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TAX JUSTICE: THE IMPACT OF GLOBAL TAX POLICY ON DEVELOPING COUNTRIES AND THE ROLE IRELAND CAN PLAY

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Tax is the most sustainable source of development finance providing developing countries with revenue for investment in essential services and infrastructure, while promoting greater accountability between state and citizen. Yet the sovereign right of government to tax economic activity has been undermined by increasingly globalised capital flows, a number of commonly prescribed tax policies which form part of the so called "tax consensus" – a concept increasingly challenged in the wake of the financial crisis – and by the exploitation of loopholes between jurisdictions by individuals and multinationals. It is estimated that corporate tax evasion costs developing countries $160 billion each year – greater than the global aid budget.

This paper explores recent developments in global taxation and their impact on developing countries. Key questions are raised regarding Ireland's role within this global system of capital movement. Findings suggest that tax competition and the lack of international tax cooperation are harmful for developing countries and that Ireland should consider the impact of its tax policy on development, both domestically and in international negotiations.

Introduction

Throughout history, sovereign governments have used taxation as a means of exerting and maintaining control through raising revenue and by regulating and controlling business activity within their jurisdictions.[2] Effective taxation maintains public services by raising revenue for investment in state institutions, re-pricing, to ensure social and environmental costs are reflected in market prices,[3] redistributing wealth through the socio-economic strata of society, and by promoting democratic accountability between governments and their tax paying citizens.[4]

Since the 1960s, however, effective taxation within a state jurisdiction has become progressively more challenging. International capital mobility and increasingly complex capital flows render national taxation policies ineffective in exerting control over, and raising revenue from, international actors such as multinational corporations (MNCs).

In response a number of nation states shifted policy focus to use taxation as a means of attracting foreign direct investment (FDI) and capital; a process known as tax competition. In this climate, corporations and wealthy individuals can take advantage of tax incentives by locating operations in low tax jurisdictions. Concomitantly, the rhetoric of taxation shifted from one of moral or civic duty, reflecting the desire to participate in a social group,[5] to a view presenting taxation as a cost to business, which can and should be avoided.

The increasing complexity of company structures and the differentiation in tax rates between jurisdictions creates a mechanism and an incentive for companies operating internationally to mis-price intra-company trade to shift capital from where wealth-creating activities occur to where tax rates are lowest. This practice has long-term negative implications for low-tax jurisdictions[6] as well as the loss of revenue for locations from where profits are shifted.

The financial crisis has sparked renewed interest in addressing those evading and avoiding tax, as states struggle to recover revenue streams to pay for expensive bank bailouts and provide public services; tax has become a significant political issue on the international stage. Discussions at the G20 have heralded the "beginning of the end" of tax havens, recognising that developing countries should be enabled to benefit from a "new cooperative tax environment".[7] While there are a number of significant weaknesses in the current G20 proposals, it is clear that the financial crisis presents a unique window of opportunity for non-governmental organisations (NGOs) and policymakers to shape this new cooperative tax environment in a way that benefits developing countries.

This paper outlines some of the impacts and implications of tax competition, and in particular, addresses the mechanisms used to shift capital around the globe to take advantage of low-tax jurisdictions. This background provides the basis for examining the impact of low-tax jurisdictions on the global economy, particularly developing countries.

Ireland's taxation policy is then examined in the context of international capital flows, raising questions regarding Ireland's role in this system and the long-term implications of current taxation policy on the economies of developing countries. It is argued that Ireland should consider these issues as a matter of policy coherence for development in international negotiations and multilateral fora.

The global tax environment

Tax policy over the past two decades has involved a shift of power. Power once held by the nation state to control and glean revenue from businesses and individuals has been eroded and the influence of international financial institutions and MNCs on tax policy has increased. Nation states use taxation policy as a carrot to attract investment. This tax competition has been used successfully to create short-term economic growth in states which have limited natural resources or other competitive advantages.

While tax laws and regulations generally operate at the national level, national borders do not bind capital. As a result, a series of legal and financial loopholes can be exploited in order to avoid tax (which is legal), or evade tax (which is illegal), by shifting capital between tax jurisdictions to minimise the tax due on profits and dividends.

This section examines some of the key concepts, mechanisms and practices, which facilitate capital movement between jurisdictions. A distinction can be drawn between two issues. First, the increasing mobility of capital and the way in which tax competition creates increasing challenges for revenue authorities and places downward pressure on states to reduce the tax burden. Secondly, many of the legal institutions set up to facilitate international capital mobility and foster investment can be abused.

Tax competition

Jurisdictions use tax policy to vie for investment by lowering corporate tax rates or offering other tax advantages such as investment subsidies or grants.[8] As such governments are frequently pressurised to offer attractive tax incentives. In an international environment largely tolerant of tax minimization, this practice can result in an effective race to the bottom.

Some of the most significant incentives that countries offer include temporal tax incentives, such as tax holidays or complete tax exemption for companies operating in specific sectors,[9] and spatial tax incentives such as Special Economic Zones (SEZ) or Export Production Zones (EPZ)[10] – special commercial regions in which taxation, as well as other regulatory requirements are relaxed.[11]

In addition a country can allow firms to reduce their overall global tax liabilities by offering low or zero tax rates for specific types of business, usually subsidiary companies of MNCs. This phenomenon, known as ring-fencing means MNCs operate within a more lax financial environment with lower tax rates than indigenous small or medium enterprises (SMEs).

These policies present significant challenges for the state. Ultimately, if the tax burden is lowered for corporations, either public spending must decrease, or the tax burden must be shifted to other sectors of the population. In addition to this downward pressure, some of the international mechanisms facilitating global capital flows can be abused.

Tax havens and secrecy jurisdictions

The concept of tax competition encourages nation states, particularly those that have few natural resources and are geographically isolated, to create mechanisms which facilitate the free, lightly regulated and often secretive movement of capital around the globe. These are often termed tax havens or secrecy jurisdictions. Definitions of tax havens are contested, as jurisdictions seek to avoid the associated negative connotations of criminality and corruption which can harm prospects for attracting FDI. Multilateral organisations such as the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) have proposed definitions and lists of tax havens or offshore financial centres (OFCs) using various methods and indicators to identify such jurisdictions.[12] The term "secrecy jurisdiction" encapsulates the problem of these locations: a lack of transparency with regard to financial transactions.

Not all secrecy jurisdictions exhibit the same features and many harbour legitimate financial services. However some common characteristics can be identified. Secrecy jurisdictions offer minimal tax rates on certain types of finance and capital; they provide secrecy with respect to financial transactions; and these factors create international pressure for nations to compete as low-tax regimes or risk losing revenue.[13] The OECD identifies characteristics of tax havens including zero or nominal taxes levied and a lack of effective exchange of information[14] – which mean businesses and individuals can benefit from secrecy rules to hide from scrutiny by tax authorities. A further characteristic feature of tax havens is a lack of transparency concerning the operation of the legal or administrative provisions designed to regulate corporations. These provisions can be used to attract transactions that are carried out purely for purposes of tax minimisation by both MNCs and wealthy individuals seeking to minimise their tax burden.

Secrecy jurisdictions, often remote island economies, glean their main source of income through attracting capital and providing lucrative financial services. However, a number of other jurisdictions have taken on some of these characteristics by setting up OFCs in an attempt to increase their financial services sector. These jurisdictions exhibit a diversified economy with a standard tax system, but alongside this exists certain exceptions implemented to attract particular types of financial activities and corporations, and a large number of double taxation treaties to facilitate capital flows and prevent double taxation when capital is repatriated.[15]

Double taxation treaties

Double taxation treaties, usually bi-lateral agreements, are mechanisms designed to ensure that income arising in one jurisdiction and received in another is only taxed once or that taxation revenues are shared between the jurisdictions.[16] This is generally viewed as positive for economic development as it encourages businesses to invest internationally[17] and promotes the sharing of information among countries with double taxation treaties.[18] However, countries with these treaties can also be used to channel money between jurisdictions to minimise tax payable, particularly if withholding taxes are minimised to encourage investment.[19]

In many cases double taxation treaties between developed and developing countries have, from their inception, operated to the disadvantage of developing countries, as they favour residence-based rather than source-based taxation. Those holding significant assets in developing countries are more frequently located in developed countries, meaning the effect of many double taxation treaties is that capital flows from developing to developed nations.[20] Developing countries also often have limited capacity and expertise to effectively negotiate international taxation agreements.[21]

Intellectual property rights

In an effort to root footloose FDI, some jurisdictions have sought to use their taxation systems to attract research and development (R&D) functions for MNCs within their jurisdictions. R&D require a highly skilled workforce, meaning that it is more difficult for MNCs to relocate than traditional manufacturing functions. This kind of investment is attracted by offering tax holidays on R&D, and crucially low levels of withholding tax on profits and dividend payments, through double taxation treaties. MNCs locate intellectual property rights in low tax jurisdictions, which can then be declared as large proportions of the profit made on products manufactured elsewhere in the world. This practice, which will be further developed later in the paper, is open to transfer mis-pricing.

Illegal tax evasion: transfer mis-pricing and mis-invoicing

Mechanisms adopted by secrecy jurisdictions such as financial secrecy, low tax rates, double taxation treaties and the use of patents and intellectual property rights are open to abusive practices on the part of MNCs and aggressive tax planners. Transfer mis-pricing involves the trade of goods and services *within* MNCs while mis-invoicing involves similar trade *between* MNCs. Both are widespread practices used for the purpose of shifting capital across borders.

Transfer pricing, which involves two or more subsidiary companies owned or controlled by the same MNC trading with one another, is both legitimate and widespread. It is estimated that 60% of world trade is conducted within MNCs.[22] When goods are traded at market value, known in regulatory circles as “arms length pricing” this is legitimate and acceptable.[23]

However, the illegitimacy of such deals arises when prices for goods and services are manipulated to increase costs or reduce sales values so that the tax burden in states with higher tax rates is reduced. Greater taxable profits are then declared in states with lower tax rates by increasing sales value or reducing costs. Since these transactions are carried out within MNCs, nothing is sold outside the parent company. Yet because capital travels across national borders, transfer mis-pricing becomes an effective way to shift capital from the jurisdiction where profit is made, to a low tax environment. This process can take place at any point in the supply chain of a product and complex accounting mechanisms are often used to route capital through any number of different secrecy jurisdictions or low tax jurisdictions, particularly using double taxation treaties.

Transfer mis-pricing can occur in all trade sectors and as such is relevant to both MNCs with manufacturing, service and extractive functions. However, where resource rents are paid on minerals extracted rather than taxes levied, the tax consequence of mis-pricing may be less relevant.

Examples of mis-pricing include fridge freezers being imported to Spain from China for a cost of €0.27. Such units would usually be expected to fetch hundreds of euros on the open market. This transaction resulted in a total of €8 billion being shifted from China to the EU.[24]

The imbalance of power between MNCs and nation states and the nature of international capital flows and company structures mean that the effectiveness of national taxation regimes is undermined. In addition financial loopholes between national tax policies and the lack of financial transparency in some jurisdictions can facilitate transfer pricing abuse.

The impact of tax competition and secrecy jurisdictions

Tax competition

Recently, developing countries have begun to offer tax incentives in an effort to attract FDI.[25] However, while it has been demonstrated that successful tax competition can benefit nation states in the short term, is argued that this is not an effective tool for development in fragile developing economies.

Developing countries, desperate for investment, offer low tax or royalty rates in areas attractive to international investors. Often unaware of the real value of goods, they agree to very low tax rates.[26] International companies with teams of legal and tax advisors have greater capacity to negotiate low tax rates and threaten to take their business elsewhere. Billionaire philanthropist, George Soros describes this dichotomy of power as asymmetric information, asymmetric bargaining power, and asymmetric agency. Citizens are often unaware of tax deals struck with multinationals, which limits accountability of the government. In sub-Saharan Africa, the practice of offering tax incentives to MNCs combined with high levels of tax avoidance curtailed the ability of African governments to take advantage of the commodity boom in 2008 which, if managed correctly, could have created great wealth for many African countries.[27]

Secrecy jurisdictions

Adopting the policies which characterise secrecy jurisdictions offers a number of short term benefits to nation states and MNCs. These include increased employment for financial workers, inflows of capital to domestic banks which increases lending ability and attraction of international businesses which bring new skills and technology.[28] However, tax competition can have negative effects, allowing larger firms that can locate internationally to benefit from the cost advantage of lower taxes, thus disadvantaging smaller firms operating in a single jurisdiction. Furthermore, as this competitive advantage is unrelated to market performance, it distorts the market and is not conducive to local economic growth.[29] Ring-fencing of tax measures to attract particular types of investment further compounds this disadvantage.

Abuse of the loopholes in tax policy between jurisdictions has a number of significant negative impacts on developed and particularly developing countries. Secrecy jurisdictions compete to attract capital by offering minimal tax rates on dividends, personal wealth and patent income, allowing capital to accrue rapidly within the jurisdiction without wealth creating activity. Within secrecy jurisdictions, indigenous industries and local people are negatively impacted as living costs rise in line with new inflows of capital. Jurisdictions where wealth creating activity occurs lose out on tax revenues as capital is shifted out of their country to the low tax jurisdiction.

Secrecy jurisdictions also facilitate the swift transfer of finance and currency speculation, contributing to international financial instability.[30] In particular, Stewart,[31] Blackburn[32] and Cobham[33] outline how secrecy jurisdictions have facilitated the operation of the shadow banking system, widely regarded as a primary contributor to the recent credit crunch.[34]

The impact of illicit capital flight on developing countries

The net global impact of illicit capital flight is difficult to quantify. Although the OECD, the World Bank and many of the world's governments recognise illicit capital flight to be a major global issue, the difficulties in obtaining data and making reliable estimates means that these institutions have yet to publish estimates of the scale of capital flight.[35] NGOs and academics have conducted the limited research that is available and while this research is contested, the estimates give a broad indication of the gravity of the issue.

Ray Baker of USA NGO Global Financial Integrity estimates that $500-800 billion of illicit flows exit developing and transitional economies every year.[36] Of this, the commercial component constitutes 62.5%, criminal activity 30% and corruption 2-5%. Christian Aid estimates that developing countries lose $160 billion each year in tax revenue on this capital.[37] This is more than one and a half times the global aid budget in 2007[38] and much greater than the $40-60 billion which the World Bank estimates will be required to meet the Millennium Development Goals of halving world poverty by 2015.

Christian Aid estimates that between 2005 and 2007 abuse of the trade pricing of commodities resulted in a total amount of capital flow from non-EU countries into the EU and USA of €850.1 billion. If tax had been levied on this capital at current rates, non-EU countries would have raised €279 billion in revenue.[39]

Meanwhile, these estimates suggest that the world's 49 poorest countries would have raised an additional €2.6 billion in tax. Among the low-income countries, the biggest tax losses occurred in Nigeria (€734 million), Pakistan (€446 million), Vietnam (€367 million) and Bangladesh (€272 million).

These estimates show that Ireland has a role to play in this process. While most of the estimated €5.8 billion mis-priced capital that flowed into Ireland between 2005 and 2007 came from high-income countries, €268 million of that total came from the world's 49 poorest countries. That figure was more than a quarter of Irish Aid's total aid budget for 2008 (€899 million).

Ndikumana and Boyce[40] estimate that the externally held assets of sub-Saharan Africa are 2.9 times the region's external debt. For some countries, the ratio is more dramatic. Notably, Zimbabwe, an Irish Aid bilateral aid country, has 5.1 times its external stock of debt held in offshore assets.

Table 1 shows estimated capital flight, FDI and overseas development assistance (ODA) for Irish Aid priority countries. In Ethiopia, Uganda and Lesotho, capital flight is greater than total overseas aid and for all of the countries presented, capital flight is greater than Irish Aid spending.

The impact of addressing the issue of capital flight on international business and capital flows means that not all of this money would be available to developing countries and assumptions must be carefully qualified. However, the scale of the estimates suggests that significant amounts of money could be made available to developing countries under a more cooperative international tax regime.

Loss of revenue not only reduces a country's direct spending power but also limits its financial capabilities. As wealth is stored offshore, national banks have fewer resources for lending, and so the cost of borrowing increases and lending is limited.[42] Wealth spent nationally would support local industry and stimulate the local economy. Collier et al. estimate that African GDP is 16% lower than it would have been had private wealth been retained nationally.[43]

This loss of revenue can perpetuate dependence on ODA among developing countries, aid that often comes with conditions that are damaging in the long term, including loans that must be repaid with interest.[44] Evidence suggests that dependency on aid from the developed world undermines a country's sovereign decision-making powers, and shifts government accountability from citizens back to donors. Alternatively where states are dependent on their citizens for revenue, they are more likely to act in the interests of those citizens and promote economic development for the wider population.[45]

Table 1. Estimated capital flight, FDI and ODA for Irish Aid priority and countries, figures in $ millions[41]

Country	*Real capital flight (2004)**	*Total ODA (2008)°*	*Irish ODA (2008)§*	*Net external debt (2008)°*	*FDI net inflow (2008)°*	*Imports°*	*Exports°*	*Irish Aid development focus§*
Priority Countries								
Ethiopia	1,759.9	1300	46.93 (2007)	6,300	N/A	4,900	1,900	Vulnerability, health, education, HIV/AIDS governance
Uganda	835.6	713.9	64.53	4,500	258	2,600	1,300	Education, HIV/AIDS, governance
Tanzania	590.6	889.1	58.66	7,800	473	3,800	2,900	Governance, health, HIV/AIDS, budget support, agriculture and rural livelihoods.
Zambia	-437.1	1,500	39.59 (allocated)	5,700	259	3,100	3,900	Social protection, HIV/AIDS, governance, local level development
Malawi	189.8	345.2	4.39 (approx)	3,200	3	768	513.1	Responding to food crisis, strengthening democracy
Mozambique	-562.7	784.1	52.79	5,100	108	2,900	2100	Governance, human capital, economic development, budget support.
Lesotho	89.7	41	13.19 (2007)	690	47	1,400	705.4	HIV/AIDS, education, health, rural water and sanitation, governance

See endnote 41 for an explanation of the symbols used in the column heads

Cerra et al. have shown the link between capital flight and levels of debt. Increased levels of debt in developing economies are generally consistent with higher levels of capital flight.[46] Ndikumana and Boyce have estimated that for every dollar borrowed externally in a year, approximately 80 cent leaves as capital flight: one dollar debt overhang leads to 3.2-3.5 cents capital flight.[47] Capital flight can be debt driven but can stimulate more borrowing, creating a vicious cycle of dependency.[48] Ndikumana and Boyce estimate that the real capital flight from sub-Saharan Africa was $420 billion between 1970 and 2004, totalling $607 billion with imputed interest, rendering Africa a net creditor to the rest of the world.[49]

As tax competition continues and countries participate in a race to the bottom, it is conceivable that low rates will be insufficient to gather the necessary tax to create a net gain for the country. If rates are low enough, there will be a net economic loss as companies use public and common goods, but pay tax at a rate lower than the cost of their use of infrastructure. This is known as free-riding.[50]

It has been demonstrated that the impact of the tax competition policies and the lack of international tax cooperation feed on and reproduce inequality by benefiting the wealthy and MNCs – and limiting the ability of sovereign governments, particularly in the developing world, to provide services for their citizens.[51]

Context of "tax innovation" in Ireland

Ireland is an island economy with few natural resources. Following independence in the early 20th century, protected national industries produced limited economic growth; by the 1960s, unemployment and emigration were the norm. Since the 1970s however, Ireland has built its economic growth on FDI, manipulating its tax system to attract MNCs.[52]

Ireland's tax innovation policy can be divided into five distinct phases. *Phase one* involved export tax relief which attracted MNCs looking to establish bases in Europe. When this scheme expired in the 1980s, *phase two* taxed goods manufactured in Ireland at a rate of 10%. The definition of manufacturing was left to case law rather than legislation and over time evolved to cover any kind of irreversible process resulting in a different commercial product.[53] *Phase three* began when Ireland's low corporate tax rate and ring-fencing of manufacturing industries were challenged in the EU and by the OECD,[54] and led to a change in Ireland's taxation policy. The base rate was raised to 12.5% and applied to all industries, allowing Ireland to avoid designation as a secrecy jurisdiction under OECD rules.[55]

Recently, *phase four* has been sparked by rising operating costs and the reality of MNCs relocating manufacturing operations outside of Ireland. One of the effects of exploiting tax policy to attract FDI is a growing dependence on this external investment and therefore vulnerability to capital flight.[56] Rising salaries, property values and more costly goods and services have resulted in Ireland becoming a victim of its own success and as a result, taxation policy has been amended to attract investment in R&D.

By offering tax breaks on R&D and targeting intellectual property rights, Ireland has sought to root MNCs in Ireland, by attracting high skilled functions, which are less easily relocated. Killian and Mullins[57] noted in 2006 that Ireland has offered various incentives in this regard including tax credits for R&D expenditure, stamp duty exemption and, crucially, patent income exemption for R&D and limited rules on transfer pricing.

Ireland has a highly educated population and has invested heavily in "skilling up" the workforce for employment in R&D. From a taxation perspective, however, the benefit for MNCs in locating R&D operations in Ireland is the opportunity to build up intellectual property rights in Ireland. Patent income from subsidiary companies around the world can then be paid to Irish firms on these intellectual property rights. Until recently patent income exemption in Ireland's tax law reduced tax liability on this income to 0%. Subsequently, dividends from this income paid by the Irish company to other jurisdictions, for example were not regarded as taxable.[58] This policy exemption incentivised MNCs to designate as much of their activity as relating to intellectual property rights as possible. Yet because of the opaque nature of intellectual property rights this channel of royalty payments is open to abuse through transfer mis-pricing and makes it difficult for critics of this system and criminal courts to produce evidence of this abuse.

While this is arguably an astute means of ensuring Ireland's tax competitiveness in the next round of tax competition, it involves both political and economic risks for the country. In the long term, it maintains Ireland's heavy dependence on FDI (particularly from the USA)[59] and therefore leaves the economy vulnerable to factors outside the government's control, such as changes in taxation treaties with other countries and undercutting by other countries.[60] The Obama administration's announcements on reform of

America's rules around taxation of USA companies operating abroad in May 2009 caused significant worry among the jurisdictions dependent on USA investment.[61] While the adjustment to attracting R&D has sought to maintain FDI in Ireland, in the long term this is equally open to being undercut, particularly by EU accession countries.

Ireland's taxation rates and double taxation treaties

Currently, Ireland's corporate tax rate of 12.5% is augmented by more than 50 double taxation treaties. These tax treaties are crucial to the maintenance of Ireland as a favoured location for FDI. Usually negotiated on a bi-lateral basis, though often based on standard templates from the OECD or the UN, these treaties cover issues such as primary and secondary taxing rights.[62] They also cover the remittance of dividends, royalties or interest to another country, allowing companies to make profit in a low tax regime, then have this tax credited against their tax due in the country to which profits are remitted. This allows subsidiaries of MNCs to repatriate profits to the parent company without eroding them. Given Ireland's dependence on FDI, the importance of taxation treaties leaves Ireland's economy vulnerable to the renegotiation of these treaties. A change in the USA-Ireland double taxation treaty, or the way in which USA MNCs are taxed, could pose significant problems for Ireland's economy.

Conclusions – key questions for the Irish context

It is argued that the exploitation of loopholes in national tax policies by nation states using tax policy has long-term negative impacts for both developed and developing countries. For the global economy, the lack of transparency afforded by secrecy jurisdictions allows illicit transfers of wealth and irresponsible lending to occur. However, the principles of tax competition have also been critiqued as posing a risk to both developed and developing countries alike.

The policy coherence agenda

Ireland, through its low corporation tax rate, and network of double taxation treaties is a global player in international capital flows. While Ireland has benefited greatly from this policy in the short-term, the policy presents significant risks and potential disadvantages to developed and developing countries alike.

On a global scale, capital flight dwarfs ODA and at the scale of Irish Aid priority countries, capital flight accounts for more money leaving the country annually than Irish Aid is giving.

Ultimately, aid donors and agencies should aspire for their recipients to raise their own revenue to support economic and social development, including provision of essential services, and the development of infrastructure and stable political institutions which would foster investment. Tax is the best way to fund this development and has also been shown to have positive effects on democratic accountability and good governance – crucial to effective development. This should not be undermined by an international tax regime which facilitates capital flight.

It is clear that in the context of international capital flows, a greater level of international tax cooperation is required. This has been recognised by the world's governments through the UN Financing for Development process, and more recently by the G20, G8 and by the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System (the Stiglitz Commission).

The international policy agenda on tax has shifted dramatically in 2008-2009. The G20's communiqué at the London Summit in April 2009 committed to "take action against non-cooperative jurisdictions, including tax havens and…deploy sanctions to protect our public finances and financial systems".[63] Their claim that "The era of banking secrecy is over" was a bold statement of how the financial crisis has changed the policy landscape. However, there is a need for governments and civil society alike to seize the current window of opportunity and ensure that developing countries can benefit from this reform.

In shaping this new climate of regulation and transparency, the Irish government and Irish civil society should take a lead on the international scene by supporting calls for greater transparency in tax matters. Ireland is not a G20 member, but within the UN process has supported greater tax cooperation by accepting the EU negotiating position within the UN Financing for Development conference in Doha in 2008.[64] This should be strengthened through Ireland's bilateral engagement with G20 countries and with the OECD.

Exchange of tax information would equip all countries including developing countries with the information they need to target individuals and companies holding assets offshore in trusts and other vehicles. The G20's London Summit proposals involve blacklisting of jurisdictions which have not indicated a willingness to sign 12 OECD Tax Information Exchange Agreements. It is essential that all countries are included in this process though a multilateral rather than bilateral information sharing process. In addition, the "on request" nature of these treaties has rendered them ineffective in the past, as a requesting authority needs significant evidence that abuse is occurring before it is granted information. Therefore a truly multilateral agreement on the *automatic* exchange of tax information between jurisdictions is required.

Similarly, an international accounting standard on country by country reporting would equip developing countries with the information they need to target their resources toward those companies abusing the transfer pricing system. It would identify where wealth creating activity is occurring within an MNC and whether tax payments to the state reflect this.

In addition, Irish Aid should consider supporting the capacity development of revenue authorities in programme countries and supporting international initiatives such as the International Tax Compact, the Africa Tax Administration Forum and the UNDP South-South Sharing of Successful Tax Practices project (S^4TP).

Endnotes

1 Views expressed in this paper do not represent organisational policy of those organisations affiliated with the authors, but rather reflect personal perspectives.

2 Killian S. and Mullins, M. (2007), *Taxing Thoughts: Tax Competition and the True Cost of Intellectual Capital*, Tax Justice Research Workshop, University of Nairobi, http://visar.csustan.edu/aaba/KillianNairobi.pdf; accessed 30 August 2008

3 For example taxing tobacco to limit damage to health and increased healthcare costs.

4 McDonald, O., and Jumu, K. (2008), "Can tax challenge bad governance?", *Christian Aid Occasional Paper No. 1*, June; Cobham, A. (2007), "The tax consensus has failed! Recommendations to policymakers and donors, researchers and civil society", *The Oxford Council on Good Governance, Economy Recommendation No. 8*; Ross, M.(2004), *Does taxation lead to representation?*, mimeo: University of Linz; Mahon, J. (2005), "Liberal states and fiscal contracts: aspects of the political economy of public finance", paper presented at the annual meeting of the American Political Science Association; Mahon shows that the strongest effect on democratic accountability exists for direct taxation – where citizens contribute to the state through income and corporate taxation.

5 Bosco, L. and Mittone, L. (1997), "Tax evasion and moral constraints: some experimental evidence", *Kyklos*, pp.297-324; Bosco and Mittone note that tax compliance is most likely in conditions where perceived levels of redistribution are high, and individuals' expectations of others' compliance are high.

[6] Heavy dependence on foreign investment has several possible drawbacks: it often skews tax policy away from fostering entrepreneurship and local industry, produces a geographic bias towards areas close to ports and airports, produces inflation which marginalises the poor and unemployed and ultimately carries the risk of loss to other competing countries.

[7] G20 London Summit Communique, Annex - Declaration on strengthening the financial system, http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-fin-sysm; accessed 1 October 2008

[8] Tax Justice Network (2006a), *Tax Justice Briefing: Tax Competition*, www.taxjustice.net; accessed 27 August 2008

[9] Given the mobility of capital and labour after the "holiday" period is over, MNCs can leave for another jurisdiction and seek a more favourable tax regime; Tax Justice Network (TJN, 2006a), op.cit.; accessed 27 August 2008

[10] Such as in Shannon, Ireland or West Bengal, India.

[11] Tax Justice Network (2006b), *Tax Justice Glossary*

[12] Tax Justice Network (2007a), *Identifying Tax Havens*, www.taxjustice.net; accessed 27 August 2008

[13] Oxfam (2000), *Tax Havens: Releasing the Hidden Billions for Poverty Eradication*, Oxfam GB Policy Paper

[14] OECD (1998), http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_37427,00.html; accessed 29 May 2009

[15] Van Dijk, M., Weyzig, F. and Murphy, R. (2006), *The Netherlands: A Tax Haven?,* SOMO: Amsterdam

[16] Tax Justice Network (2006a), op.cit.

[17] Particularly in developing countries where foreign investors often perceive tax systems to be unpredictable, double taxation treaties bring a perception of stability.

[18] Irish, C. (1974), "International double taxation agreements and income taxation at source", 5, *The International and Comparative Law Quarterly*, Vol. 23, No. 2, pp.292-316

[19] Van Dijk *et. al* demonstrate that this practice is used by the Netherlands to create tax revenue by allowing capital to flow through the country from tax havens to countries where MNCs are headquartered with minimal withholding taxes. Van Dijk, M., Weyzig, F. and Murphy, R. (2006), *The Netherlands: A Tax Haven?,* SOMO: Amsterdam

[20] Irish, C. (1974), op.cit., pp.292-316

[21] Hogg, A. et al. (2008), *Death and Taxes: The True Toll of Tax Dodging*, London: Christian Aid

[22] Neighbour, J. (2002), "Transfer pricing: keeping it at arm's length", January: http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_p; accessed 18 May 2009

[23] The OECD has developed transfer pricing guidelines for MNCs which have been adopted in a large number of OECD and non-OECD countries: http://www.oecd.org/document/34/0,3343,en_2649_33753_1915490_1_1_1_1,00.html [Accessed 1.10.09]

[24] McNair, D. and Hogg, A. (2009), *False Profits: Robbing the Rich to keep the Poor Tax Free*, London: Christian Aid

[25] In 2007 Ghana granted its first offshore banking permit to Barclays Bank of Ghana, with the hope of attracting international firms, increasing investment poised to create a tax haven in its capital city Accra. Tax Justice Network (2007b), *"Ghana, the next tax haven?"* 14 September http://taxjustice.blogspot.com/2007/09/ghana-next-tax-haven.html: accessed 26 August 2008

[26] Hogg, A. et al. (2008), op.cit.

[27] Lambrechts, K. (ed. 2009), *Breaking the Curse: How Transparency Taxation and Fair Taxes can turn Africa's Mineral Wealth in Development*, Third World Network Africa, Tax Justice Network Africa, ActionAid International, Christian Aid

[28] Research by KPMG shows that tax competition is related to short-term growth, but needs to be supported by strong legal and economic infrastructure. Ireland is an example of tax competition-based growth, but this growth is dwindling after 15 years because of new tax competition in Eastern Europe. This is an illustrative case of the fragile nature of success through tax competition. More sustainable growth could be achieved by competition in human capital and infrastructure, competition that would not be bound by a low tax rate: KPMG (2006), "*14-year survey supports link between tax and economic success":* http://www.kpmg.ca/en/news/pr20061101.html; accessed 26 August 2008

[29] Weyzig, F. and Van Dijk, M., (2007), *Tax Havens and Development Partner: Incoherence in Dutch Government Policies?* Amsterdam: SOMO

[30] Oxfam (2000), op.cit.; Green New Deal Group (2008), *A Green New Deal: Joined-up policies to solve the Triple Crunch of the Credit Crisis, Climate Change and high Oil Prices*, London: New Economics Foundation

[31] Stewart, J. (2008), "Shadow regulation and the shadow banking system: the role of the Dublin International Financial Services Centre", *Tax Justice Focus*, Second Quarter, Vol. 4, Issue 2

[32] Blackburn, R., (2008), "The subprime crisis" *New Left Review*, 50, March-April

[33] Cobham, A. (2008), *The Morning after the Night before: The Impact of the Financial Crisis on the Developing World,* London: Christian Aid

[34] Blackburn outlines how secrecy enabled managers of structured investment vehicles (SIVs) and collateralised debt obligations (CDOs) to package unsecured debt and sell it on to investors with low risk ratings. The greater the risk, the higher potential profit for the fund manager. Secrecy also enabled the trading of synthetic CDOs: significant funds based on no real capital but modelled on the risk rating of other "real" funds.

[35] A conference in Washington DC in September 2009 hosted by the Task Force on Financial Integrity & Economic Development took this research agenda forward and included the involvement of the World Bank.

[36] Baker, R.W. (2005), *Capitalism's Achilles' Heel: Dirty Money and How to Renew the Free-Market System*, New Jersey: Wiley

[37] Hogg, A. et al. (2008), op.cit.

[38] Estimated to be $103.7 billion

[39] McNair, D. and Hogg (2009), op.cit. This estimate does not include intangibles such as services and intellectual property rights.

[40] Ndikumana, L., Boyce, J. K. (2008), *New estimates of capital flight from Sub-Saharan African countries: linkages with exernal borrowing and policy options*, Amherst: University of Massachusetts, Working Paper Series, Number 166

[41] Data Sources: § Irish Aid: http://www.irishaid.gov.ie/countries.asp: accessed 29 July 2008; Irish ODA converted from € to $ at a rate of 1:1.46; ° The Heritage Foundation (2008) Index of Economic Freedom http://www.heritage.org/research: accessed 26 August 2008; Ndikumana, L., Boyce, J. K. (2008), op.cit. Due to difficulties in obtaining data, this table compares data spread over a number of years. It is acknowledged that capital flight and ODA figures vary, however, the table is designed to give a broad indication of the estimated scale of capital flight over this period in comparison to ODA.

[42] Ndikumana and Boyce (2008), op.cit. p.2

[43] Collier, P., Hoeffler, A. and C. Pattillo (2001), "Flight capital as a portfolio choice", *World Bank Economic Review,* 15 (1), pp.55-80, see in particular p.60.

[44] Kapoor, S.(2005), "Plugging the leaks – a very short paper on curbing capital flight, tax avoidance and tax evasion" for International Policy Dialogue, *"New Sources of Development Financing"* organised by Inwent and the Federal Ministry for Economic Cooperation and Development (BMZ), August

[45] McDonald, O. and Jumu, K. (2008), op.cit.

[46] Cerra, V., Rishi, M. and. Saxena S.C. (2005), *Robbing the Riches: Capital Flight, Institutions, and Instability*, IMF Working Paper

[47] Ndikumana and Boyce (2008) calculated this figure from research on 30 sub-Saharan African countries.

[48] Cerra et al. (2005), op. cit., pp.12-13

[49] Ndikumana and Boyce (2008), op.cit., p.6

[50] Oxfam (2000), op.cit. p.16

[51] Baker (2005), op.cit., p.238 suggests that by concealing a proportion of the wealth of the super-rich, global inequality is underestimated and figures which suggest that global inequality is diminishing are inaccurate. This is an important consideration on a national level also, as losses on revenue limits redistribution of wealth.

[52] Killian S. and Mullins, M. (2007), op.cit.

[53] Ibid.

[54] In 1997 the EU issued guidelines on tax competition, followed by an OECD project on harmful tax competition in 1998. The OECD outlined that a country would be designated a tax haven if it offered a lack of transparency and a very low rate of tax available either with no real economic activity or restricted to particular classes of companies.

[55] This would have a negative effect on Ireland's double tax treaties.

[56] Christensen, J. (2008), "The language of offshore", Second Quarter, Vol. 4, Issue 2, Tax Justice Focus, www.taxjustice.net; accessed 27 August 2008

[57] Killian S. and Mullins, M. (2007) op.cit.

[58] Ibid.

[59] Jobs are split 50:50 among Irish firms and foreign owned firms. However, in terms of economic output, foreign owned firms account for 65% of gross output and 80% of total merchandise and ICT service exports.

[60] In 2006 the USA Treasury Department began work on rules to deal with abuse involving USA companies transferring intellectual property rights to overseas tax havens: Finfacts Team (2005), "US multinationals overseas profits: Ireland's patent income tax-exemption may fund over 5% of Irish Government annual spending in 2006", 21 November: http://www.finfacts.ie/irelandbusinessnews/publish/article_10003995.shtml; accessed 31 August 2008

[61] Houlder, V. and Steen, M.(2009), "Obama's tax reforms anger 'haven' countries", *Financial Times*, 5 May

[62] For example on profits made by a company operating in one country but based in another.

[63] See http://www.forbes.com/2009/04/02/communique-g20-text-markets-equity-economy.html; accessed 29 May 2009

[64] ec.europa.eu/development/icenter/repository/CC%20DOHA%20Guidilines%20for%20EU%20participation%20EN2008%2011%2011.pdf; accessed 1 October 2008