Future scope

Kasper Brandt

September 6, 2023

- Tax revenues relative to GDP remain low in the Global South (World Bank 2020).
- Inherently associated with international transactions

 Unfair competition and misallocation of resources.
- Strong over-representation of wealthy households ⇒ Higher inequality (Alstadsæter et al. 2019).
- Perception about other people evading (complying with) taxes
 ⇒ Increasing risk of evading (complying) oneself (Alm
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- "If there is already a clear global consensus around the wider definition, it is a well-kept secret." - Forstater (2018)
- 'Illicit' = 'Illegal'?
 - Oxford Dictionary: "Forbidden by law, rules, or customs"
 - Cambridge Dictionary: "Illegal or disapproved of by society"
 - Counter-argument: Spatial and temporal differences in customs.
 More pragmatic with legality.
- 'Financial' = Cash, profits, loans, or equity.
 What about real estate and luxury goods? More appropriate considering all assets.
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- The European Union, the African Union, and the United
- Where does this leave us? In the paper, I advocate for the

illegal trade practices.

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All agree IFFs include activities related to illegal markets, terrorism, tax evasion, corruption, deliberate misreporting, and

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- The European Union, the African Union, and the United Nations further acknowledge legal practices, such as abusive transfer pricing, as IFFs.
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- The present framework applies the profit shifting terminology, but can be thought of in more general tax avoidance terms.
- Traditionally, studies tend to focus on the marginal gains and costs of shifting profits ⇒ Interior solutions.
- Recent studies emphasize the importance of fixed costs (Davies et al. 2018; Johannesen et al. 2019) \Rightarrow Corner solutions more likely.
- Profit shifting may further depend on whether activities are illegal or illicit.

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$$\Gamma = (\tau_i - \tau_j) \times PS_{legal} - C_{legal} + (\tau_i - \tau_j) \times PS_{illegal} - C_{illegal} - \alpha \times \beta \times (\tau_i - \tau_j) \times PS_{illegal}^{\gamma}$$

Where:

 Γ = Additional profits.

 τ_i - τ_j = Tax rate gap between countries i and j.

 PS_{legal} and $PS_{illegal}$ = Profits shifted legally and illegally.

 C_{legal} and $C_{illegal}$ = Fixed costs of legal and illegal profit shifting.

 $\alpha = \mathsf{Capacity}$ of the tax authorities.

 $\beta = \text{Punishment if being caught.}$

 $\gamma =$ Potential convexity in risk of being caught.

Optimal illegal profit shifting:

$$\begin{split} &\frac{\partial \Gamma}{\partial PS_{illegal}} = \left(\tau_{i} - \tau_{j}\right) - \gamma \times \alpha \times \beta \times \left(\tau_{i} - \tau_{j}\right) \times PS_{illegal}^{\gamma - 1} = 0 \\ &\Rightarrow \gamma \times \alpha \times \beta \times PS_{illegal}^{\gamma - 1} = 1 \\ &\Rightarrow PS_{illegal}^{\gamma - 1} = \frac{1}{\gamma \times \alpha \times \beta} \\ &\Rightarrow PS_{illegal} = \left(\frac{1}{\gamma \times \alpha \times \beta}\right)^{\frac{1}{\gamma - 1}} \end{split}$$

Methods and findings

- Optimal size is negatively associated with capacity of tax authorities, punishment, and convexity in risk of being caught.
- Not dependent on the tax rate gap.

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$$PS_{illegal}^* \leq \Pi - PS_{legal}^*$$
 or $(\tau_i - \tau_j) \times (\Pi - PS_{legal}^*) > C_{illegal} + \alpha \times \beta \times (\tau_i - \tau_j) \times (\Pi - PS_{legal}^*)^{\gamma}$

- $\Gamma^* > 0$
- In order to shift profits legally (illicitly), either of the two conditions must be met:

 - $(\tau_i \tau_i) \times PS_{legal}^* < C_{legal}$ and $\Gamma^* > 0$

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- Balance of payment
- Aggregate liabilities and assets ('Zucman' method)
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- Aggregate corporate income tax bases
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- Around \$7.6T held in unrecorded wealth by individuals in tax havens in 2014 (Zucman 2015).
- Pre-tax profits to wages ratios are substantially higher in low-tax countries for MNEs. Not for domestic firms (Tørsløv et al. 2018).
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- Less-developed countries more exposed to profit shifting (Fuest et al. 2011; Johannesen et al. 2019).
- 'Zero-profit-firms' account for a substantial part of profit shifting estimates (Bilicka 2019; Johannesen et al. 2019).
- In line with high fixed costs of setting up a tax-optimizing scheme, profit shifting is concentrated among a few large MNEs (Davies et al. 2018; Wier and Reynolds 2018).
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Findings (other approaches)

- Rent seeking following windfall gains in the oil industry and aid disbursements (Andersen et al. 2017; Andersen et al. 2020).
- Tax haven secrecy services are of high value to firms
- Following wealth tax reforms, individuals in Colombia hid assets
- Studies on anti-IFF legislation based exclusively on high-income

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- Studies on anti-IFF legislation based exclusively on high-income countries. These include: 1) thin-capitalization rules (Overesch and Wamser 2010; Buettner et al. 2012); 2) transfer pricing regulation (Lohse and Riedel 2013; Beer and Loeprick 2015); 3) controlled foreign corporation rules (Egger and Wamser 2015; Clifford 2019); 4) Mandatory disclosure of tax payments (Johannesen and Larsen 2016); and 5) information exchange treaties (Johannesen and Zucman 2014; Menkhoff and Miethe 2019).

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- Indirect and direct evidence of profit shifting in the Global South. Further, how to tax MNEs?
- Effects of anti-IFF legislation and information exchange treaties in the Global South.
- Effects of improving capacity of tax authorities, and in particular, evaluating different types of technical assistance
- Advance on the precision of shipping and insurance costs to improve validity of the trade misinvoicing methodology.
- Meta-analysis of the tax semi-elasticity in which the validity of each estimate is scrutinized rather than included automatically.
- The review paper further includes an overview of relevant data sources and examples of studies applying them.

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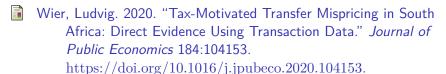
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