



CATA Penang, Malaysia

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Shadow economy

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Trust and taxation

3 layers of Trust needed in society

- ▶ We all assume that our neighbors are paying their taxes too (**trust in solidarity**);
- ▶ We trust that the authority over us to collect and to spend taxes responsibly (**trust in institutions**);
- ▶ Trust in the implicit relationship and mutuality between past taxpayers and present beneficiaries; because most taxes are paying of past debts or investing in future expenditures (**trust in time**)



The tax gap is defined as the amount of tax liability faced by taxpayers that is not paid on time. The tax gap is the difference between **taxes owed** and **taxes paid**.

- Tax policy gap
- Tax compliance gap



Tax policy gap	Tax compliance gap
Tax voluntarily foregone	Tax evasion
<p>The choice not to tax needs to be quantified</p> <ol style="list-style-type: none"> 1. to explain why the decision was taken 2. to inform choice on those bases that are taxed 3. to communicate the decision to taxpayers 4. to defend the political choice 	<p>Criminal non-declaration of income or the claiming of false deductions for affect against declared income</p>
	Tax avoidance
<p>Tax reliefs, allowances, etc</p> <ol style="list-style-type: none"> 1. Personal allowances 2. Relief for specific types of expenditure 3. Incentives for favoured behaviour e.g. pension spending 4. Tax holidays 5. Preferential tax rates 6. Subsidies to particular business or companies 	<p>Arranging affairs in a way that exploits uncertainty in tax law and acting legally but against the spirit of the law</p>
	Irrecoverable or delayed tax debt
	<p>A figure only known by tax authorities</p>

Calculation of the tax gap

Bottom up:

- ▶ Calculate the errors in audited tax returns
- ▶ Extrapolate across the sample base
- ▶ Maybe extrapolate for non-submitted tax returns
- ▶ Estimation for unidentified taxpayers

Top down

- ▶ Identify the tax base in GDP
- ▶ Using external data
- ▶ Estimate the tax base at a standard rate before allowing for:
 - That value of tax bases not taxed
 - The value of reliefs, allowances and other spends by tax
 - The resulting in a theoretical tax yield
 - This is then compared with actual yield.

Remarks regarding both

Bottom up:

- ▶ **Almost unable to estimate the size of the tax loss due to the shadow economy**
- ▶ **Subject to systematic error within the tax authority sampling base**
- ▶ **Really only of any use in micro-economically checking the potential efficiency of the tax authority**

Top down

- ▶ **The choices available in raising that tax**
- ▶ **The extent to which the shadow economy undermines that capacity**
- ▶ **The extent of tax spends -the 'generosity' of the government and to whom it is extended**
- ▶ **The overall efficiency of the tax authority at a macro rather than a micro level**

Restrictions to measure the tax gap

- Primarily there is a lack of political will to know how the economy might be managed (which is what the top down tax gap reveals)
- There is a lack of willing amongst many economists to recognise the role of tax in the macro-economy (due to the primacy of monetary policy in much macro-economic thinking)
- Because tax does not effectively appear in the economic modelling of the macro-economy -it is simply not assumed to be important
- There has been a lack of willing to collect data on : •
 - The shadow economy in GDP, in case it is embarrassing
 - The cost of tax bases foregone
 - The cost of tax reliefs and allowances
 - Tax bases outside GDP

Tanzi's method

- ▶ **Popular methods based on Tanzi theory: if taxes are high then more cash in the economy**
- ▶ **The relation between tax rate and excess cash supply is crucial in the Tanzi-model (positive and significant)**
- ▶ **The underground economy is cash-based**
- ▶ **Tanzi proposes: the excess money supply is unrecorded money used in the underground economy**
- ▶ **But the relation is not stable over time**
 - ▶ Apparently people do not hold cash to avoid taxes anymore
 - ▶ Or because the tax rate hasn't changed significantly

Some examples (1)

- ▶ **Migrant smuggling highly profitable business**
 - ▶ Annual turnover: EUR 6 billion in EU
 - ▶ Cash 52%, hawala 20%, family resident in EU 16%, other 12%
 - ▶ Money involved ends up in pocket of non-residents
- ▶ **Infringement of intellectual property rights**
 - ▶ Transaction mutually agreed upon
 - ▶ Legal enterprises: producing counterfeited and pirated products, captured in national accounts
 - ▶ Illegal enterprises: money laundering including tax evasion
 - ▶ Sales of illegal copies for money generate value added; similar to fencing.

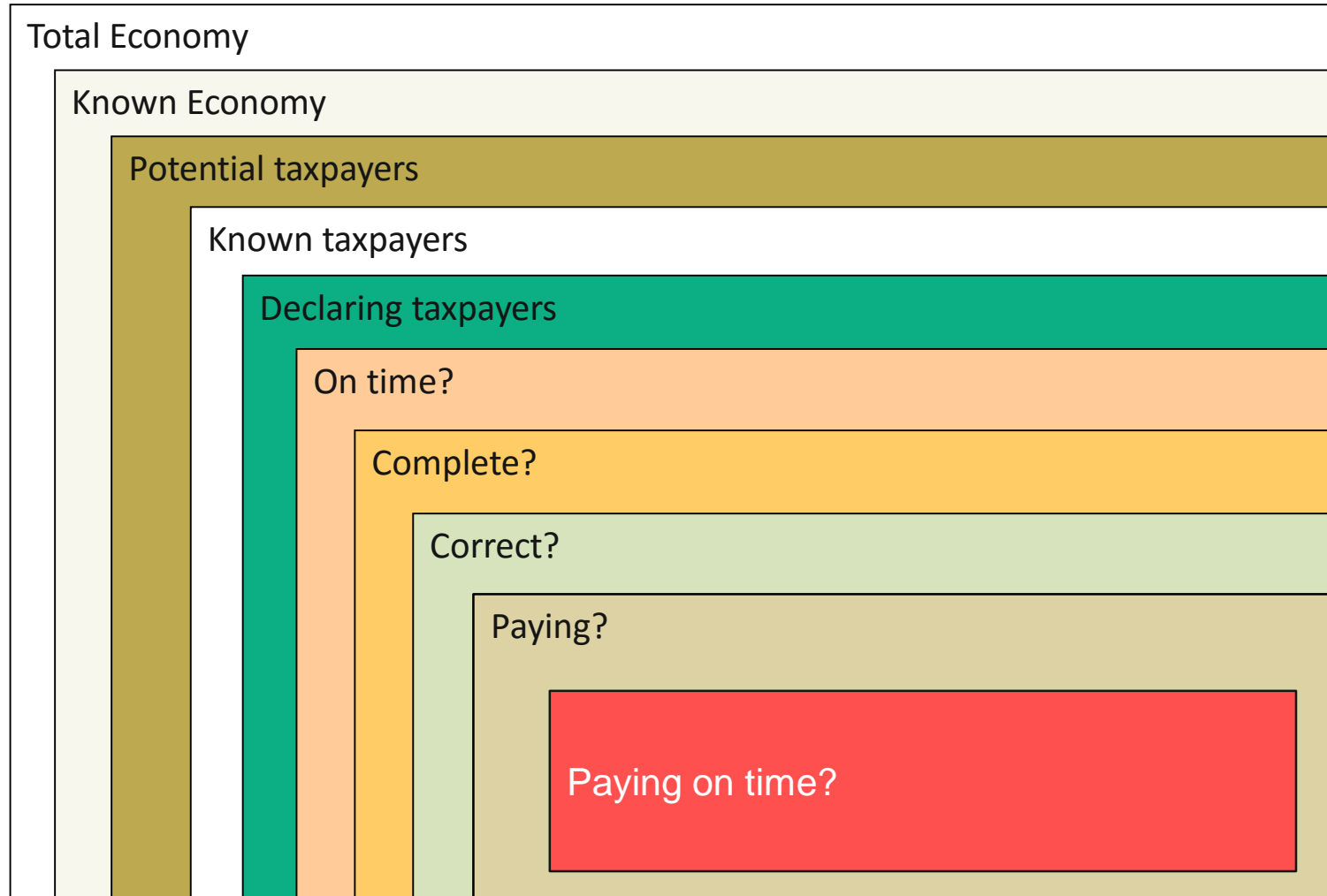
Some examples (2)

▶ **Bribery**

- ▶ Interaction between institutional units by mutual agreement: freedom of choice to enter into bribery or not
- ▶ Additional payments on top of official prices=genuine market price?
- ▶ Bribery linked to production of goods and services
- ▶ Bribery from an income point of view



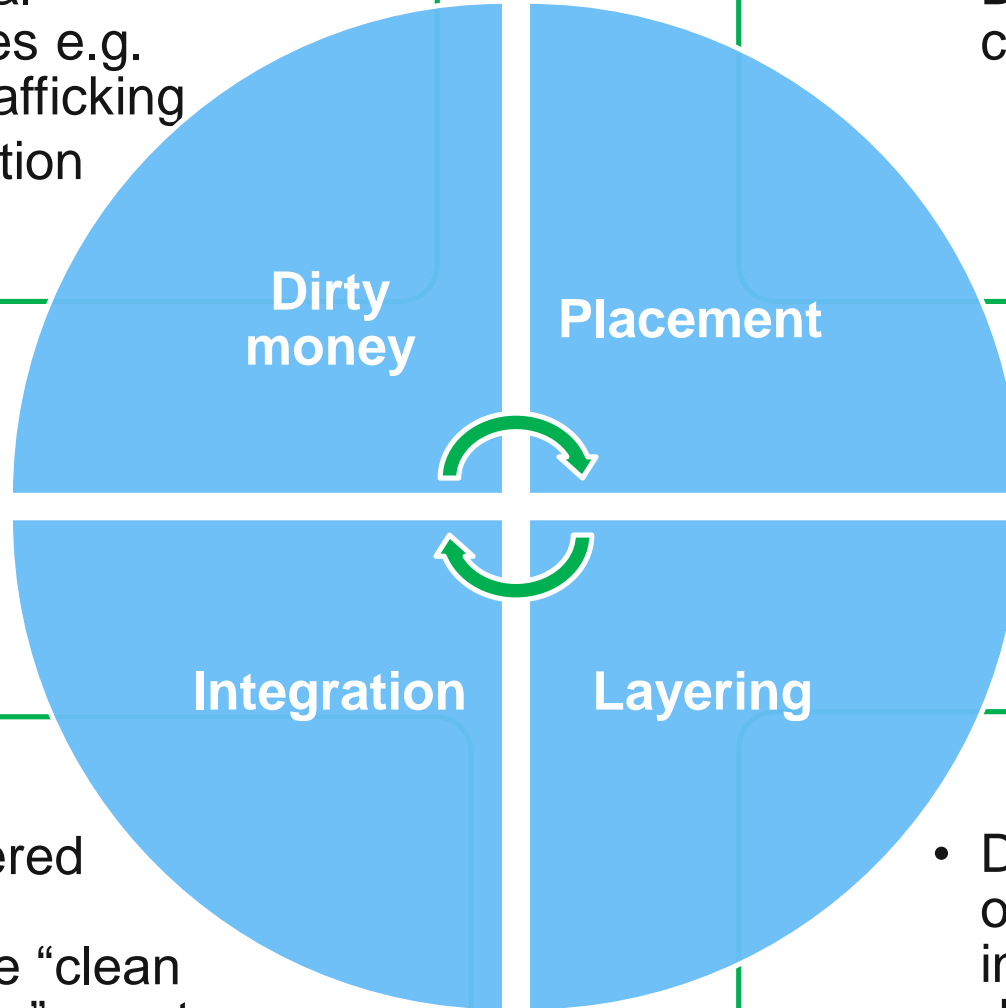
Tax administration performance



Stages of money laundering

- Criminal activities e.g. drug trafficking
- Corruption

- Disposal of cash



- Use layered funds to purchase “clean legitimate” assets

- Disguise origin of initial deposit

The market

Real estate market

Owner

Object

Financing

Purchase

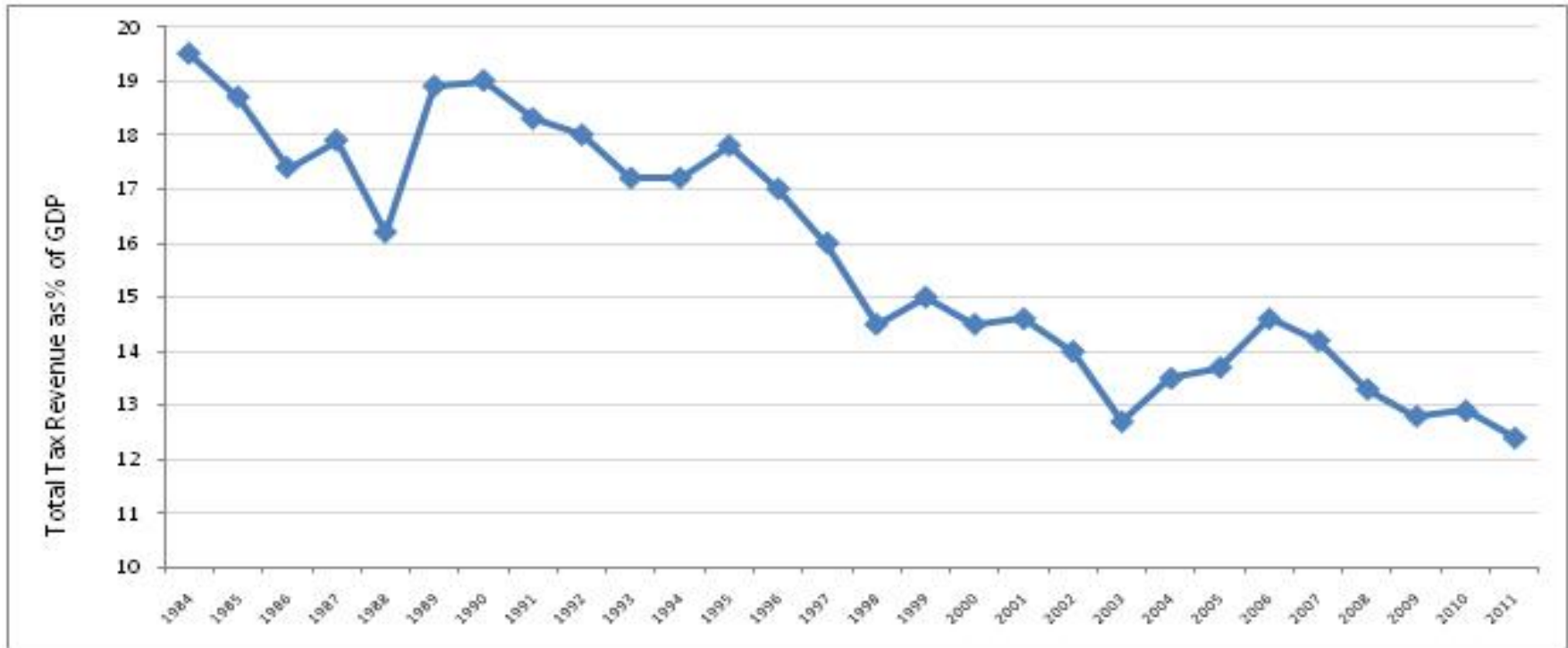
Financier

Financial market

Criminal market

Public institutions

Example of a country in the region Declining Tax Revenue to GDP Ratio (1977-2010)



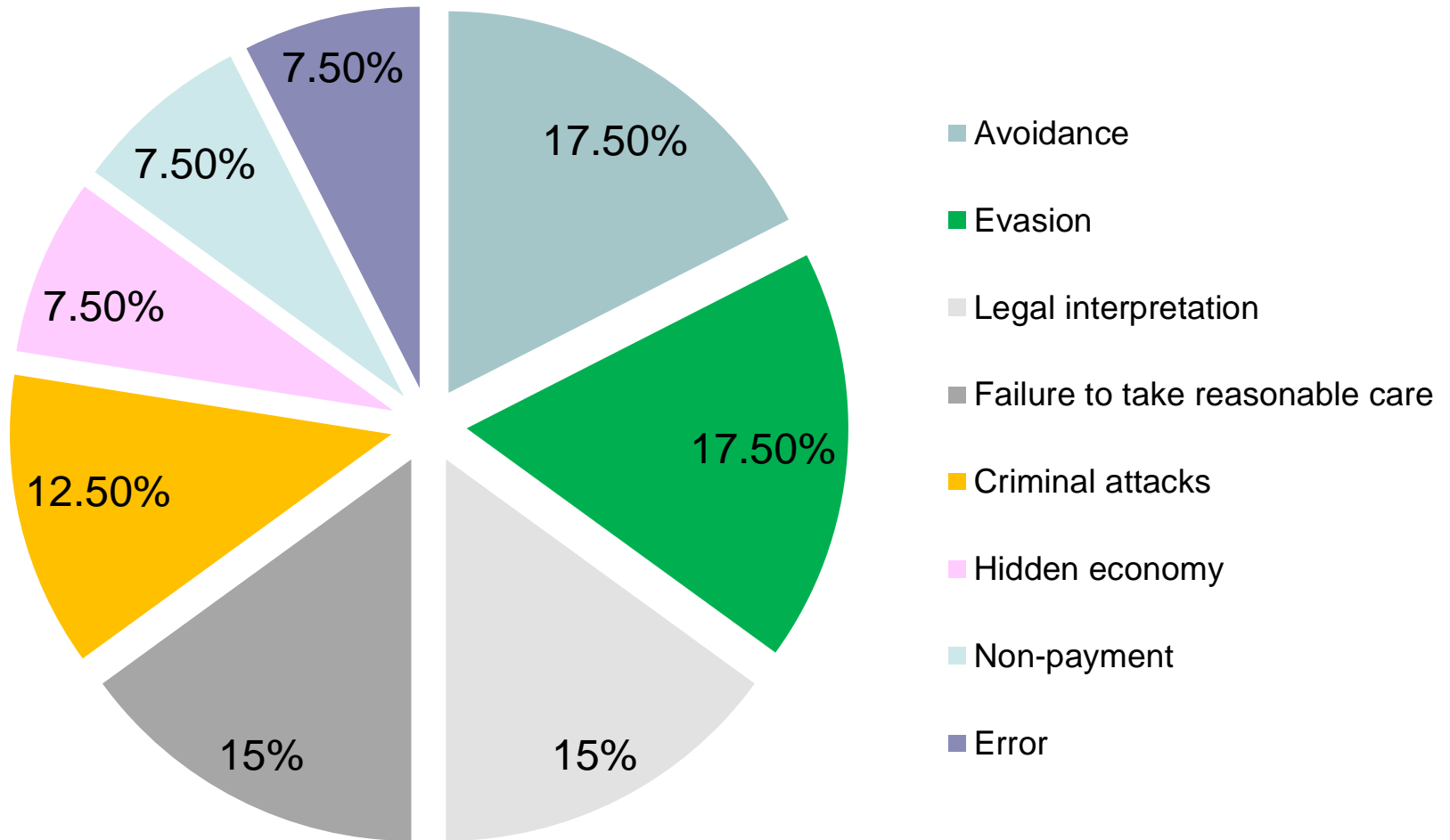
	2014	2015	2016	2017	2018	2019	2020	2021
Income Tax	1.9	2.3	2.0	2.7	3.2	3.7	4.1	4.1
VAT	2.6	2.0	2.2	2.7	3.6	3.9	4.2	4.2
Excise Tax	2.5	4.4	3.8	3.7	3.6	3.5	3.4	3.3
Other trade Tax	1.2	1.6	1.7	1.6	1.6	1.5	1.5	1.5
Total Tax	11.4	13.0	13.0	13.9	14.1	14.6	15.2	15.0



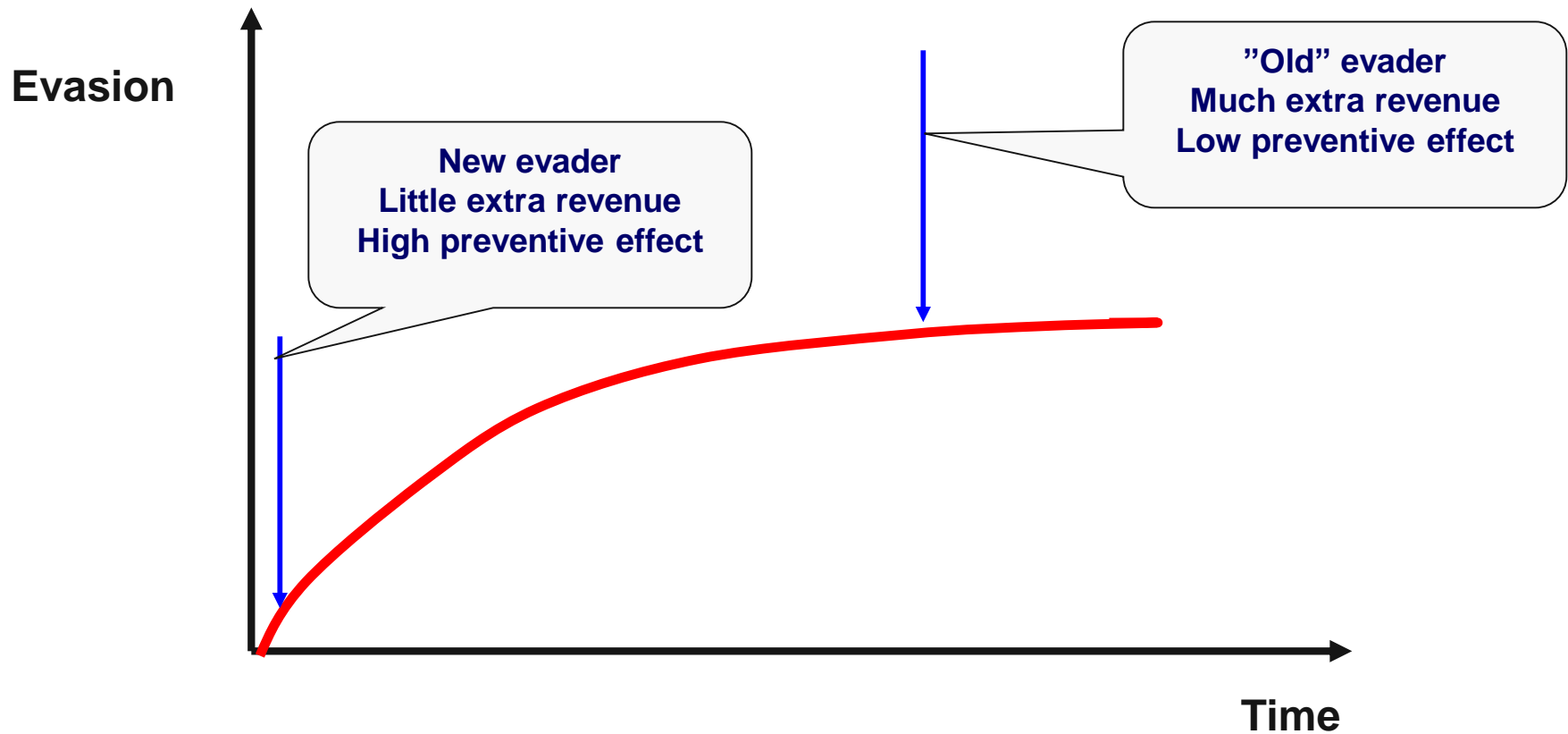
What is underground economy (UE)?

Formal (declared economy)	Household: Agricultural goods and own production of investment goods		Included in GDP	TOTAL (theoretical) GDP	
	Public goods				
	Declared part of the market economy				
Informal (non-declared economy)	Shadow economy	Non-declared part of the market economy	Normal under declaration (full price)		Partly included in GDP
		= The black economy	Black activities (less than full price)		
	Shadow economy	Illegal economic activity (e.g. prostitution and drug-dealing)			In practice, not included in GDP
		Tax evasion, e.g. transfer income, interests received and deductions, etc.			Not included in GDP
	Household: Services				

UK - Reasons for the tax gap (2015)



One evading taxpayer

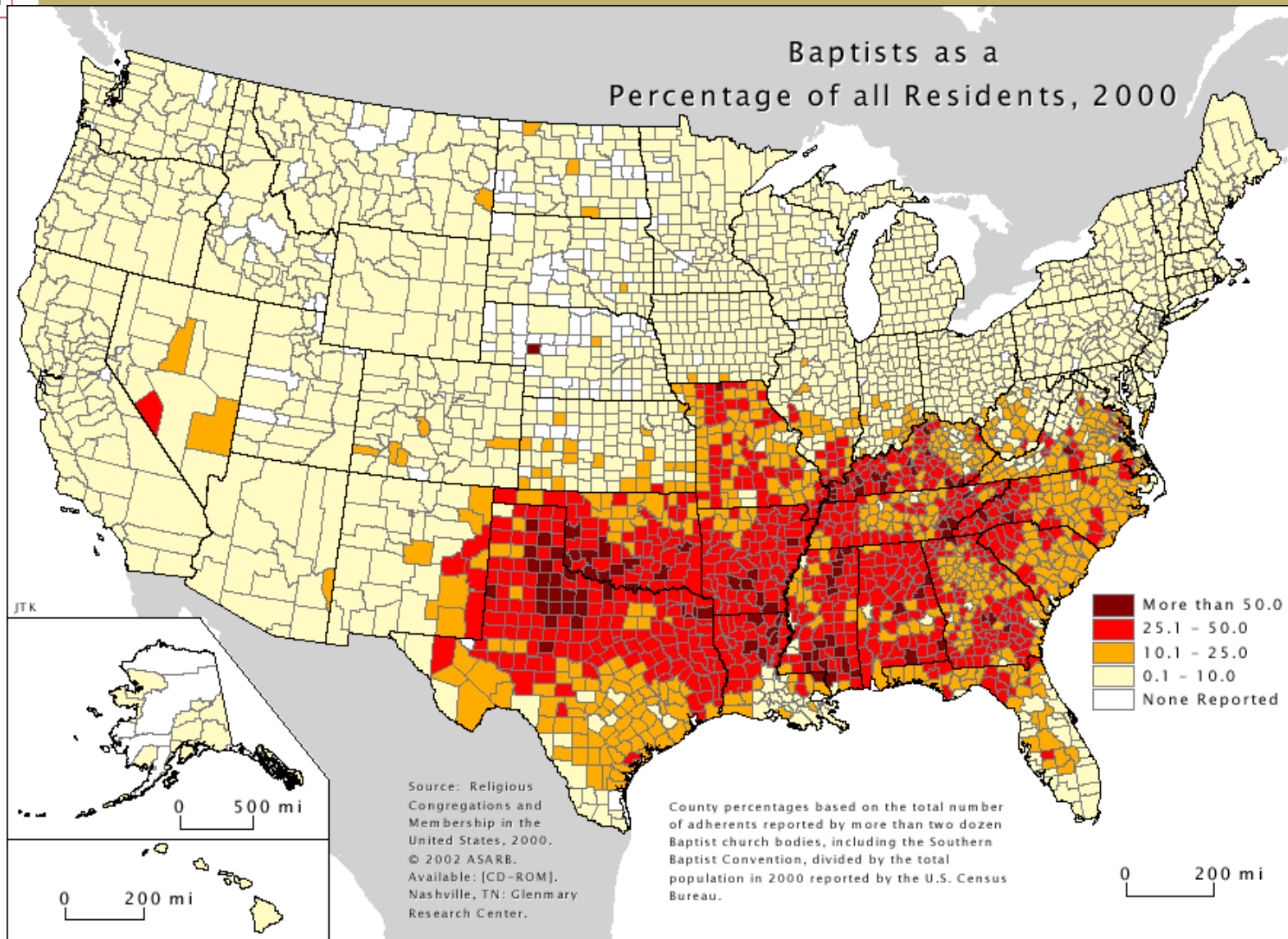




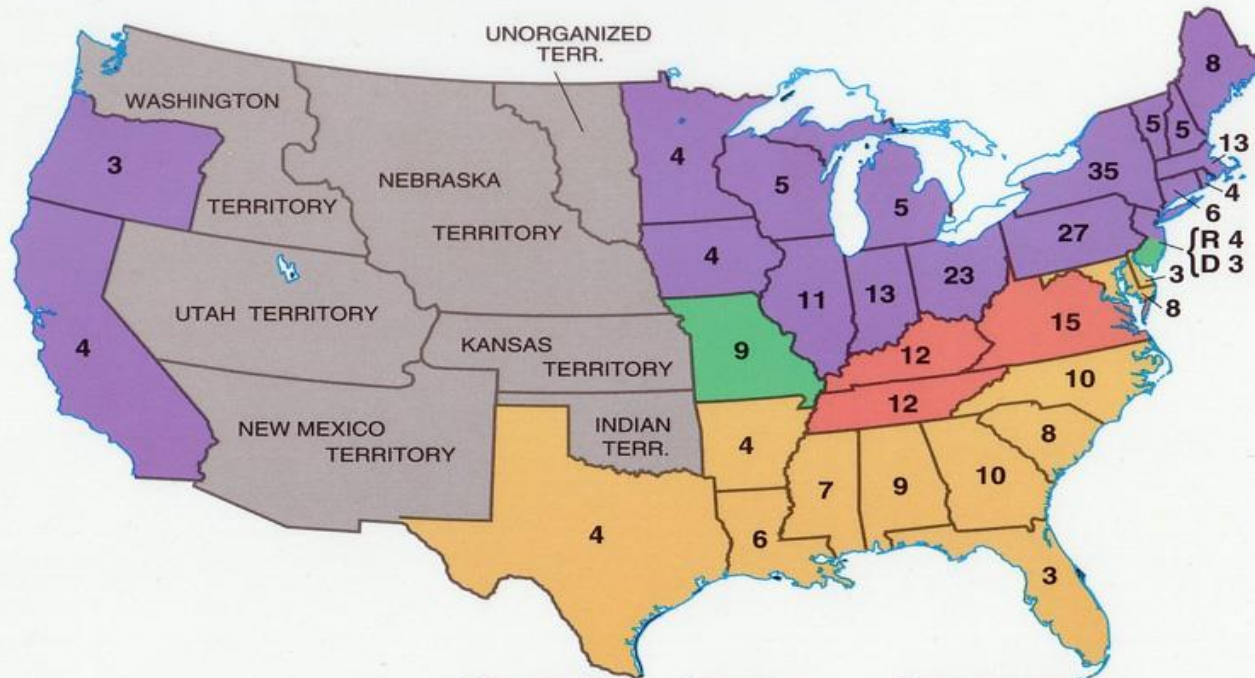
Highest donations and highest non-compliance



Bible Belt



USA (1860 elections)



	Electoral Vote	Popular Vote	Percentage of Popular Vote
Republican Abraham Lincoln	180	1,865,593	39.8
Democratic, Southern John C. Breckinridge	72	848,356	18.1
Democratic, Northern Stephen A. Douglas	12	1,382,713	29.5
Constitutional Union John Bell	39	592,906	12.6
Divided	3 4		

Non compliance or non cooperation?

Non-cooperation Movement 1920-1922

Started by Mahatma Gandhi





CATA IBFD

Base Erosion and Profit Shifting Assessment Tool (B.A.T.)

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12 November 2019



Developing BAT



Implemented by



Ministry of Foreign Affairs of the Netherlands

▶ **2018 IBFD Report for GIZ:**

“Implementing OECD/G20 BEPS Package in Developing Countries: An assessment of priorities, experiences, challenges and needs of developing countries”

▶ Country Survey

▶ Desk Study

▶ 2018 IBFD Report for GIZ:

- ▶ Implementation of OECD/G20 BEPS package
- ▶ Inclusive Framework – Minimum Standards

▶ Findings:

- ▶ Countries' tax strategic plans: no/hardly references to BEPS
- ▶ **Disconnection** between tax authorities (policy vs administration)
- ▶ Should I join the **Inclusive Framework**? Do I need to implement the **Minimum Standards**?
- ▶ What are my base erosion and profit shifting **priorities**?
- ▶ **Overlapping** of development partner's assistance



Developing BAT

- ▶ **2019 B.A.T.**
 - ▶ Tax system's **strengths and weaknesses** concerning international tax avoidance through **base erosion and profit shifting**, including (but not limited to) the OECD/G20 BEPS?
 - ▶ Country's **priorities**?
 - ▶ **Necessary measures** and **needs** to implement those measures?
 - ▶ **Realistic plan** that **development partners** may support?

- ▶ **2019 B.A.T.**
 - ▶ ***First Step: What is there already?***
 - ▶ Analysis of existing analytical tools (TADAT, Tax Diamond, etc.)
 - ▶ Conceptual design of B.A.T.
 - ▶ ***Second Step: Developing B.A.T.***
 - ▶ Key Areas
 - ▶ Performance Indicators
 - ▶ **Scoring Criteria**
 - ▶ Data collection instruments
 - ▶ **Questionnaire**
 - ▶ **Interviews**
 - ▶ **Template report**

▶ 2019 B.A.T.

▶ Third Step: Piloting

- ▶ **English speaking country** – GIZ - Zambia
- ▶ **French speaking country** – GIZ – Bukina Fasso
- ▶ **English speaking country** – Foreign Affairs NL
- ▶ **French speaking country** - Foreign Affairs NL



Developing BAT: Key Assessment Areas

- **Key Area of Assessment A:** Country strategy on tax avoidance, tax avoidance through selected OECD/G20 BEPS Actions, including Minimum Standards, and tax avoidance through other base erosion and profit shifting issues
- **Key Area of Assessment B:** Adoption of measures, including compliance with the OECD/G20 BEPS Minimum Standards, to deal with selected OECD/G20 BEPS issues and other base erosion and profit shifting issues
- **Key Area of Assessment C:** Tax administration organization to apply measures to deal with selected OECD/G20 BEPS Actions issues, including Minimum Standards, and other base erosion and profit shifting issues
- **Key Area of Assessment D:** Staff expertise to effectively apply measures to deal with selected OECD/G20 BEPS Actions issues, including Minimum Standards, and other base erosion and profit shifting issues.
- **Key Area of Assessment E:** Sufficient and operational IT infrastructure to implement effectively selected OECD/G20 BEPS Actions.

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