headquartered, and so this has encouraged companies to keep their profits in low tax jurisdictions. The issue has been summarised by the OECD as follows;

“Digitalisation and globalisation have undermined the basic rules that have governed the taxation of international business profits for the past century. Large multinational enterprises (MNEs) are able to earn significant revenue in foreign markets without those markets seeing much, if any, tax revenue as a result”⁴⁷.

The OECD reform agreed in July 2021⁴⁸ seeks to, at least partially, reform the global tax infrastructure in order to amend this state of affairs. It has two pillars and will be finalised in October 2021, with implementation from 2023⁴⁹.

⁴⁴ Dietsch (2015)

⁴⁵ OECD (2014, P. 14, as cited in van Apeldoorn, 2016).

⁴⁶ 014, P. 1 G20 Saint Petersburg Declaration (2013, p. 12)

⁴⁷ OECD (2021, p. 8)

⁴⁸ OECD (2021)

⁴⁹ 132 member jurisdictions have agreed to it as of 9 July 2021. It is noted that not all Inclusive Framework members have joined as of the time of writing.

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Pillar 1: Nexus and Profit Allocation

Under Pillar 1 is a new formula for profit allocation in order to address issues of economic globalisation and digitalisation. With this rule, if a company sells in a country, it will be taxable in that country. However, there are certain inclusion criteria which determine if this pillar will apply to a company. Under Pillar One, 20-30%⁵⁰ of profits of the largest and most profitable MNEs (above a set profit margin) would be reallocated to the market jurisdictions where the MNE's users and customers are located. This is similar to unitary taxation above.

The scope of this pillar only applies to multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue). Approximately one hundred of the most profitable companies in the world will be subject to the rules under this pillar. These companies collectively make over \$500 billion of profit, and a significant percentage of that profit will be allocated between the countries in which they make their sales or the services are provided.

Under the first pillar also are included solutions for determining the allocation of **taxing rights**, and ensuring that taxing rights are given to countries even if an MNE does not have a physical presence there; for example with intangible goods. The **nexus** rule means that for a company to be taxable in a country, it will no longer need to be physically present or a permanent establishment in the country. The threshold of sales to trigger the nexus rule (i.e. the new taxing rights) is €250,000 in countries with GDP lower than 40 billion euros, and 1 million euros in countries with larger revenues.

If both of these pillars are implemented, the largest and most profitable companies in the world will pay more taxes where the clients are, in other words where the company's goods or services are consumed. It is estimated that taxing rights on more than USD 100 billion of profit are expected to be reallocated to market jurisdictions each year.

There are two exceptions to this; extractive industries and financial services. Regarding the former, the OECD rationale is that the rent belongs to the land where the extractions take place. Regarding the latter, it was given an exception due to complexity. However both are included under Pillar 2.

Pillar 2: Minimum level of tax

OECD negotiations have frequently included discussions on the introduction of a global minimum level of taxation and in June 2021, the G7 finance ministers finally committed to a global minimum tax rate.

⁵⁰ The exact number will be decided in October 2021.



Under Pillar 2 exists a system to ensure that MNEs pay a minimum level of tax on profits: at least 15% effective tax on the profits they make abroad from the country in which their headquarters is located. This pillar is an effort to put a floor under the race to the bottom. It does not eliminate tax competition, but it does set multilaterally agreed limitations on it. It allows governments around the world to allow additional taxes on the foreign profits of MNEs headquartered in their jurisdiction, at least to the agreed minimum rate of 15%. This move is estimated to generate around USD \$150 billion in new tax revenues globally per year. The rate would apply to any company with over EUR 750 million annual revenue.

This will likely have impacts on tax havens. Many studies have analysed how MNEs shift their profits in response to changes in corporate tax rate differentials finding that, on average, if a country increases its corporate taxation by one percentage point with respect to other countries, MNEs will decrease profits reported in that country by around 1% and shift them to other countries with a lower level of taxation (Heckemeyer and Overesch 2017, Huizinga and Laeven 2008, Beer et al. 2020, Dharmapala 2014 as cited in Acciari et al., 2021).⁵¹ Acciari et al. explored if this phenomenon changes depending on whether the tax change happens in a low or high-tax country. They found that profit shifting is significantly more sensitive to tax rate changes in countries with tax rates lower than the world average, and is less sensitive in countries close to the average. Specifically, they found that MNEs are eight times more sensitive to changes in tax rates occurring in countries with a tax rate much lower than the world average and 60% less sensitive to changes in tax rates among countries with similar tax rates, so it is likely that some countries will resist these new measures.

Criticism

Many African civil society organisations have called for a rejection of the G7 global tax deal hosted by the OECD⁵² for a few reasons. Firstly, the fact that only approx. 100 companies would be affected under Pillar 1 has been deemed inadequate, and not enough of the company's profits would be reallocated. Secondly, the proposed allocation of tax revenue under Pillar 2 would be allocated to the countries in which these MNEs are headquartered, which tend to be rich, northern countries which have historically extracted profits from the south. Thirdly, the two-pillar proposal does not progress the establishment of a UN tax body. Finally, the 15% rate enshrined within Pillar 2 has been shown to, at least in three countries, *reduce* the tax revenues accruing to African countries and so would have impact on certain countries' ability to service their debt. This is in contravention to the OECD's claim,

⁵¹ Heckemeyer and Overesch 2017, Huizinga and Laeven 2008, Beer et al. 2020, Dharmapala 2014 as cited in Acciari et al., 2021 as cited in Acciari, Bratta and Santomartino, 2021.

⁵² Nguegan (2021)



“The OECD estimates that on average, low-, middle- and high-income countries would all experience revenue gains, but these gains would be expected to be larger (as a share of current corporate income tax revenues) among low income jurisdictions”.⁵³

Instead, the members of the network propose that the Minimum *Effective* Tax Rate (METR) is used instead of 15%, so that the existing debt profile of countries is taken into account.

An ‘inclusive’ framework?

There is another fundamental issue with the OECD proposal. In the current system of global tax regulation and reform, negotiations take place within a body called the Inclusive Framework which is hosted by the OECD. So who does this framework include, and is it genuinely inclusive? In order to be part of it, countries must have agreed to commit to following the outcome of the 2015 BEPS negotiations. The issue with this is that these negotiations followed an agenda informed by the interests of rich countries. In fact, over 100 developing countries were excluded when the 2015 package was negotiated. There are a number of reasons for this, ranging from a concern regarding BEPS’ ability to genuinely ameliorate the global situation of tax injustice, to the annual membership fee of approximately €20,000. Demanding that countries may only be part of current negotiations by committing to previously agreed decisions taken without their consent or input is coercive and cannot be said to be truly inclusive.

Additionally, the OECD is biased towards its members. According to its founding convention⁵⁴, it is to ensure “the highest sustainable economic growth and employment and a rising standard of living in Member countries”. There are only 38 members, and they are all rich countries. Therefore developing countries would in effect be paying an organisation (the OECD) of which they are not a member, when their limited resources may be better utilised in their interests at a genuinely global and inclusive body, such as the UN.

Although the Inclusive Framework boasts 139⁵⁵ members (including countries and jurisdictions), the picture comes into sharper focus as the nature and type of member is scrutinised. Out of the world’s 195 countries, approx. one third have chosen not to join the IF⁵⁶. What’s more, it is telling that of the world’s 46 least developed countries (LDCs), 37 of them are not taking part in the IF⁵⁷, equating to four fifths or 80% of LDCs. This casts doubt on the accuracy of the term ‘inclusive’ in this context.

⁵³ OECD (2021, p. 14)

⁵⁴ OECD (1960)

⁵⁵ Members of the OECD/G20 Inclusive Framework on BEPS (2021)

⁵⁶ The IF members include a number of jurisdictions (e.g. many British overseas territories) as well as countries

⁵⁷ As of July 2021, those that are part of the IF are: Benin, Burkina Faso, Democratic Republic of the Congo, Djibouti, Haiti, Liberia, Senegal, Sierra Leone and Zambia <https://unctad.org/topic/least-developed-countries/list>
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Civil society proposal: UN body for global tax regulation

The current global tax system which consists of a complicated web of bilateral trade treaties and differing regulations across regions and countries results in inconsistent policies across the world, leading to the emergence of policy mismatches which are amenable to exploitation by those seeking to dodge paying tax. In this world of globalisation and capital mobility, there remains no international body tasked with ensuring tax rules are applied fairly, making it deeply challenging to regulate this area. A global problem requires a global solution. That is why the Group of 77 (G77), representing more than 130 developing countries, has repeatedly proposed the establishment of an intergovernmental tax body under the auspices of the United Nations (UN) to plug the gaps and fix the loopholes in the global tax system.

Why the UN?⁵⁸ The UN is the only global institution where all governments participate as equals, and so it is a good forum to seek to achieve a global commitment to action. Because of this feature of the UN, it is the only body that can legitimately claim to be in a position to create a level playing field. In order for a level playing field to emerge, all countries must feel that if they change their tax policies, they will not be negatively impacted to the advantage of another country. If they feel this, it will contribute to hesitancy due to the perceived **'first mover'** disadvantage, whereby more stringent tax policies may simply result in businesses and wealthy individuals registering themselves in other jurisdictions.

There are a number of other reasons to have a UN tax body. A UN tax body would also allow for stronger cooperation between tax administrations, facilitating an increase in transparency via automatic exchange of information. It would also likely result in governments needing to rely less on unilateral (one-sided) action. It would also contribute to the creation of a better global environment for business due to the increase in certainty regarding policies around the globe, reducing perceived risk and increasing investment. Crucially, it would also likely speed up an end to the race to the bottom, as governments would no longer have reason to fear capital flight due to the existence of lower-tax jurisdictions or more favourable tax policies elsewhere. Additionally, a globally coordinated system of tax regulation is likely to see increased buy-in from governments because, as aforementioned, all governments are equals in the UN so it is unlikely that a government will be hesitant to adopt policies because they are seen to have been created without the participation of said government. What's more, if the world's poorest countries were able to participate effectively in the development of global tax rules and standards, they would be able to ensure that the global system also works for their countries.

Negotiations regarding global tax rules impact citizens all over the world, and disproportionately those in developing countries, for the reasons already outlined. That is why these negotiations should take place in a forum where all countries are on a truly equal footing; as opposed to in the OECD where some countries are members and others are not. Additionally, no system of tax

⁵⁸ See Eurodad; Financial Transparency Coalition (2019)

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negotiations should ask developing countries to commit to following existing rule packages in order to join the negotiations. Also, all countries should be allowed to participate in setting the agenda; not just the OECD members and G7 countries as is currently the case. Finally, the secretariat leading the negotiations should be neutral, which the OECD cannot be said to be considering the interests of a certain group of countries are prioritised over those of others.



Glossary

Ability to Pay Principle

An economic principle that states that the amount of tax an individual pays should be dependent on the level of burden the tax will create relative to the wealth of the individual.

Arm's Length Principle

The international standard which states that, where conditions between related enterprises are different from those between independent enterprises, profits which have accrued by reason of those conditions may be included in the profits of that enterprise and taxed accordingly

Beneficiary-pays Principle

This principle when applied to taxation states that the user or beneficiary of the good or service provided by government should pay for that good or service. This principle suggests that the burden of taxes should be distributed among the tax payers in relation to the benefits enjoyed by them from government services or social goods. It implies that every citizen should pay tax in proportion to the utility he derives from the public goods and services. Thus, those who receive more benefits or utility from social goods should pay more than others.

Capital Flight

A phenomenon characterized by large outflows of assets and/or capital from a country due to certain economic events.

Cost-of-service Principle

This principle suggests that the cost incurred by the government in providing public goods to satisfy social needs should be regarded as the basis of taxation.

Thus, tax is payable as per the cost of public goods enjoyed by the citizens. This means that the state is just like a producer of social goods and taxes are the prices for the same.

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Consumption tax (e.g. VAT, GST)

Tax levied based on spending on goods and services. Consumption taxes are indirect taxes. Common examples of consumption taxes include Value Added Tax (VAT), Goods and Services Tax (GST), Sales Tax and Excise Taxes.

Direct tax

Taxes levied directly on an individual's wealth, profits and/or income. These include Personal Income Tax, Corporate Income Tax and Property Taxes, among others.

Elasticity

If a producer or consumer is inelastic, it will demand the same quantity no matter what the price. Demand remains the same even if the price changes. If a producer or consumer is elastic, the producer or consumer is very sensitive to price. Demand may change if the price changes. The elasticity will determine the proportion of tax incidence between producers and consumers of a good. In the case of cigarettes, demand is inelastic because cigarettes are addictive. The burden then falls mainly on the consumers, as that represents the inelastic side of the market. If consumers may change their demand but sellers cannot change their supply (for example, the location of their hotels), then the tax burden is on the seller as the seller needs to incentivise the buyer to purchase from them. Buyers could have their vacation elsewhere, so it is not in the seller's interest to pass the tax burden onto the buyer. The more elastic the demand curve, the easier it is for consumers to reduce quantity instead of paying higher prices. The more elastic the supply curve, the easier it is for sellers to reduce the quantity sold instead of taking lower prices.

Effective Tax Rate

An average rate of tax payable by an organization or a person

Equal Sacrifice Principle

States that everyone should give up the same amount of utility when paying income taxes.



Excise Tax

An excise tax is a legislated tax on specific goods or services at purchase such as fuel, tobacco, alcohol, and sugary drinks. They are primarily taxes that must be paid by businesses, usually increasing prices for consumers indirectly. Excise taxes are primarily a business tax, separate from other taxes a business must pay, like income taxes. Excise taxes are often called 'sin' taxes due to the fact that they are often placed on goods with a high social cost. Excise taxes are usually 'hidden' as they are added without consumers being entirely aware of them.

Horizontal equity

Horizontal equity conforms to the concept that people with a similar ability to pay taxes should pay the same or similar amounts.

Incentive (of tax)

An aspect of a country's tax code designed to encourage a particular economic activity by reducing tax for an economic agent in the country. Tax incentives come in various forms, including but not limited to reductions in rates for specific tax types, or tax holidays whereby a business can operate for a defined period of time without paying the specified tax. Tax incentives can have both positive and negative impacts on an economy

Incidence (of tax)

A term used to refer to the division of the tax burden between buyers and sellers. Tax incidence falls mostly upon the group that responds least to price (the group that has the most inelastic price-quantity curve). The tax incidence depends on the relative price elasticity of supply and demand. When supply is more elastic than demand, consumers bear most of the tax burden. When demand is more elastic than supply, producers bear most of the tax burden. Tax incidence falls mostly upon the group that responds least to price (the group that has the most inelastic price-quantity curve).

Indirect tax

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Taxes that are collected through intermediaries and later transferred to the tax authority. An example of indirect taxes is consumption tax, where the tax is added to the price of the product or service and collected by the vendor/provider.

Nexus

Whether a business owes sales taxes to a particular government depends on the way that government defines nexus. A nexus is generally defined as a physical presence, but this "presence" is not limited to having an office or a warehouse. Nexus is the connection between the taxing authority and an entity that must collect or pay the tax.

Marginal tax rate

The tax percentage on the highest [unit of currency] earned.

Multiple taxation

A situation in which multiple taxes are levied on the same income of a person or business. This can happen when the same income is subject to taxation by both local and central government.

Marginal Utility

The amount of additional utility provided by an additional unit of an economic good or service, for example a unit of currency.

Policy Space

The ability of national policymakers to use policy instruments for reaching their national goals.

Principle of Economic Allegiance

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Progressive taxation

A tax in which the tax rate rises as the taxable amount increases, and is based on the ability-to-pay principle. The purpose of a progressive tax system is to increase the tax burden to those most able to pay. A good example is the graduated Pay As You Earn (PAYE) rate of tax.

Proportionate Principle

A proportional tax is an income tax system that levies the same percentage tax to everyone regardless of income. A proportional tax is the same for low, middle, and high-income taxpayers. Proportional taxes are sometimes referred to as flat tax.

Regressive taxation

A tax imposed in such a manner that the tax rate goes down as the amount subject to taxation goes up, which is a complete opposite of progressive taxation. Some flat-rated taxes, such as the VAT, might be regressive in practice when they are applied uniformly and effectively charge a larger percentage of income from low-income earners than from high-income earners. A regressive tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases.

Residence country

The investor's country of residence. The residence country is also sometimes referred to as the capital-exporting country.

Revenue (of Government)

Government revenue or National revenue is money received by a government from taxes and non-tax sources to enable it to undertake government expenditures.

Sales Tax

Retail sales taxes are only charged to the end user of a good or service.

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Source country

The country that hosts the inward investment. The source country is also sometimes referred to as the capital-importing country.

Special Economic Zone (SEZ)

A special economic zone (SEZ) is an area in a country that is subject to different economic regulations than other regions within the same country. The SEZ economic regulations tend to be conducive to—and attract—foreign direct investment (FDI).

Sudden Stops

The abrupt reduction of capital flows into a nation's economy. They can be triggered by foreign investors or domestic residents.

Tax

A compulsory contribution to state revenue levied on different economic agents (such as businesses and individuals) by the government, for example on their income or added to the cost of some goods, services and transactions. While fees and/or levies usually refer to a situation where they are paid in direct exchange for a service, taxes are typically paid to the general state or local budget.

Tax Avoidance

Tax avoidance is the use of legal methods to reduce the amount of income tax that an individual or business owes.

Tax Base

The tax base is the total amount of income, property, assets, consumption, transactions, or other economic activity subject to taxation by a tax authority.

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Tax Consensus

Tax Dodging

A catch-all non-legal term to refer to activities related to reducing one's tax liability either legally or illegally.

Tax Evasion

Tax evasion is an illegal practice where a person or entity intentionally does not pay due taxes.

Tax Gap

The difference between what tax should be paid and what is actually paid.

Taxing Rights

The rights a country has to tax a certain entity.

Tax (or fiscal) Neutrality

A concept that states that fiscal decisions (taxing, spending, or borrowing) of a government can or should avoid distorting economic decisions by businesses, workers, and consumers. The idea of a fiscally neutral policy is one in which demand is neither stimulated nor diminished by taxation (or government spending).

VAT (Value Added Tax)

A VAT is a consumption tax placed on a product at every point where value is added in the supply chain, from production to the point of sale. For example, the three stages show points of value addition. 1) A baker buying wheat from a farmer will pay VAT on the purchase. 2) The supermarket, when buying the baked loaf will pay VAT. 3) The customer buying the loaf from the

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supermarket will also pay VAT. It is therefore collected at each stage in the supply chain, in contrast to a sales tax, which is only assessed and paid by the consumer at the very end of the supply chain. VAT is based on taxpayers' consumption rather than income. VAT applies equally to every purchase.

Vertical equity

Vertical equity usually refers to the idea that people with a greater ability to pay taxes should pay more. Vertical equity follows from the laddering of income tax to progressively higher rates. The laddering of income taxes conforms to the underlying definition of vertical equity, as those who have a greater ability to pay tax, pay a higher proportion of their income.



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Creative commons advice

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