Appendix C. A protocol on measures against tax related Illicit Financial Flows (IFFs)

Why is this protocol important?

IFFs can include flows originating from illicit activities, illicit transactions to transfer funds that have a licit origin, and flows stemming from licit activity being used in an illicit way.

The problem is systemic, as highlighted in the 2021 UN High Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FATCI Panel) report.

Illicit financial flows include tax avoidance by multinationals and wealthy individuals, who take advantage of globalization in order to arbitrate between the tax systems of different jurisdictions, choosing the most convenient ones to minimize their tax liabilities. In addition, international vulnerability to IFFs is increased when a country's incoming and outcoming flows take place in secrecy jurisdictions.

For all the above, enhancing transparency, exchange of information and international administrative cooperation in tax matters is key, and has indeed proven to have impressive effects on tax collection. It is important to remove the barriers that limit the reach of such cooperation in the case of low-income countries. It is also important to advance on a wider use of information exchanged for tax purposes, so to address related financial crimes.

However, transparency should not be the sole aspect to be worked on. The design of the international tax architecture needs to be addressed also to support countries exercise their taxing rights and fight aggressive tax evasion and avoidance.

Key aspects that should be included in a protocol on measures against tax related IFF

ICRICT considers that the definition of IFF should be addressed by a protocol of this nature and should consider the work already developed by UNCTAD and UNODC, among others, observing that IFFs are multi-dimensional, and can include flows originating from both licit and illicit activities, including tax evasion and avoidance.

Further, the issue of measuring IFFs is also a relevant one which should also be considered in the protocol.

Therefore, some priority areas to be included in a protocol on measures against tax related IFFs, particularly those related to tax avoidance by MNEs, are:

- Fair reallocation of taxing rights between countries, underpinned by the principle of unitary taxation and formulary apportionment of all profits of all multinationals across different jurisdictions.

- Simplification of the right to tax at source payments for royalties, interest, dividends and fees for services (most common channels for profit shifting), regardless of whether they may be classified as technical or professional, or delivered by an independent person or an enterprise; and regardless of the physical presence.

- The adoption of solutions for intra-group payments as well as for the taxation of capital gains which result from Offshore Indirect Transfers (OITs) of assets.

- Public country-by-country reporting of multinationals' economic activities based on the robust Global Reporting Initiative standard for public reporting on tax (Tax:207).

- Extend the reach and effective implementation of the automatic exchange of information on income derived through digital platforms.

Further, the adoption of solutions for the valuation of intragroup trade in goods that consider effective ways of taxing exports at the country of origin in the case of natural resources (including goods), should also be considered.

In addition, and in the same way as was observed by the **report** produced by the UN FACTI Panel in 2021, ICRICT notes that some other issues that should also be addressed in a protocol on measures against tax related illicit financial flows are:

- Provide for effective capital gains taxation.

- Taxation must be equitably applied on services delivered digitally. This requires taxing MNEs based on group global profit.

- End information sharing asymmetries in relation to exchange of information for tax purposes, so that all countries can participate on an equal footing.

- Establish guidelines for exchange of information at the national level across agencies as standard practice to combat all varieties of illicit flows.

- Provide solutions for the elimination of barriers for a wider use (e.g. for anti-money laundering) of information exchanged for tax purposes.

Finally, ICRICT stresses that transparency of ownership and control of companies, partnerships, trusts and other legal entities that can hold assets and open bank accounts is critical to determining where illicit funds are moving and who is moving them. Therefore, enhancing automatic exchange of information and beneficial ownership registers should be one of the commitments resulting from this protocol.

All countries should require beneficial ownership information to be provided when they incorporate companies, and register assets, for that information to be updated regularly, and for that information to be available on the public record.

Further, it should be noted that advancing the transparency and digitalization of commercial registers , including information on financial statements, that can be used for building comparable data for the application of the arm's length principle (until another global principle replaces it), would also serve the purpose of reducing IFFs.