Tax policy and international cooperation and assistance for the achievement of human rights

This is the fourth in a series of advocacy tools produced by RightingFinance to assist education and dissemination of standards on tax policy and human rights contained in a report produced by the UN Special Rapporteur on Extreme Poverty and Human Rights.[1] (Unless otherwise noted, textual references in the text are from that report).

Normative basis

"States have a duty to provide international assistance and cooperation commensurate with their capacities, resources and influence, as established in Articles 55 and 56 of the Charter of the United Nations and in several international human rights treaties. Particularly important are the obligations of international assistance and cooperation enshrined in the International Covenant on Economic, Social and Cultural Rights (arts. 2, para. 1 and 1, para. 1), the Convention on the Rights of the Child (art. 4) and the Convention on the Rights of Persons with Disabilities (art. 32), on the basis of the recognition that some countries will not be able to achieve the full realization of economic, social and cultural rights if other countries in a position to assist do not do so." (para. 29)

"As part of international cooperation and assistance, States have an obligation to respect and protect the enjoyment of human rights everywhere, which involves avoiding conduct that would foreseeably risk impairing the enjoyment of human rights by persons beyond their borders, and conducting assessments of the extraterritorial impact of laws, policies and practices." (para. 30)

"States must refrain from any conduct that impairs the ability of another State to comply with its own human rights commitments. Furthermore, they have an obligation to create an international enabling environment for the fulfilment of economic, social and cultural rights, including in matters relating to taxation. They should also coordinate with each other in order to cooperate effectively in the universal fulfilment of economic, social and cultural rights." (para. 31)

BOX 1

Transfer pricing: How is it linked to tax evasion and avoidance?

Although we may intuitively think of international trade as trade happening between companies based in different countries, in the modern world, more than 60 per cent of cross-border exchanges of goods and services take place within the same company or the same group of companies. In these cases, since there is no real "negotiation" for the price, what in an ordinary sale would be the negotiated price of the good or service becomes a non-negotiated value assigned to such good or service. This value is known as "transfer pricing."

As long as transfer pricing remains close to the price that would be charged for the same exchange in a transaction among unrelated companies, it is perfectly legitimate. But companies have been found to abuse and manipulate transfer pricing in order to overstate profits in countries with low taxes or understate profits in countries with high taxes. Christian Aid estimated that approximately USD 160 billion in public revenue are lost to developing countries due to transfer mispricing. Global Financial Integrity estimates that the portion of such practices due to misinvoicing, alone, accounts for the majority of near USD 1 trillion of untaxed flows out of developing countries.[3]

Application in tax policy

International cooperation to prevent tax evasion and abuse

"Without absolving any State of its obligation to raise the maximum available resources domestically to ensure the progressive realization of economic, social and cultural rights, there are limits to national-level actions in the absence of global reforms. Many States are undoubtedly hamstrung in their efforts to enact progressive taxation and combat illicit financial flows that

BOX 2

Challenging double taxation treaties

A double taxation treaty is an agreement between two (or more) countries to divide up taxing rights on cross-border income between them, primarily for the avoidance of double taxation.

Countries sign double taxation treaties with the ostensible objective to prevent a taxpayer from being taxed twice, once at their residence and once at the place where their income originated, if this is a different one.

But oftentimes, especially when the treaties are signed between a developed and a developing country (or between a tax haven and a developing country), they limit source-based taxation, which means that developing countries can only collect tax revenues from foreign investors to a limited extent.

Treaties are not just a constraint on levying taxes on companies genuinely from the country with which the treaty was signed. For instance, the Ireland-Zambia tax treaty, denies the right to tax any of the outflows of cross border income normally subject to withholding taxes, which is one example of imbalanced division of taxing rights. But companies from countries other than Ireland, by the simple expedient of setting up a minimal-presence company in Ireland, can take advantage of the treaty.[4]

could fight inequality and enhance the realization of economic, social and cultural rights." (para. 74)

"Individual countries, in particular low-income countries, are severely constrained in the measures that they alone can take against tax abuse." (para. 61)

Although tax evasion can happen in a purely domestic context – and in these cases the obligation of international cooperation would not be relevant, it can also involve more than one country: "Illicit financial flows inevitably involve at least two countries," (para. 75) and "are international in nature and therefore beyond the capacity of one State alone to tackle." (para. 61)

Moreover, "[L]arge scale tax evasion is not possible in a domestic vacuum." (para. 61)

This is important because it means that although tax evasion may happen in a domestic vacuum, tackling it will not yield as high an amount of public revenue as tackling the largest-scale tax evasion. In fact, the international dimension of tax evasion is quite significant, and proportionately more so in developing countries.

It follows that the human rights obligations relevant in such cases will not only be those of the state that loses the revenue, but at least in equal part those of any state whose action or omission enabled the cross-border flows to take place.

"Globalization and increased cross-border flows of goods and capital have vastly increased the chances that one State's actions or omissions may affect another State's ability to raise public revenues, and increased the ways and means that companies and individuals can use to evade and avoid taxes. . . . The tax laws and structures of one State can therefore erode the national tax bases of other States and hamper the application of progressive tax rates and the achievement of redistributive goals, ultimately threatening the realization of rights. There is therefore a particularly urgent need for States to cooperate proactively on matters of tax and fiscal policy. In particular, high-income States that enable or fail to tackle tax abuse and illicit financial flows must shoulder some responsibility for the shortcomings of the tax and public finance systems in developing countries and related poverty rates, lack of enjoyment of human rights and economic inequalities." (para. 75)

More specifically: "The actions of States to facilitate and/or actively promote tax abuse and other illicit financial flows through their tax secrecy laws and policies could jeopardize their compliance with international human rights obligations, particularly with regard to international cooperation and economic, social and cultural rights. States should therefore take concerted and coordinated measures against tax evasion globally as part of their domestic and extraterritorial human rights obligations and their duty to protect people from human rights violations by third parties, including business enterprises." (para. 62)

Tax abuse through transfer mispricing and lack of disclosure on beneficial ownership

"Transnational corporations are able to shift profits across borders . . . in order to take advantage of tax rates that are lower than in the country where the profit is made. This practice, which deprives both developed and developing countries of billions of dollars worth of potential tax revenue, is known as tax 'base erosion and profit shifting." (para. 76)

"The problem is exacerbated by a lack of accessible

information on “beneficial ownership” (the ultimate owner of companies, trusts and funds) and the fact that companies are not required to report systematically their income and activities on a country-by-country basis.” (para. 77)

Specifically, in the case of natural resource sectors, “the rightful benefits in terms of revenue often go abroad (sometimes to tax havens), aided by the fact that extractive industries are often not required to disclose their profits on a project-by-project basis.” (para. 71)

The abuse of transfer pricing causes the largest portion of erosion of the tax base. (Box 1)

The lack of transparent and publicly-available information on who owns companies is a factor that enables abuse of transfer pricing, in addition to other tax evasion maneuvers.

Another enabling factor is the ability of companies to file reports that aggregate information on their operations at the global level. This makes it harder to identify in which countries they performed the activities generating a cost or a profit. That is why tax justice advocates have called for country-by-country reporting, a requirement for companies to file certain types of information, especially revenues, profits, costs and tax payments, disaggregated country-by-country. This would make it more difficult to hide over or under-statements for tax evasion purposes.

“Insufficiently regulated financial sectors have also played a role in enabling the aggressive avoidance or evasion of taxation by other actors, for instance through structured finance instruments, transfer pricing or profit shifting.” (para. 68)

Tax competition

“States increasingly grant tax incentives (or tax holidays) to corporations as they compete to attract foreign investment. Many least developed countries, for example, offer extremely favourable tax deals to foreign investors in agriculture and mining owing to the perceived competition between countries for this investment.” (para. 64) “[T]he granting of incentives has global ramifications, as it creates a “race to the bottom.” (para. 65)

Action to grant tax incentives could violate human rights obligations when not respecting certain principles and criteria.[2] While this could be analyzed as a human rights violation by the country granting the incentive, incentives often involve competition to attract foreign investment. Arguably, therefore, concerted measures by states to prevent such competitive behavior is part of their potential international assistance and cooperation to fulfill human rights that should come under analysis.

International tax agreements

“While the rules of some international treaties address the handling of cross-border financial flows, they are manifestly inadequate to deal with the nature of modern globalized business. Owing to gaps in the interaction of different tax systems and, in some cases, because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere or be simply undertaxed.” (para. 76)

Human rights obligations are applicable to states in the course of negotiating, signing and implementing double taxation agreements to which they are Parties. (Box 2)

“Incentives sometimes take the form of a “tax stability” “or “advance pricing” agreement, signed with foreign investors to insulate them from future changes in the domestic tax rates for an extended period of time. These types of agreement should also be examined with caution under human rights law, because they reduce public resources regardless of the evolving impact on human rights” (para. 66)

When human rights standards for granting tax incentives are violated through embedding such incentives in a tax stabilization agreement, some degree of responsibility

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corresponds to all parties to the agreement. Such agreements trigger the duty to respect on the part of the foreign company with which they are signed, but also the human rights obligations of the State where such company is based.

Tax havens

"Transnational corporations are able to shift profits across borders – including to tax havens where they have little or no real commercial presence – in order to take advantage of tax rates that are lower than in the country where the profit is made." (para. 76)

"The availability of offshore financial centres (tax havens) that offer low or no taxes and secrecy is a major factor. More than $21 trillion in private assets are reportedly held in tax havens to evade and avoid taxes. Tax havens enable large-scale tax abuse (as well as illicit activities, such as corruption) and deprive other countries of the revenue they need to fulfil their obligations. In addition, given that most tax havens are located in – or under the jurisdiction of – wealthy countries, the global flow of money to these centres exacerbates global inequalities." (para. 61)

Tax-related actions by international organizations

"When acting as a member of an international organization, a State remains responsible for its own conduct in relation to its human rights obligations within and outside its territory. This includes identifying the possible human rights impact of measures agreed at the international level, including the impact on persons living in poverty.

Therefore, when a State makes decisions about loans as a member of an international financial institution, careful consideration of human rights obligations would mitigate against imposing conditions regarding fiscal policies that may jeopardize the human rights of the borrower State's population or undermine that State's ability to use maximum available resources to realize economic, social and cultural rights." (para. 33)

Questions for reflection

- Has the state acted in a way that negatively affected the ability of another state to raise public revenues (for instance, by facilitating tax abuse)? Or failed to take measures that could have helped another state to raise public revenue (for instance by failing to cooperate in a way that could have prevented tax evasion in another country)?
- What measures has the state taken to prevent its companies from engaging in abuse of transfer pricing, or base erosion and profit shifting? Does it require disclosure of beneficial ownership or country-by-country reporting of companies registered in its jurisdiction? Does it regulate financial firms so as to ensure they do not aid or cooperate in schemes to abuse transfer pricing?
- What actions has the state taken to cooperate with others in order to prevent tax competition?
- Does the state have processes to ensure double taxation agreements are consistent with its human rights obligations, from negotiation to implementation? How about tax stability agreements signed by it or by its companies with other states?
- What actions has the state taken to avoid its citizens, as well as companies registered or operating in its jurisdiction, do not use tax havens to facilitate tax abuse or other illicit activities?
- Does the state ensure its positions as member of international financial institutions on tax-related matters do not jeopardize the human rights of people in states receiving financing? Does it ensure this across all conditions, rankings and policy assessments developed by such institutions?

Endnotes

1 A/HRC /26/28, May 22 2014 (available at http://www.rightingfinance.org/?p=1195).

2 See also second advocacy tool in this series: "Maximum available resources, non-retrogression and minimum essential levels in tax policy."

3 Christian Aid 2008. Death and Taxes: the True Toll of Tax Dodging; Global Financial Integrity 2013. Illicit Financial Flows from Developing Countries 2002-2011.

4 Center for Trade Policy and Development and Action Aid 2014. Policy Brief on Double Taxation Agreements.

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