International Cooperation: Comparing Trade and Tax (or Tariffs and Corporate Taxes; or Erik and Erika)

Professor Mick Moore

2. Erik does Customs work. The 21st century has been good to him.

- Trade expansion
- Successful moves into trade facilitation and international value chain security
- His global organisations – WTO and WCO – seem relatively successful

ICTD

3. Erika collects corporate taxes from TNCs. The 21st century has not been good to her

- More tax avoidance/evasion by TNCs
- Growth of tax havens
- Public campaigns have exposed her limitations
- G20 has ordered the OECD to do something about the problem – BEPS process

ICTD

4. Why is Erik doing so well?

- Creation of WTO (authoritative, representative)
- Able to respond to new agendas – VAT, trade facilitation and global value chain security – as tariff collection function has declined
- Growth of transfer mispricing poses less of a challenge to raising tariff revenue than to taxing corporate profits (for Erika)

ICTD

5. Illustration

Transfer mispricing in Customs: Manufacturing company sells a washing machine to its wholly owned subsidiary in another country. The importer and exporter claim a $900 value for the machine. The true value is $1000. The import tariff is 15%. This 10% undervaluation leads to a customs revenue loss of ($150 - $135) = $15 = 10% of correct revenue.

Transfer mispricing in CIT: Importer sells the washing machine for $1200. The real value of the washing machine at wholesale – at time of import – was $1000. Through transfer mispricing skullduggery, the import value for CIT purposes is set at $1100. The income tax rate is 30 percent. The importing company has reduced its taxable income from $200 to $100, and its tax bill from $60 to $30 – a loss of 50% of the correct revenue.

The public revenue loss from a small transfer pricing mis-valuation is much greater where tax is levied on the basis of net income rather than any gross measure of value, income etc.

ICTD

6. Why is Erika doing less well?

- Growth of digital, 'immaterial' economy raises very challenging problems for corporate tax collectors
- No globally-representative, authoritative revenue organisation – OECD and the Big Boys rule
- The system for taxing corporate income from cross-border activities is 'leaky'; it leaks more as economies globalise (and the OECD/Big Boys are reluctant to fix it).

ICTD

7. What is the system for taxing corporate income from cross-border activities?

1. Emphasis on taxing companies on profits, not activities. Not appropriate for all situations
2. The residence principle – and arms-length pricing
3. Discretionary information exchange for tax purposes
4. Big role for bilateral tax treaties, that often remove taxing rights (withholding taxes, taxation of capital gains from offshore asset transfer) for weaker parties
5. Growth of 'tax havens'

ICTD

8. Some major consequences

1. Wide scope for transfer mispricing (goods, finance, intellectual property etc)
2. Organisationally weak tax administrations are disadvantaged = poor countries
3. Threat to revenue where governments depend heavily on CIT = poor countries
4. Not yet clear how OECD can persuade its Big Boys (large countries; with high international capital mobility; 'home' to big TNCs) to go along with limited BEPS reform proposals (October).

ICTD

9. The WCO?

Is it acceptable that in so many countries Customs and 'internal tax' organisations should both be collecting information from TNCs about transfer pricing (and mispricing) and make limited efforts to share and compare that information?

ICTD

Thank you for your attention

ICTD