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Problem of Using Tax Havens to Maximize After Tax Profits: A Study of Multinationals (MNCs) in Nigeria

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ABSTRACT

According to Okafor (2012), it has been observed over the years that income tax revenue has generally been grossly understated due to improper tax administration arising from under assessment and inefficient machinery for collection. In Nigeria revenue derived from income taxes has been grossly understated due to improper tax administration, assessment and collection (Ola, 2001; Oluba, 2008. Adegbie and Fakile, 2011). Persons and companies are known to routinely evade and avoid taxes due to corrupt practices and the existence of various loopholes in the tax laws. The idea of multinational corporations however, has been around for centuries but in the second half of the twentieth century multinational corporations have become very important enterprises. Tatum (2010) proposes that multinationals operate in different structural models. The first and common model is for the multinational corporation positioning its executive headquarters in one nation, while production facilities are located in one or more other countries. This model often allows the company to take advantage of benefits of incorporating in a given locality, while also being able to produce goods and services in areas where the cost of production is lower (Ozoigbo and Chukuezi, 2011). While institutions like MNCs are important for economic development, particularly in resource rich countries, the interaction between multinational corporations and host country institutions is not well understood. Presently multinational corporations and their activities have dominated discussion on political economy. Activities of the MNCs in Nigeria have generated a repulsive reaction from many economic theorists like (Onimode 1982). They went ahead to regard MNCs as monsters that have consistently and systematically stultified economic development in various parts of the world. This is seen in not just the economic and environmental damage they cause the Nigerian economy, it is also in their attitude towards taxation issues in Nigeria. In fact, they have various ways of "shielding taxes" that are meant for the economic development of their host nations such as Nigeria. The main objective of this paper is to analyze the problem of Tax havens used by multinationals in Nigeria to maximize their Net profit and its effect on economy, The paper also draw from examples of the study in the US economy as most multinationals based in Nigeria are either from US or Europe as well as Asia – how they use Tax havens – other nations with loose law on taxation, do profit repatriation and ultimately reduce the Tax payable to Nigerian Nation. In doing this, however, the work is divided into sections – **section one** (Overview); **section two**, **three and Four.** Section **two** looks at the Conceptual framework, it defines the concept of Multinationals, Tax Havens and After Tax Profits. **Section Three** looks at how MNCs use Tax Heavens to Maximize after Tax Profits, section **four** concludes with summaries.

Keywords: After Tax Profits, Tax Havens, Multinational corporations (MNCs) Nigeria.

SECTION ONE

OVERVIEW OF TAX AND TAXATION ISSUES

A Tax is a fee charged or levied by a government on a product, income, or activity. If it is levied directly on personal or corporate income, it is called a direct tax. If it is levied on the price of a good or service, then it is called an indirect tax (Worlu and Nkoro, 2012). Furthermore, the institute of Chartered accountants of Nigeria (2006) and the Chartered institute of Taxation of Nigeria (2002) defined tax as "*an enforced contribution of money to government pursuant to a defined authorized legislation*."(Okafor, 2012). Conversely, every tax must be based on a valid state. Without a valid statute, no legitimate tax can be imposed. The main reason for taxation is to finance government

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expenditure and to redistribute wealth which translates to financing development of the country (Ola, 2001, Jhingan, 2004, Musgrave and Musgrave, 2004, Bhartia, 2009). Whether the taxes collected are enough to finance the development of the country will depend on the needs of the country and, countries can seek alternative sources of revenue to finance sustainable development (Unegbu and Irefin, 2011). Tax revenue is the receipt from tax structures.

Revenues accruing to an economy, such as Nigeria, can be divided into two main categories, which are; Oil Revenue (includes revenue from royalties, Petroleum Profit Tax (PPT), gas tax) and Non-Oil revenue (includes trade, loans, direct and indirect taxes paid by other sectors of the economy, Aids, agriculture etc).

Sanni (2007) advocate the use of tax as an instrument of social engineering, to stimulate general and/or sectoral economic growth. In that regard, taxation could have a positive or negative effect on both the individual and on government. To the individual, low income tax rate constitutes an incentive to work or save, while high income tax rate represents a disincentive to work or save. To the government, high tax rates provides the most reliable, important and dominant source of government revenue, for promoting the economic development of the nation.

In view of this, the tax rate is often a major consideration in the choice of organizational form of business (Okafor, 2008), and may also be associated with varying levels of foreign direct investment (Desai et. al., 2004).

However, tax revenue mobilization as a source of financing developmental activities in less developed economies has been a difficult issue primarily because of various forms of resistance, such as evasion, avoidance corrupt practices attending to it. These activities are considered as sabotaging the economy and are readily presented as reasons for the underdevelopment of the country. Government collects taxes in order to provide an efficient and steadily expanding non-revenue yielding services, such as infrastructure-education, health, communications system etc, employment opportunities and essential public services (such as the maintenance of laws and order) irrespective of the prevailing ideology or the political system of a particular nation (Worlu and Nkoro, 2012).Tax is also the nexus between state and its citizens, and tax revenues are the lifeblood of the social contract. The very act of taxation has profoundly beneficial effects in fostering better and more accountable government (Tax Justice Network (TJN), 2012). Musgrave and Musgrave (2004) also stated that the economic effects of tax include micro effects on the distribution of income and efficiency of resource use as well as macro effect on the level of capacity output, employment, prices, and growth. However, the use of tax as an instrument of fiscal policy to achieve economic growth in most less develops countries cannot be reliable because of dwindling level of revenue generation. Consequent upon this, changing or fine-tuning tax rates has been used to influence or achieve macroeconomic stability. A critical examples of governments that have influenced their economic development through revenue from tax are; Canada, United States, Netherland, United Kingdom. They derive substantial revenue from Company Income tax, Value Added Tax, Import Duties and have used same to create prosperity (Oluba 2008).

A significant share of the tax revenue increase in Africa stems from natural resource taxes. This included income from production sharing, royalties, and corporate income tax on oil and mining companies (Pfister, 2009). Nigeria is a developing country whose major export is mainly crude oil. Also endowed with other natural resources such as; natural gas, tin, iron ore, coal, limestone, lead, zinc and arable land (Economy Watch, 2011). As a sovereign nation, Nigeria has a land mass that covers about 923, 768 sq km and have a population of about 149,229,090. According to Tran (2008), emerging economies are nations that have large territories and populations, and they are undertaking extraordinary development projects that call for new infrastructure, such as power-generating plants and telecommunications systems.

Also, United Nations (2005) asserts that, achieving the Millennium Development Goals (MDGs), for instance, low-income countries (LICs) are required to increase their domestic revenues by around 4 percent of the GDP. Also, to meet the MDGs, OECD countries have been urged to raise their level of aid to LICs to about 0.7 percent of their Gross National Income – but this is as nothing when compared to potential tax revenues. The infrastructural developments demand a lot of resources and funding. In many rich countries, tax constitutes 30-40 percent of the GDP (Golit, 2008 and TJN, 2012). Nigeria with a budget of N4.97 trillion for the year 2011, representing 12% increase of 2010 annual budget (Unegbu and Irefin, 2011) shows that tax revenue is one of the ways of funding

infrastructural developments specified in the budget. The tax base in Nigeria since had been on the increase in order to mobilize the resources needed to execute infrastructural projects. According to Kaldor (1963), those who believe that insufficient growth and investment is mainly a consequence of a lack of resources are chiefly concerned with increasing the resources available for investment through additional taxation. The availability and mobilization of revenue is the fundamental factor on which an economic development is sustained and managed. As noted by TJN(2012), tax is the most important, the most beneficial, and the most sustainable source of finance for development. Tax revenue in Africa, for example, is worth ten times the value of foreign aid. The long-term goal of poor countries must be to replace foreign aid dependency with tax self-reliance.

However, in Nigeria the contribution of tax revenue has not been encouraging, thus expectations of government are being cut short. Corruption, evasion, avoidance and tax haven indicators are strongly associated with low revenue (Attila, Chambas, and Combes, 2008) and indeed, corruption functions like a tax itself. According to Adegbie and Fakile, 2011), the more citizens lack knowledge or education about taxation in the country, the greater the desire and the opportunities for tax evasion, avoidance and non-compliance with relevant tax laws. In this respect, the country will be more adversely affected because of absence of tax conscience on the part of individuals and the companies and the failure of tax administration to recognize the importance of communication and dialogue between the government and the citizens in matters relating to taxation. In the face of resource deficiency in financing long term development, Nigeria has heavily resorted to foreign capital, such loans and aid as the primary means to achieve rapid economic growth. Thereby accumulate huge external debt in relation to gross domestic product and serious debt servicing problems in terms of foreign exchange flow and, as such majority of the populace live in abject poverty. Government has expressed concern over these and has vowed to expand the tax revenue in order to meeting its mandate. Kiabel and Nwokah (2009) argue that the increasing cost of running government coupled with the dwindling revenue has left all tiers of government in Nigeria with formulating strategies to improve the revenue base. Also, Ndekwu (1991) noted that, more than ever before, there is now a great demand for the optimization of revenue from various tax sources in Nigeria. This probably influenced the decision of the Federal Government of Nigeria (FGN), which in 1991 set up a Study Group on the Review of the Nigerian Tax System and Administration. This review is what subsequently led to the development of the Comprehensive Tax Policy as we shall see later in this work.

Also, that an accurate estimation of the optimal level of expenditure requires knowledge of the productivity of the tax system and that it will assist in identifying a sustainable revenue profile for the country. As noted by IMF (cited in TJN, 2012) : "Developing countries must be able to raise the revenues required to finance the services demanded by their citizens and the infrastructure (physical and social) that will enable them to move out of poverty. Taxation will play the key role in this revenue mobilization. . . . .

As a means of meeting their expenditure requirements, many developing countries undertook tax reforms in the 1980s. However, most of these reforms focused on tax structure rather than on tax administration geared towards generating more revenue from existing tax sources (Osoro, 1991).

According to Okafor (2012), it has also been observed over the years that income tax revenue has generally been grossly understated due to improper tax administration arising from under assessment and inefficient machinery for collection. In Nigeria revenue derived from income taxes has been grossly understated due to improper tax administration, assessment and collection (Ola, 2001; Oluba, 2008. Adegbie and Fakile, 2011). Persons and companies are known to routinely evade and avoid taxes due to corrupt practices and the existence of various loopholes in the tax laws. According to Naiyelu (1996), the success or failure of any tax system depends on the extent to which it is properly managed; the extent to which the tax law is properly interpreted and implemented (Okafor, 2012). In addition, tax objectives set by government are usually not adequately met. So government objectives have always been to maximize its revenue generation capacity through taxation. However, this lofty objective is usually not achieved due to a lot of factors. Secondly, some influences usually hinder the actualization of this objective.

Furthermore, the idea of multinational corporations has been around for centuries but in the second half of the twentieth century multinational corporations have become very important enterprises.

Tatum (2010) proposes that multinationals operate in different structural models. The first and common model is for the multinational corporation positioning its executive headquarters in one nation, while production facilities are located in one or more other countries. This model often allows the company to take advantage of benefits of incorporating in a given locality, while also being able to produce goods and services in areas where the cost of production is lower (Ozoigbo and Chukuezi, 2011). While institutions like MNCs are important for economic development, particularly in resource rich countries, the interaction between multinational corporations and host country institutions is not well understood. Presently multinational corporations and their activities have dominated discussion on political economy. Activities of the MNCs in Nigeria have generated a repulsive reaction from many economic theorists like (Onimode 1982). They went ahead to regard MNCs as monsters that have consistently and systematically stultified economic development in various parts of the world. This is seen in not just the economic and environmental damage they cause the Nigerian economy, it is also in their attitude towards taxation issues in Nigeria. In fact, they have various ways of "shielding taxes" that are meant for the economic development of their host nations such as Nigeria.

The main objective of this paper is to analyze the problem of Tax havens use by multinationals in Nigeria to maximize their Net profit and its effect on economy, The paper will also draw from examples of the study in the US economy as most multinationals based in Nigeria are either from US or Europe as well as Asia – how they use Tax havens – other nations with loose law on taxation, do profit repatriation and ultimately reduce the Tax payable to Nigerian Nation. In doing this, however, the work is divided into sections – **section one** (Overview); **section two**, **three and Four.** Section **two** looks at the Conceptual framework, it defines the concept of Multinationals, Tax Havens and After Tax Profits. **Section three** looks at how MNCs use Tax Heavens to Maximize after Tax Profits, section five concludes with summaries.

SECTION TWO

CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

After Tax Profits

The online business dictionary defined Profit after tax (PAT) as "The netamountearned by a business after all taxation related expenses have been deducted. The profit after tax is often a better assessment of what a business is really earning and hence can use in its operations than its total revenues". (www.businessdictionary.com). In other words, it is the money left for the company for more business and as well as sharing for shareholders.

Tax Havens

According to wikipeadia.org, A **tax haven** is a state, country or territory where certain taxes are levied at a low rate or not at all.[2] Individuals and/or corporate entities can find it attractive to establish shell subsidiaries or move themselves to areas with reduced or nil taxation levels relative to typical international taxation. This creates a situation of tax competition among governments. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies. According to other definitions,[6] the central feature of a haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions. In its December 2008 report on the use of tax havens by American corporations,[7] the U.S. Government Accountability Office was unable to find a satisfactory definition of a tax haven but regarded the following characteristics as indicative of it: nil or nominal taxes; lack of effective exchange of tax information with foreign tax authorities; lack of transparency in the operation of legislative, legal or administrative provisions; no requirement for a substantive local presence; and self-promotion as an offshore financial center.

Similarly, Investopedia.com sees Tax Haven as "A country that offers foreign individuals and businesses little or no tax liability in a politically and economically stable environment. Tax havens also provide little or no financial information to foreign tax authorities. Individuals and businesses that do not reside a tax haven can take advantage of these countries' tax regimes to avoid paying taxes in their home countries. Tax havens do not require that an individual reside in or a business operate out of that country in order to benefit from its tax policies. It went further to list some countries that have become Tax Havens as:

Andorra, the Bahamas, Belize, Bermuda, the British Virgin Islands, the Cayman Islands, the Channel Islands, the Cook Islands, Hong Kong, the Isle of Man, Mauritius, Lichtenstein, Monaco, Panama, Switzerland and St. Kitts and Nevis are all considered tax havens. However, pressure from foreign governments that want to collect all the tax revenue they believe they are entitled to has caused some tax haven countries to sign tax information exchange agreements (TIEAs) and mutual legal assistance treaties (MLAT) that provide foreign governments with formerly secret information about investors' offshore accounts. (http://www.investopedia.com/terms/t/taxhaven.asp) assessed on 20/07/2013

MULTINATIONAL CORPORATIONS (MNCS): CONCEPT AND OBJECTIVE

The term *multinational corporation* (MNC) can be defined and described from differing perspectives and on a number of various levels, including law, sociology, history, and strategy as well as from the perspectives of business ethics and society. Multinational corporations are companies which seek to operate strategically on a global scale. A multinational corporation is a company, firm or enterprise that operates worldwide with its headquarters in a metropolitan or developed country. Hill (2005) defines Multinational Enterprise as any business that has productive activities in two or more countries. Certain characteristics of Multinational Corporations should be identified at the start since they serve, in part, as their defining features. Often referred to as "multinational enterprises," and in some early documents of the United Nations they are called "transnational organizations," Multinational Corporations are usually very large corporate entities that while having their base of operations in one nation—the "home nation"—carry out and conduct business in at least one other, but usually many nations, in what are called the "host nations." Multinational Corporations are usually very large entities having a global presence and reach (Kim, 2000). Multinational corporations (MNCs) can spur economic activities in developing countries and provide an opportunity to improve the qualities of life, economic growth, and regional and global commons (Litvin, 2002).

In Nigeria, for example, MNCs are operating in almost all sector of the economy. The list of MNCs in Nigeria includes (but not limited to this) Oil giants such as Shell, ExxonMobil, ChevronTexaco, Total FinaElf (now Total), Conoco, BP, Agip, Eni and Snamprogetti. Others are those in the non oil sectors - NBC (makers of Coca Cola), Standard Chartered Bank , Citibank as well as Sab Miller – the brewery giant, just to mention but a few. With the list long enough, there is no doubt that their impact on the economy of Nigeria if they do not adequately pay their tax will be huge and as such the tax havens they shield tax with needs to be uncovered. The preceding paragraphs uncovers various countries of which are used as Tax havens to shield tax payable to the base of operation and ultimately maximize profit.

SECTION THREE

HOW MNCS USE TAX HAVENS FOR MAXIMIZING AFTER TAX PROFIT

A recent report by Gravelle (2013) a senior Economic Specialist with US Congress has it that "The federal government loses both individual and corporate income tax revenue from the shifting of profits and income into low-tax countries." The revenue losses from this tax avoidance and evasion are difficult to estimate, but some have suggested that the annual cost of offshore taxa buses may be around $100 billion per year.1 International tax avoidance can arise from wealthy individual investors and from large multinational corporations; it can reflect both legal and illegal actions Tax avoidance is sometimes used to refer to a legal reduction in taxes, whereas evasion refers total reductions that are illegal. Both types are discussed in this report, although the dividing line is not entirely clear. A multinational firm that constructs a factory in a low-tax jurisdiction rather than in the United States to take advantage of low foreign corporate tax rates is engaged in avoidance, whereas a U.S. citizen who sets up a secret bank account in the Caribbean and does not report the interest income is engaged in evasion. There are, however, many activities, particularly by corporations, that are often referred to as avoidance but could be classified as evasion. One example is transfer pricing, where firms charge low prices for sales to low-tax affiliates but pay high prices for purchases from them. If these prices, which are supposed to be at arm's-length, are set at an artificial level, then this activity might be viewed by some as evasion, even if such pricing is not overturned in court because evidence to establish pricing is not available. Most of the international tax reduction of individuals reflects evasion, and this amount has been estimated to range from about $40 billion to about $70 billion a year.2 This evasion occurs in part because the United States does not withhold tax on many types of passive income (such as interest) paid to foreign entities; if U.S. individuals can channel their

investments through a foreign entity and do not report the holdings of these assets on their tax returns, they evade a tax that they are legally required to pay. In addition, individuals investing in foreign assets may not report income from them.

Corporate tax reductions arising from profit shifting have also been estimated. As discussed below, estimates of the revenue losses from corporate profit shifting vary substantially, ranging from about $10 billion to about $90 billion.

In addition to differentiating between individual and corporate activities, and evasion and avoidance, there are also variations in the features used to characterize tax havens. Some restrictive definitions would limit tax havens to those countries that, in addition to having low or non-existent tax rates on some types of income, also have such other characteristics as the lack of transparency, bank secrecy and the lack of information sharing, and requiring little or no economic activity for an entity to obtain legal status. A definition incorporating compounding factors such as these was used by the Organization for Economic Development and Cooperation

(OECD) in their tax shelter initiative. Others, particularly economists, might characterize as a tax haven any low-tax country with a goal of attracting capital, or simply any country that has low or non-existent taxes. This report addresses tax havens in their broader sense as well as in their narrower sense.

Although international tax avoidance can be differentiated by whether it is associated with individuals or corporations, whether it is illegal evasion or legal avoidance, and whether it arises in a tax haven narrowly defined or broadly defined, it can also be characterized by what measures might be taken to reduce this loss. In general, revenue losses from individual taxes are more likely to be associated with evasion and more likely to be associated with narrowly defined tax havens, while corporate tax avoidance occurs in both narrowly and broadly defined tax havens and can arise from either legal avoidance or illegal evasion. Evasion is often a problem of lack of information, and remedies may include resources for enforcement, along with incentives and sanctions designed to increase information sharing, and possibly a move towards greater withholding. Avoidance may be more likely to be remedied with changes in the tax code.

Several legislative proposals have been advanced that address international tax issues. Furthermore, President Obama has proposed several international corporate tax revisions which relate to multinational corporations, including profit shifting, as well as individual tax evasion. Some of the provisions relating to multinationals had earlier been included in a bill introduced in the 110th Congress by Chairman Rangel of the Ways and Means Committee (H.R. 3970). Major revisions to corporate international tax rules are also included in S. 3018, a general tax reform act introduced by Senators Wyden and Gregg in the 111th Congress, and a similar bill, S. 727, introduced by Senators Wyden and Coats in the 112th Congress.3 This bill has provisions to tax foreign source income currently, which could limit the benefits from corporate profit shifting. Ways and Means Chairman Dave Camp has proposed a lower corporate rate combined with a move to a territorial tax system (which would exempt foreign source income). Because a territorial tax could increase the scope for profit shifting, the proposal contains detailed provisions to address these issues. A territorial tax proposal has also been introduced by Senator Enzi (S. 2091).

The Senate Permanent Subcommittee on Investigations has been engaged in international tax

Investigations since 2001, holding hearings proposing legislation. In the 111th Congress, the Stop Tax Haven Abuse Act, S. 506, was introduced by the chairman of that committee, Senator Levin, with a companion bill, H.R. 1265, introduced by Representative Doggett. The Senate Finance Committee also has circulated draft proposals addressing individual tax evasion issues. A number of these anti-evasion provisions (including provisions in President Obama's budget outline) have been adopted in the Hiring Incentives to Restore Employment (HIRE) Act, P.L. 111-147. In the112th Congress, a revised version of the Stop Tax Haven Abuse Act (H.R. 2669 and S. 1346) was introduced. On the 111th Congress, S. 386, introduced by Chairman Leahy of the Senate Judiciary Committee, would have expanded the money-laundering provisions to include tax evasion and provide additional funding for the tax division of the Justice Department. These tax-related provisions were not included in the final law, P.L. 111-21. S. 569, also introduced by Chairman Levin, would impose requirements on the states for determination of beneficial owners of corporations formed under their laws. This

proposal has implications for the potential use of incorporation in certain states as a part of an international tax haven plan. (Gravelle, 2013)

Where Are the Tax Havens?

There is no precise definition of a tax haven. The OECD initially defined the following features

of tax havens: no or low taxes, lack of effective exchange of information, lack of transparency and no requirement of substantial activity (OECD, 1998). Other lists have been developed in legislative proposals and by researchers. Also, a number of other jurisdictions have been identified as having ax haven characteristics.

Formal Lists of Tax Havens

The OECD created an initial list of tax havens in 2000. A similar list was used in S. 396, introduced in the 110th Congress, which would treat firms incorporated in certain tax havens as domestic companies; the only difference between this list and the OECD list was the exclusion of the U.S. Virgin Islands from the list in S. 396. Legislation introduced in the 111th Congress to address tax haven abuse (S. 506, H.R. 1265) uses a different list taken from IRS court filings, buthas many countries in common. The definition by the OECD excluded low-tax jurisdictions, some of which are OECD members, which were thought by many to be tax havens, such as Ireland, and Switzerland. These countries were included in an important study of tax havens by Hines and Rice

Table1. *Lists the countries that appear on various lists, arranged by geographic location. These tax havens tend to be concentrated in certain areas, including the Caribbean and West Indies and Europe, locations close to large developed countries. There are 50 altogether.*

S/No	Region	Countries Listed on Various Tax Haven Lists
1	Caribbean/West Indies	Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, d,e British Virgin Islands, Cayman Islands, Dominica, Grenada, Montserrat,a Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Turks and Caicos, U.S. Virgin Islands.
2	Central America	Belize, Costa Rica, Panama
3	Coast of East Asia	Hong Kong, Macau, Singapore
4	Europe/Mediterranean	Andorra Channel Islands (Guernsey and Jersey),Cyprus Gibralter, Isle of Man, Ireland, Liechtenstein, Luxembourg, Malta, Monaco, San Marino, Switzerland
5	Indian Ocean	Maldives, Mauritius, Seychelles
6	Middle East	Bahrain, Jordan, Lebanon
7	North Atlantic	Bermuda
8	Pacific, South Pacific	Cook Islands, Marshall Islands, Samoa, Nauru, Niue, Tonga, Vanuatu
9	West Africa	Liberia

Source: *Gravelle, Jeniffer, 2013*

Developments in the OECD Tax Haven List

The OECD list, the most prominent list, has changed over time. Nine of the countries in **Table 1**did not appear on the earliest OECD list. These countries not appearing on the original list tend tobe more developed larger countries and include some that are members of the OECD (e.g., Switzerland and Luxembourg).It is also important to distinguish between OECD's original list and its blacklist. OECD subsequently focused on information exchange and removed countries from a "blacklist if they agree to cooperate." OECD initially examined 47 jurisdictions and identified a number as not meeting the criteria for a tax haven; it also initially excluded six countries with advance agreements to share information (Bermuda, the Cayman Islands, Cyprus, Malta, Mauritius, and San Marino). The 2000 OECD blacklist included 35 countries; this list did not include the six countries eliminated due to advance agreement. The OECD had also subsequently determined hat three countries should not be included in the list of tax havens (Barbados, the Maldives, and Tonga). Over time, as more tax havens made agreements to share information, the black list dwindled until it included only three countries: Andorra, Liechtenstein, and Monaco.

A study of the OECD initiative on global tax coordination by Sharman, also discussed in a book review by Sullivan, argues that the reduction in the OECD list was not because of actual progress towards cooperation so much as due to the withdrawal of U.S. support in 2001, which resulted in the

OECD focusing on information on request and not requiring reforms until all parties had signed on (Sharman, 2007). This analysis suggests that the large countries were not successful in this initiative to rein in on tax havens. A similar analysis by Spencer and Sharman suggests little real progress has been made in reducing tax haven practices (Spencer and Sharman, 2007). Interest in tax haven actions has increased recently. The scandals surrounding the Swiss bank UBS AG (UBS) and the Liechtenstein Global Trust Group (LGT), which led to legal actions by the United States and other countries, focused greater attention on international tax issues, primarily information reporting and individual evasion (Joint Committee on Tax compliance and Enforcement, 2009). The credit crunch and provision of public funds to banks have also heightened public interest. The tax haven issue was revived recently with a meeting of the G20 industrialized and developing countries that proposed sanctions and a number of countries began to indicate commitments to information sharing agreements (Anthony and Jordan, 2009).

The OECD currently has three lists: a "white list" of countries implementing an agreed-upon standard, a "gray" list of countries that have committed to such a standard and a "black" list of countries that have not committed. On April 7, 2009, the last four countries on the "black" list, which were countries not included on the original OECD list—Costa Rica, Malaysia, the Philippines, and Uruguay—were moved to the "gray" list (OECD). The gray list includes countries not identified as tax havens but as "other financial centers." According to news reports, Hong Kongand Macau were omitted from the OECD's list because of objections from China, but are mentioned in a footnote as having committed to the standards; they also noted that a "recent flurry of commitments brought 11 jurisdictions, including Austria, Liechtenstein, Luxembourg, country (Nauru) appeared on the gray list for tax havens and one (Guatemala) appeared on the gray list for financial centers.

Similarly, many countries that were listed on the OECD's original blacklist protested because of the negative publicity and many now point to having signed agreements to negotiate tax information exchange agreements (TIEA) and some have negotiated agreements. The identification of tax havens can have legal ramifications if laws and sanctions are contingent on that identification, asis the case of some current proposals in the United States and of potential sanctions by international bodies.

Other Jurisdictions with Tax Haven Characteristics

Criticisms have been made by a range of commentators that many countries are tax havens or have aspects of tax havens and have been overlooked. These jurisdictions include major countries such as the United States, the UK, the Netherlands, Denmark, Hungary, Iceland, Israel, Portugal, and Canada. Attention has also been directed at three states in the United States: Delaware, Nevada, and Wyoming. Finally, there are a number of smaller countries or areas in countries, such as Campioned' Italia, an Italian town located within Switzerland, that have been characterized as tax havens.

A country not on the list in **Table 1**, but which is often considered a tax haven, especially for corporations, is the Netherlands, which allows firms to reduce taxes on dividends and capital gains from subsidiaries and has a wide range of treaties that reduce taxes (Van Dirk et al, 2007). In 2006, for example, Bono and other members of the U2 band moved their music publishing company from Ireland to the Netherlands after Ireland changed its tax treatment of music royalties (Obrien, 2006). A recent newspaper report explained the role of the Netherlands in facilitating movement to tax havens through provisions such as the various "Dutch sandwiches," that allow money to be funneled out of other countries that would charge withholding taxes to non-European countries, to be passed on in turn to tax havens such as Bermuda and the Cayman Islands (Drucker, Jesse (2006).

Some have identified the United States and the United Kingdom as having tax haven characteristics. Luxembourg Prime Minister Jean-Claude Junker urged other EU member states to challenge the United States for tax havens in Delaware, Nevada, and Wyoming (Gnaedinger, C. 2006). One website offering offshore services mentions, in their view; several overlooked tax havens which include the United States, United Kingdom, Denmark, Iceland, Israel, and Portugal's Madeira Island.

(Others on their list and not listed in **Table 1** were Hungary, Brunei, Uruguay, and Labuan [Malaysia]). In the case of the United States the article mentions the lack of reporting requirements and the failure to tax interest and other exempt passive income paid to foreigner titles, the limited liability corporation which allows a flexible corporate vehicle not subject to taxation, and the ease of incorporating in certain states (Delaware, Nevada, and Wyoming).

Another website includes in its list of tax havens Delaware, Wyoming, and Puerto Rico, along with other jurisdictions not listed in **Table 1**: the Netherlands, Campioned' Italia, a separate listing for Sark (identified as the only remaining "fiscal paradise"), the United Kingdom, and a coming discussion for Canada (http://www.offshore-manual.com/taxhavens/.) Sark is an island country associated with Guernsey, part of the Channel Islands, and Campioned' Italia is an Italian town located within Switzerland.

The Economist reported a study by a political scientist experimenting with setting up sham corporations; the author succeeded in incorporating in Wyoming and Nevada, as well as the United Kingdom and several other places (The Economist, March, 2008). Michael McIntyre discusses three U.S. practices that aid international evasion: the failure to collect information on tax exempt interest income paid to foreign entities, the system of foreign institutions that act as qualified intermediaries (see discussion below) but do not reveal their clients, and the practices of states such as Delaware and Wyoming that allow people to keep secret their identities as stockholder or depositor (Mclntyre, Michael, 2009).

In a meeting in late April 2009, Eduardo Silva, of the Cayman Islands Financial Services Association, claimed that Delaware, Nevada, Wyoming, and the United Kingdom were the greatest offenders with respect to, among other issues, tax fraud. He suggested that Nevada and

Wyoming were worse than Delaware because they permit companies to have bearer shares, which allows anonymous ownership. A U.S. participant at the conference noted that legislation in the United States, S. 569, would require disclosure of beneficial owners in the United States.

In addition, any country with a low tax rate could be considered as a potential location for shifting income to. In addition to Ireland, three other countries in the OECD not included in **Table 1** have tax rates below 20%: Iceland, Poland, and the Slovak Republic. Most of the eastern European countries not included in the OECD have tax rates below 20%.

The Tax Justice Network probably has the largest list of tax havens, and includes some specific cities and areas (Tax Justice Network, 2005).

In addition to the countries listed in **Table 1**, they include in the Americas and Caribbean, New York and Uruguay; in Africa, Mellila, Sao Tome e Principe, Somalia, and South Africa; in the Middle East and Asia, Dubai, Labuan (Malaysia), Tel Aviv, and Taipei; in Europe, Alderney, Belgium, Campioned' Italia, City of London, Dublin, Ingushetia, Madeira, Sark, Trieste, Turkish Republic of Northern Cyprus, and Frankfurt; and in the Indian and Pacific oceans, the Marianas. The only county listed in **Table1** and not included in their list was Jordan.

Methods of Corporate Tax Avoidance

U.S. multinationals are not taxed on income earned by foreign subsidiaries until it is repatriated to the U.S. parent as dividends, although some passive and related company income that is easily shifted is taxed currently under anti-abuse rules referred to as Subpart F. (Foreign affiliates or subsidiaries that are majority owned U.S. owned are referred to as controlled foreign corporations, or CFCs, and many of these related firms are wholly owned.) Taxes on income that is repatriated (or, less commonly, earned by branches and taxed currently) are allowed a credit for foreign income taxes paid. (A part of a parent company treated as a branch is not a separate entity for tax purposes, and all income is part of the parent's income.)

Foreign tax credits are limited to the amount of tax imposed by the United States, so that they, in theory, cannot offset taxes on domestic income. This limit is imposed on an overall basis, allowing excess credits in high-tax countries to offset U.S. tax liability on income earned in low tax countries, although separate limits apply to passive and active income. Other countries either employ this system of deferral and credit or, more commonly, exempt income earned in foreign jurisdictions. Most countries have some form of anti-abuse rules similar to Subpart F.

If a firm can shift profits to a low-tax jurisdiction from a high-tax one, its taxes will be reduced without affecting other aspects of the company. Tax differences also affect real economic activity, which in turn affects revenues, but it is this artificial shifting of profits that is the focus of this report (Gravelle, 2013). Because the United States taxes all income earned in its borders as well as imposing a residual tax on income earned abroad by U.S. persons, tax avoidance relates both to U.S. parent

companies hifting profits abroad to low-tax jurisdictions and the shifting of profits out of the United States by foreign parents of U.S. subsidiaries. In the case of U.S. multinationals, one study suggested that about half the difference between profitability in low-tax and high-tax countries, which could arise from artificial income shifting, was due to transfers of intellectual property (or intangibles)and most of the rest through the allocation of debt (Grubert, Harry, 2003). However, a study examining import and export prices suggests a very large effect of transfer pricing in goods (as discussed below) (Pak and Zdanowicz, 2002).

Some evidence of the importance of intellectual property can also be found from the type's offirms that repatriated profits abroad following a temporary tax reduction enacted in 2004; one third of the repatriations were in the pharmaceutical and medicine industry and almost 20% in the computer and electronic equipment industry.

Allocation of Debt and Earnings Stripping

One method of shifting profits from a high-tax jurisdiction to a low-tax one is to borrow more in the high-tax jurisdiction and less in the low-tax one. This shifting of debt can be achieved without changing the overall debt exposure of the firm. A more specific practice is referred to as earnings stripping, where either debt is associated with related firms or unrelated debt is not subject to tax by the recipient. As an example of the former earnings stripping method, a foreign parent may lend to its U.S. subsidiary. Alternatively, an unrelated foreign borrower not subject to tax on U.S. interest income might lend to a U.S. firm.

The U.S. tax code currently contains provisions to address interest deductions and earnings stripping. It applies an allocation of the U.S. parent's interest for purposes of the limit on the foreign tax credit. The amount of foreign source income is reduced when part of U.S. interest is allocated and the maximum amount of foreign tax credits taken is limited, a provision that affects firms with excess foreign tax credits. There is no allocation rule, however, to address deferral, so that a U.S. parent could operate its subsidiary with all equity finance in a low-tax jurisdiction and take all of the interest on the overall firm's debt as a deduction. A bill introduced in 2007

(H.R. 3970) by Chairman Rangel of the Ways and Means Committee would introduce such an allocation rule, so that a portion of interest and other overhead costs would not be deducted until the income is repatriated. This provision is also included in President Obama's proposals for International tax revision. While allocation-of-interest approaches could be used to address allocation of interest to high-tax countries in the case of U.S. multinationals, they cannot be applied to U.S. subsidiaries of foreign corporations. To limit the scope of earnings stripping in either case, the United States has thin capitalization rules. (Most of the United States' major trading partners have similar rules.) A section of the Internal Revenue Code (163(j)) applies to a corporation with a debt-to-equity ratio above 1.5 to 1 and with net interest exceeding 50% of adjusted taxable income (generally taxable income plus interest plus depreciation). Interest in excess of the 50% limit paid to a related corporation is not deductible if the corporation is not subject to U.S. income tax. This interest restriction also applies to interest paid to unrelated parties that are not taxed to the recipient.

The possibility of earnings stripping received more attention after a number of U.S. firms inverted that is, arranged to move their parent firm abroad so that U.S. operations became a subsidiary of that parent. The American Jobs Creation Act (AJCA) of 2004 addressed the general problem of inversion by treating firms that subsequently inverted as U.S. firms. During consideration of this legislation there were also proposals for broader earnings stripping restrictions as an approach to this problem that would have reduced the excess interest deductions. This general earnings stripping proposal was not adopted. However, the AJCA mandated a Treasury Department study on this and other issues; that study focused on U.S. subsidiaries of foreign parents and was not able to find clear evidence on the magnitude (US Department of Treasury, Report to congress on Earnings, stripping, transfer pricing and US Income Tax Treaties, 2007).As noted in the Treasury's mandated study, there is relatively straightforward evidence that U.S. multinationals allocate more interest to high-tax jurisdictions, but it is more difficult to assess earnings stripping by foreign parents of U.S. subsidiaries, because the entire firm's accounts are not available. The Treasury study focused on this issue and used an approach that had been used in the past of comparing these subsidiaries to U.S. firms. The study was not able to provide conclusive evidence about the shifting of profits out of the United States due to high leverage rates for U.S. subsidiaries of foreign firms but did find evidence of shifting for inverted firms.

Transfer Pricing

The second major way that firms can shift profits from high-tax to low-tax jurisdictions is through the pricing of goods and services sold between affiliates. To properly reflect income, prices of goods and services sold by related companies should be the same as the prices that would be paid by unrelated parties. By lowering the price of goods and services sold by parents and affiliates in high-tax jurisdictions and raising the price of purchases, income can be shifted.

An important and growing issue of transfer pricing is with the transfers to rights to intellectual property, or intangibles. If a patent developed in the United States is licensed to an affiliate in allow-tax country income will be shifted if the royalty or other payment is lower than the true value of the license. For many goods there are similar products sold or other methods (such as cost plus markup) that can be used to determine whether prices are set appropriately. Intangibles, such as new inventions or new drugs, tend not to have comparables, and it is very difficult to know theory alty that would be paid in an arms-length price. Therefore, intangibles represent particular problems for policing transfer pricing.

Investment in intangibles is favorably treated in the United States because costs, other than capital equipment and buildings, are expensed for research and development, which is also eligible for a tax credit. In addition, advertising to establish brand names is also deductible.

Overall these treatments tend to produce an effective low, zero, or negative tax rate for overall investment in intangibles. Thus, there are significant incentives to make these investments in the

United States. On average, the benefit of tax deductions or credits when making the investment tend to offset the future taxes on the return to the investment. However, for those investments that tend to be successful, it is advantageous to shift profits to a low-tax jurisdiction, so that there are tax savings on investment and little or no tax on returns. As a result, these investments can be subject to negative tax rates, or subsidies, which can be significant. Transfer pricing rules with respect to intellectual property are further complicated because of cost sharing agreements, where different affiliates contribute to the cost. If an intangible is already partially developed by the parent firm, affiliates contribute a buy-in payment. It is very difficult to determine arms-length pricing in these cases where a technology is partially developed and there is risk associated with the expected outcome. One study found some evidence that firms with cost sharing arrangements were more likely to engage in profit shifting. (McDonald, 2008)

One problem with shifting profits to some tax haven jurisdictions is that, if real activity is necessary to produce the intangible these countries may not have labor and other resources to undertake the activity. However, firms have developed techniques to take advantage of tax laws in other countries to achieve both a productive operation while shifting profits to no-tax jurisdictions. An example is the "double Irish, Dutch sandwich" method that has been used by some U.S. firms, which, as exposed in news articles, has been used by Google (Drucker, 2010). In this arrangement, the U.S. firm transfers its intangible asset to an Irish holding company. This company has a subsidiary sales company that sells advertising (the source of Google's revenues)to Europe. However, sandwiched between the Irish holding company and the Irish sales subsidiary is a Dutch subsidiary, which collects royalties from the sales subsidiary and transfer

Them to the Irish holding company. The Irish holding company claims company management (and tax home) in Bermuda, with a 0% tax rate, for purposes of the corporate income tax. This scheme allows the Irish operation to avoid the even the lower Irish tax of 12.5%, and also, by using the Dutch sandwich, to avoid Irish withholding taxes (which are not due on payments to European Union companies). More recently, European countries have complained about companies such as Google, Apple, Amazon, Face book and Starbucks in some cases using this scheme. Profits can also be shifted directly to a tax haven as in the case of Yahoo, where the Dutch intermediary can transfer profits directly to the tax haven (in this case, the Cayman islands) because it does not collect a withholding tax as would be the case with France or Ireland (Chang Ping Szu, 2012).

Contract Manufacturing

When a subsidiary is set up in a low-tax country and profit shifting occurs, as in the acquisition of rights to an intangible, a further problem occurs: this low-tax country may not be a desirable place to

actually manufacture and sell the product. For example, an Irish subsidiary's market maybe in Germany and it would be desirable to manufacture in Germany. But to earn profits in

Germany with its higher tax rate does not minimize taxes. Instead the Irish firm may contract with a German firm as a contract manufacturer, who will produce the item for cost plus a fixed markup. Subpart F taxes on a current basis certain profits from sales income, so the arrangement must be structured to qualify as an exception from this rule. There are complex and changing regulations on this issue (Chip, William, W. 2007)

Check-the-Box, Hybrid Entities, and Hybrid Instruments

Another technique for shifting profit to low-tax jurisdictions was greatly expanded with the "check-the-box" provisions. These provisions were originally intended to simplify questions of whether a firm was a corporation or partnership. Their application to foreign circumstances through the "disregarded entity" rules has led to the expansion of hybrid entities, where an entity can be recognized as a corporation by one jurisdiction but not by another. For example, a U.S. parent's subsidiary in a low-tax country can lend to its subsidiary in a high-tax country, with the interest deductible because the high-tax country recognizes the firm as a separate corporation.

Normally, interest received by the subsidiary in the low-tax country would be considered passive or "tainted" income subject to current U.S. tax under Subpart F. However, under check-the-box rules, the high-tax corporation can elect to be disregarded as a separate entity, and thus from the

Perspective of the United States there is no interest income paid because the two are the same entity. Check-the-box and similar hybrid entity operations can also be used to avoid other types of Subpart F income, for example from contract manufacturing arrangements. According to Sicular, this provision, which began as a regulation, has been effectively codified, albeit temporarily. Hybrid entities relate to issues other than Subpart F. For example, a reverse hybrid entity can be used to allow U.S. corporations to benefit from the foreign tax credit without having to recognize the underlying income. As an example, a U.S. parent can set up a holding company in a county hat is treated as a disregarded entity, and the holding company can own a corporation that is treated as a partnership in another foreign jurisdiction. Under flow through rules, the holding company is liable for the foreign tax and, because it is not a separate entity, the U.S. parent corporation is therefore liable, but the income can be retained in the foreign corporation that is viewed as a separate corporate entity from the U.S. point of view. In this case, the entity is structured so that it is a partnership for foreign purposes but a corporation for U.S. purposes. In addition to hybrid entities that achieve tax benefits by being treated differently in the United States and the foreign jurisdiction, there are also hybrid instruments that can avoid taxation by being treated as debt in one jurisdiction and equity in another.

Cross Crediting and Sourcing Rules for Foreign Tax Credits

Income from a low-tax country that is received in the United States can escape taxes because of cross crediting: the use of excess foreign taxes paid in one jurisdiction or on one type of income to offset U.S. tax that would be due on other income. In some periods in the past the foreign tax credit limit was proposed on a country-by-country basis, although that rule proved to be difficult to enforce given the potential to use holding companies. Foreign tax credits have subsequently been separated into different baskets to limit cross crediting; these baskets were reduced from nine to two (active and passive) in the American Jobs Creation Act of 2004 (P.L. 108-357).

Because firms can choose when to repatriate income, they can arrange realizations to maximize the benefits of the overall limit on the foreign tax credit. That is, firms that have income from jurisdictions with taxes in excess of U.S. taxes can also elect to realize income from jurisdictions with low taxes and use the excess credits to offset U.S. tax due on that income. Studies suggest that between cross crediting and deferral, U.S. multinationals typically pay virtually no U.S. tax on foreign source income (US Government Accountability Office report, 2008)

This ability to reduce U.S. tax due to cross crediting is increased, it can be argued, because income that should be considered U.S. source income is treated as foreign source income, hereby raising the foreign tax credit limit. This includes income from U.S. exports which is U.S. source income, because a tax provision (referred to as the title passage rule) allows half of export income to be allocated to the country in which the title passes. Another important type of income that is considered foreign source

and thus can be shielded with foreign tax credits is royalty income from active business, which has become an increasingly important source of foreign income. This benefit can occur in high-tax countries because royalties are generally deductible from income. (Note that the shifting of income due to transfer pricing of intangibles, advantageous in low-tax countries, is a different issue.) Interest income is another type of income that may benefit from this foreign tax credit rule.

Since all of this income arises from investment in the United States, one could argue that this income is appropriately U.S. source income, or that, failing that, it should be put in a different foreign tax credit basket so that excess credits generated by dividends cannot be used to offset such income. Two studies, by Grubert and by Grubert and Altshuler, have discussed this sourcing rule in the context of a proposal to eliminate the tax on active dividends (Grubert, 2005). In that proposal, the revenue loss from exempting active dividends from U.S. tax would be offset by gains from taxes on royalties. In addition to these general policy issues, there are numerous other narrower techniques that might be used to enhance foreign tax credits; a number of these are the focus of legislation in H.R. 4213, the American Jobs and Loophole Closing Act.

The Magnitude of Corporate Profit Shifting

This section examines the evidence on the existence and magnitude of profit shifting and the techniques that are most likely to contribute to it.

Evidence on the Scope of Profit Shifting

There is ample, and simple, evidence that profits appear in countries inconsistent with an economic motivation. This section first examines the profit share of income of controlled corporations compared to the share of gross domestic product (Mahoney, Lee and Miller, Randy, 2008). The first set of countries, acting as a reference point, are the remaining G-7 countries that are also among the United States' major trading partners. They account for 32% of pre-tax profits and 38% of rest-of-world gross domestic product. The second group of countries is larger countries from **Table 1** (with GDP of at least $10 billion), plus the Netherlands, which is widely considered a tax conduit for U.S. multinationals because of their holding company rules. These countries account for about 30% of earnings and 5% of rest-of-world GDP. The third group of countries is smaller countries listed in **Table 1**, with GDP less than $10 billion. These countries account for 14% of earnings and less than 1% of rest-of-world GDP.

As indicated in **Table 2**, income to GDP ratios in the large G-7 countries range from 0.2% to

2.6%, the latter reflecting in part the United States' relationships with some of its closest trading partners. Overall, this income as a share of GDP is 0.6%. Outside the United Kingdom and Canada, they are around 0.2% to 0.3% and do not vary with country size (Japan, for example, has over twice the GDP of Italy). Note also that Canada and the United Kingdom have also appeared on some tax haven lists and the larger income shares could partially reflect that.48

Table2. *U.S. Company Foreign Profits Relative to GDP, G-7, 2008*

S/No	Country	Profits of U.S. Controlled Foreign Corporations as a Percentage of GDP
1	Canada	2.6
2	France	0.3
3	Germany	0.2
4	Italy	0.2
5	Japan	0.3
6	United Kingdom	1.3
7	Weighted Average	0.6

Table 3 reports the share for the larger tax havens listed in **Table 1** for which data are available, plus the Netherlands. In general, U.S. source profits as a percentage of GDP are considerably larger than those in **Table 2**. In the case of Luxembourg, these profits are 18% of output. Shares are also very large in Cyprus and Ireland. In all but two cases, the shares are well in excess of those in **Table 2**.

Table3. *U.S. Foreign Company Profits Relative to GDP, Larger Countries (GDP At Least $10 billion) on Tax Haven Lists and the Netherlands, 2008*

S/no	Country	Profits of U.S. Controlled Corporations as a Percentage of GDP
1	Costa Rica	1.2
2	Cyprus	9.8
3	Hong kong	2.8
4	Ireland	7.6
5	Luxembourg	18.2
6	Netherlands	4.6
7	Panama	3.0
8	Singapore	3.4
9	Switzerland	3.5
10	Taiwan	0.7

Source: *(**Gravelle, 2013**) CRS calculations*

Evidence of profit shifting has been presented in many other studies. Grubert and Altshuler report that profits of controlled foreign corporations in manufacturing relative to sales in Ireland are three times the group mean.49 GAO reported higher shares of pretax profits of U.S. multinationals than of value added, tangible assets, sales, compensation or employees in low-tax countries such as Bermuda, Ireland, the UK Caribbean, Singapore, and Switzerland.

Costa and Gravelle reported similar results for tax havens using subsequent data. Martin Sullivan reports the return on assets for 1998 averaged 8.4% for U.S. manufacturing subsidiaries, but with returns of 23.8%in Ireland, 17.9% in Switzerland, and 16.6% in the Cayman Islands. More recently, he noted that of the 10 countries that accounted for the most foreign multinational profits, the five countries with the highest manufacturing returns for 2004 (the Netherlands, Bermuda, Ireland, Switzerland, and China) all had effective tax rates below 12% while the five countries with lower returns (Canada, Japan, Mexico, Australia, and the United Kingdom) had effective tax rates in excess of 23%.53 A number of econometric studies of this issue have been done.

Estimates of the Cost and Sources of Corporate Tax Avoidance

There are no official estimates of the cost of international corporate tax avoidance, although a number of researchers have made estimates, nor are there official estimates of the individual tax gap (US Treasury Inspector General Report, 2009). In general, the estimates are not reflected in the overall tax gap estimate. The magnitude of corporate tax avoidance has been estimated through a variety of techniques and not all are for total avoidance. Some address only avoidance by U.S. multinationals and not by foreign parents of U.S. subsidiaries. Some focus only on a particular source of avoidance. Estimates of the potential revenue cost of income shifting by multinational corporations varies considerably, with estimates as high as $60 billion. The only study by the IRS in this area is an estimate of the international gross tax gap (not accounting for increased taxes collected on audit) related to transfer pricing based on audits of returns. They estimated a cost of about $3 billion, based on examinations of tax returns for 1996-1998. This estimate would reflect an estimate not of legal avoidance, but of non-compliance, and for reasons stressed in the study has a number of limitations. One of those is that an audit does not detect all non-compliance, and it would not detect avoidance mechanisms which are, or appear to be, legal. Some idea of the potential magnitude of the revenue lost from profit shifting by U.S .multinationals might be found in the estimates of the revenue gain from eliminating deferral. If most of the profit in low-tax countries has been shifted there to avoid U.S. tax rates, the projected revenue gain from ending deferral would provide an idea of the general magnitude of the revenue cost of profit shifting by U.S. parent firms. The Joint Committee on Taxation projects the revenue gain from ending deferral to be about $11 billion in FY2010 (Joint Committee on Taxation, 2008). This estimate could be either an overstatement or an understatement of the cost of tax avoidance. It could be an overstatement because some of the profits abroad accrue to real investments in countries that have lower tax rates than the United States and thus do not reflect artificial shifting. It could be an understatement because it does not reflect the tax that could be collected by the United States rather than foreign jurisdictions on profits shifted to low-tax countries. For example, Ireland has a tax rate of 12.5% and the United States a 35% rate, so that ending deferral (absent behavioral changes) would only collect the excess of the U.S. tax over the Irish tax on shifted revenues, or about two-thirds of lost revenue.

The Administration's estimates for ending deferral are slightly larger, over $14 billion. (US Budget Report, 2010). Altshuler and Grubert estimate for 2002 that the corporate tax could be cut to 28% if deferral were ended, and based on corporate revenue in that year the gain is about $11 billion (Grubert and Altsher, 2008). That year was at a low point because of the recession; if the share remained the same, the gain would be around $13billion for 2004 and $26 billion for 2007. All of these estimates are based on tax data. Researchers have looked at differences in pretax returns and estimated the revenue gain if returns were equated. This approach should provide some estimates of the magnitude of overall profits hiftingfor multinationals, whether through transfer pricing, leveraging, or some other technique. Martin Sullivan, using Commerce Department data, estimates that, based on differences in pretax returns, the cost for 2004 was between $10 billion and $20 billion. Sullivan subsequently reports an estimated $17 billion increase in revenue loss from profit shifting between 1999 and2004, which suggests that earlier number may be too small, (Tas Notes, 2004). Sullivan suggests that the growth in. $75 billion in profits is artificially shifted abroad. If all of that income were subject to U.S. tax, it would result in a gain of $26billion for 2004. Sullivan acknowledges that there are many difficulties in determining the revenue gain. Some of this income might already be taxed under Subpart F, some might be absorbed by excess foreign tax credits, and the effective tax rate may be lower than the statutory rate. Sullivan concludes that an estimate of between $10 billion and$20 billion is appropriate. Altshuler and Grubert suggest that Sullivan's methodology may involve some double counting; however, their own analysis finds that multinationals saved $7 billion more between 1997 and 2002 due to check the box rules. Some of this gain may have been at the cost of high-tax host countries rather than the United States, however. See Rosanne Altshuler and Harry Grubert, "Governments and Multinational Corporations in the Race to the Bottom," *Tax Notes International*, February 2006, pp. 459-474.

Profit shifting may be due to check-the-box. Sullivan subsequently estimated a $28 billion loss

For 2007which he characterized as conservative. Christian and Schultz, using rate of return on assets data from tax returns, estimated $87 billion was shifted in 2001, which, at a 35% tax rate, would imply a revenue loss of about $30 billion (Christian and Shhultz, 2005). As a guide for potential revenue loss from avoidance, these estimates suffer from two limits. The first is the inability to determine how much was shifted out of high-tax foreign jurisdictions rather than the United States, which leads to arrange of estimates. At the same time, if capital is mobile, economic theory indicates that the returns should be lower, the lower the tax rate. Thus the results could also understate the overall profit shifting and the revenue loss to the United States.

Pak and Zdanowicz examined export and import prices, and estimated that lost revenue due to transfer pricing of goods alone was $53 billion in 2001 (Pak and Zdanowicz, 2002). This estimate should cover both U.S. multinationals and U.S. subsidiaries of foreign parents, but is limited to one technique. Clausing, using regression techniques on cross-country data, which estimated profits reported as a function of tax rates, estimated that revenues of over $60 billion are lost for 2004 by applying a 35% tax rate to an estimated $180 billion in corporate profits shifted out of the United States (Cluasing, Kimberly, 2009). She estimates that the profit shifting effects are twice as large as the effects from shifts in actual economic activity. This methodological approach differs from others which involve direct calculations based on returns or prices and is subject to the econometric limitations with cross country panel regressions. In theory, however, it had an overall of coverage of shifting (that is both outbound by U.S. parents of foreign corporations and inbound by foreign parents of U.S. corporations and covering all techniques). Clausing and Avi-Yonah estimate the revenue gain from moving to a formula apportionment based on sales that is on the order of $50 billion per year because the fraction of worldwide income in the United States is smaller than the fraction of worldwide sales (Cluasing and Avi –Yonah, 2007). While this estimate is not an estimate of the loss from profit shifting (since sales and income could differ for other reasons), it is suggestive of the magnitude of total effects from profit shifting. A similar result was found by another study that applied formula apportionment based on an equal weight of assets, payroll, and sales(Shackelford and Slemrod, 2007). A more recent study by Clausing indicated that the revenue loss from profit shifting profit shifting may be as high as $90 billion in 2008, although an alternative data set indicates profit shifting. For the last five years, the first method yielded losses ranging from 20% to 30% of profits. Using the second method, the range was 13% to 20%.It is very difficult to develop a separate estimate for U.S. subsidiaries of foreign multinational companies because there is no way to observe

the parent firm and its other subsidiaries. Several studies have documented that these firms have lower taxable income and that some have higher debt to asset ratios than domestic firms. There are many other potential explanations these differing characteristics, however, and domestic firms that are used as comparisons also have incentives to shift profits when they have foreign operations. No quantitative estimate has been made. However some evidence of earnings stripping for inverted firms was found.

Importance of Different Profit Shifting Techniques

Some studies have attempted to identify the importance of techniques used for profit shifting. Grubert has estimated that about half of income shifting was due to transfer pricing of intangible sand most of the remainder to shifting of debt (Grubert, 2003). In a subsequent study, Altshuler and Grubert find that multinationals saved $7 billion more between 1997 and 2002 due to check the box rules (Altshuler and Grubert, 2006). Some of this gain may have been at the cost of high-tax host countries rather than the United States; however, some of the estimates discussed here conflict with respect to the source of profit shifting. ThePak and Zdanowich estimates suggest that transfer pricing of goods is an important mechanism of tax avoidance, while Grubert suggests that the main methods of profit shifting are due to leverage and intangibles. The estimates for pricing of goods may, however, reflect errors, or money laundering motives rather than tax motives. Much of the shifting was associated with trade with high-tax countries; for example, Japan, Canada, and Germany accounted for 18% of the total (Business Accents, 2004). At the same time, about 14% of the estimate reflected transactions with countries that appear on tax haven lists: the Netherlands, Taiwan, Singapore, Hong Kong, and Ireland.One study used a different approach, examining taxes offirms before and after acquisition by foreign versus domestic acquirers, but the problem of comparison remains and the sample was very small; that study found no differences.

They estimated $0.7 billion of revenue loss from four firms that inverted. Inverted firms may, however, behave differently from foreign firms with U.S. subsidiaries.

Some evidence that points to the importance of intangibles and the associated profits in tax haven countries can be developed by examining the sources of dividends repatriated during the "Repatriation holiday" enacted in 2004. This provision allowed, for a temporary period, dividends to be repatriated with an 85% deduction, leading to a tax rate of 5.25%. The pharmaceutical and medicine industry accounted for $99 billion in repatriations or 32% of the total. The computer and electronic equipment industry accounted for $58 billion or 18% of the total. Thus these two industries, which are high tech firms, accounted for half of the repatriations.

The benefits were also highly concentrated in a few firms. According to a recent study, five firms (Pfizer, Merck, Hewlett-Packard, Johnson & Johnson, and IBM) are responsible for $88 billion, Over a quarter (28%)of total repatriations. The top 10 firms (adding Schering-Plough, Du Pont, Bristol-Myers Squibb, Eli Lilly, and PepsiCo) accounted for 42%. The top 15 (adding Procter and Gamble, Intel, Coca-Cola, Altria, and Motorola) accounted for over half (52%). These are firms that tend to, in most cases, have intangibles either in technology or brand names.

Finally, as shown in **Table 5**, which lists all countries accounting for at least 1% of the total of eligible dividends (and accounting for 87% of the total), most of the dividends were repatriated from countries that appear on tax haven lists.

Table5. *Source of Dividends from "Repatriation Holiday": Countries Accounting for At Least 1% of Dividends*

S/No	Country	Percentage of Total
1	Netherlands	28.8
2	Switzerland	10.4
3	Bermuda	10.2
4	Ireland	8.2
5	Luxembourg	7.5
6	Canada	5.9
7	Cayman island	5.9
8	United Kingdom	5.1
9	Hong Kong	1.7
10	Singapore	1.7
11	Malaysia	1.2

Source: *(Gravelle, Jane G., 2013) "Tax Havens: International Tax Avoidance and Evasion" US Congressional Research Service Publications.)*

Summary of the Advantages of Tax Haven to Companies Using Them

Furthermore, analyst believed that at the risk of gross oversimplification, it can be said that the advantages of tax havens are viewed in the following four principal contexts

Personal residency

Since the early 20th century, wealthy individuals from high-tax jurisdictions have sought to relocate themselves in low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation – see Tax residence. In some cases the low-tax jurisdictions levy no, or only very low, income tax. But almost no tax haven assesses any kind of capital gains tax, or inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

Asset holding

Asset holding involves utilizing a trust or a company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction. Often the mechanism is employed to avoid a specific tax. For example, a wealthy testator could transfer his house into an offshore company; he can then settle the shares of the company on trust (with himself being a trustee with another trustee, whilst holding the beneficial life estate) for himself for life, and then to his daughter. On his death, the shares will automatically vest in the daughter, who thereby acquires the house, without the house having to go through probate and being assessed with inheritance tax. (Most countries assess inheritance tax (and all other taxes) on real estate within their jurisdiction, regardless of the nationality of the owner, so this would not work with a house in most countries. It is more likely to be done with intangible assets.)

Trading and other business activity

Many businesses which do not require a specific geographical location or extensive labor are set up in tax havens, to minimize tax exposure. Perhaps the best illustration of this is the number of reinsurance companies which have migrated to Bermuda over the years. Other examples include internet based services and group finance companies. In the 1970s and 1980s corporate groups were known to form offshore entities for the purposes of "rein voicing". These rein voicing companies simply made a margin without performing any economic function, but as the margin arose in a tax free jurisdiction, it allowed the group to "skim" profits from the high-tax jurisdiction. Most sophisticated tax codes now prevent transfer pricing schemes of this nature.

Financial intermediaries

Much of the economic activity in tax havens today consists of professional financial services such as mutual funds, banking, life insurance and pensions. Generally the funds are deposited with the intermediary in the low-tax jurisdiction, and the intermediary then on-lends or invests the money (often back into a high-tax jurisdiction). Although such systems do not normally avoid tax in the principal customer's jurisdiction, it enables financial service providers to provide multi-jurisdictional products without adding an additional layer of taxation. This has proved particularly successful in the area of offshore funds. This type of methodology has been used by Google and came to light in the year 2010 when it was reported that Google uses techniques called the "Double Irish" and "Dutch Sandwich" to reduce its corporate income tax to 2.4%, by funneling its corporate income through Ireland and from there to a shell in the Netherlands where it can be transferred to Bermuda, which has no corporate income tax. The search engine is using Ireland as a conduit for revenues that end up being costed to another country where its intellectual property (the brand and technology such as Google's algorithms) is registered. In Google's case this country is Bermuda. In the year 2009, the internet giant made a gross profit of €5.5bn, but reported an operating profit of €45m after "administrative expenses" of €5.467bn were stripped out. Administrative expenses largely refer to

royalties (or a license fee) Google pays it Bermuda HQ for the right to operate. Google has uncovered a highly efficient tax structure across six territories that meant Google paid just 2.4% tax on operations outside the US.

Anonymity and Bearer Shares

Bearer shares allow for anonymous ownership, and thus have been criticized for facilitating money laundering and tax evasion; these shares are also available in some OECD countries, such as in the U.S. state of Wyoming. In 2010, a study in which the researcher attempted to set-up anonymous corporations found that 13 of the 17 attempts were in OECD countries such as the United States and the United Kingdom while 4 of 28 attempts were successful in countries typically labeled tax havens. In 2011, an OECD peer review recommended that the United Kingdom improve its bearer share laws.

Incentives for Nations to Become Tax Havens

There are several reasons for a nation to become a tax haven. Some nations may find they do not need to charge as much as some industrialized countries in order for them to be earning sufficient income for their annual budgets. Some may offer a lower tax rate to larger corporations, in exchange for the companies locating a division of their parent company in the host country and employing some of the local population. Other domiciles find this is a way to encourage conglomerates from industrialized nations to transfer needed skills to the local population. Still yet, some countries simply find it costly to compete in many other sectors with industrialized nations and have found a low tax rate mixed with a little self-promotion can go a long way to attracting foreign companies. Many industrialized countries claim that tax havens act unfairly by reducing tax revenue which would otherwise be theirs. Various pressure groups also claim that money launderers also use tax havens extensively, although extensive financial and know your customer regulations in tax havens can actually make money laundering more difficult than in large onshore financial centers with significantly higher volumes of transactions, such as New York City or London.

In 2000, the Financial Action Task Force published what came to be known as the "FATF Blacklist" of countries which were perceived to be uncooperative in relation to money laundering; although several tax havens have appeared on the list from time to time (including key jurisdictions such as the Cayman Islands, Bahamas and Liechtenstein), no offshore jurisdictions appear on the list at this time.

Anti-avoidance

To avoid tax competition, many high tax jurisdictions have enacted legislation to counter the tax sheltering potential of tax havens. Generally, such legislation tends to operate in one of five ways:

1. Attributing the income and gains of the company or trust in the tax haven to a taxpayer in the high-tax jurisdiction on an arising basis. Controlled Foreign Corporation legislation is an example of this.
2. Transfer pricing rules, standardization of which has been greatly helped by the promulgation of OECD guidelines.
3. Restrictions on deductibility, or imposition of a withholding tax when payments are made to offshore recipients.
4. Taxation of receipts from the entity in the tax haven, sometimes enhanced by notional interest to reflect the element of deferred payment. The EU withholding tax is probably the best example of this.
5. Exit charges, or taxing of unrealized capital gains when an individual, trust or company emigrates.

However, many jurisdictions employ blunter rules. For example, in France securities regulations are such that it is not possible to have a public bond issue through a company incorporated in a tax haven. Also becoming increasingly popular is "forced disclosure" of tax mitigation schemes. Broadly, these involve the revenue authorities compelling tax advisors to reveal details of the scheme, so that the loopholes can be closed during the following tax year, usually by one of the five methods indicated above. Although not specifically aimed at tax havens, given that so many tax mitigation schemes involve the use of offshore structures, the effect is much the same. Anti-avoidance came to prominence in 2010/2011 as NGOs and politicians in the leading economies looked for ways of reducing tax avoidance, which plays a role in forcing unpopular cuts to social and military programs.

The International Financial Centers Forum (IFC Forum) has asked for a balanced debate on the issue of tax avoidance and an understanding of the role that the tax neutrality of small international financial centers plays in the global economy.

Modern Developments - Proposed U.S. Legislation

The Foreign Account Tax Compliance Act (FATCA) was initially introduced to target those who evade paying U.S. taxes by hiding assets in undisclosed foreign bank accounts. With the strong backing of the Obama Administration, Congress drafted the FATCA legislation and added it into the Hiring Incentives to Restore Employment Act (HIRE) signed into law by President Obama in March 2010.An unintended but serious problem with FATCA is that compliance is so expensive for non-US banks that they are refusing to serve American investors. Concerns have also been expressed that, because FATCA operates by imposing withholding taxes on US investments, this will drive foreign financial institutions (particularly hedge funds) away from investing in the US and thereby reduce liquidity and capital inflows into the US.

Key Provisions of FATCA

FATCA requires foreign financial institutions (FFI) of broad scope – banks, stock brokers, hedge funds, pension funds, insurance companies, trusts – to report directly to the IRS all clients who are U.S. Persons. Starting January 1, 2013 (later delayed to 2014), FATCA will require FFIs to provide annual reports to the Internal Revenue Service (IRS) on the name and address of each U.S. client, as well as the largest account balance in the year and total debits and credits of any account owned by a U.S. person.[53] If an institution does not comply, the U.S. will impose a 30% withholding tax on all its transactions concerning U.S. securities, including the proceeds of sale of securities.

In addition, FATCA requires any foreign company not listed on a stock exchange or any foreign partnership which has 10% U.S. ownership to report to the IRS the names and tax I.D. number (TIN) of any U.S. owner. FATCA also requires U.S. citizens and green card holders who have foreign financial assets in excess of $50,000 to complete a new Form 8938 to be filed with the 1040 tax return, starting with fiscal year 2010).The delay is indicative of a controversy over the feasibility of implementing the legislation as evidenced in this paper from the Peterson Institute for International Economics.

Proposed German Legislation

In January 2009, Peer Steinbrück, the former German financial minister, announced a plan to amend fiscal laws. New regulations would disallow that payments to companies in certain countries that shield money from disclosure rules be declared as operative expenses. The effect of this would make banking in such states unattractive and expensive.

Liechtenstein Banking Scandal

Main article: affair In February 2008, Germany announced that it had paid €4.2 million to Heinrich Kieber, a former data archivist of LGT Treuhand, a Liechtenstein bank, for a list of 1,250 customers of the bank and their accounts' details. Investigations and arrests followed relating to charges of illegal tax evasion. The German authorities shared the data with U.S. tax authorities, but the British government paid a further £100,000 for the same data. Other governments, notably Denmark and Sweden, refused to pay for the information regarding it as stolen property. The Liechtenstein authorities subsequently accused the German authorities of espionage.

However, regardless of whether unlawful tax evasion was being engaged in, the incident has fuelled the perception amongst European governments and press that tax havens provide facilities shrouded in secrecy designed to facilitate unlawful tax evasion, rather than legitimate tax planning and legal tax mitigation schemes. This in turn has led to a call for "crackdowns" on tax havens. Whether the calls for such a crackdown are mere posturing or lead to more definitive activity by mainstream economies to restrict access to tax havens is yet to be seen. No definitive announcements or proposals have yet been made by the European Union or governments of the member states.

G20 Tax Havens Blacklist

At the London G20 summit on 2 April 2009, G20 countries agreed to define a blacklist for tax havens, to be segmented according to a four-tier system, based on compliance with an "internationally agreed tax standard. The list as per April 2 of 2009 could be viewed on the OECD Data, but it was removed by 2012. The four tires were:

1. Those that have substantially implemented the standard (includes most countries but China still excludes Hong Kong and Macau).
2. Tax havens that have committed to – but not yet fully implemented – the standard (includes Montserrat, Nauru, Niue, Panama, and Vanuatu)
3. Financial centres that have committed to – but not yet fully implemented – the standard (includes Guatemala, Costa Rica and Uruguay).
4. Those that have not committed to the standard (an empty category)

Those countries in the bottom tier were initially classified as being 'non-cooperative tax havens'. Uruguay was initially classified as being uncooperative. However, upon appeal the OECD stated that it did meet tax transparency rules and thus moved it up. The Philippines took steps to remove itself from the blacklist and Malaysian Prime Minister NajibRazak had suggested earlier that Malaysia should not be in the bottom tier. On April 7, 2009, the OECD, through its chief Angel Gurria, announced that Costa Rica, Malaysia, the Philippines and Uruguay have been removed from the blacklist after they had made "a full commitment to exchange information to the OECD standards."[65]Despite calls from the former French President Nicolas Sarkozy for Hong Kong and Macau to be included separately from China on the list, they are as yet not included independently, although it is expected that they will be added at a later date.

Government response to the crackdown has been broadly supportive, although not universal. Luxembourg Prime Minister Jean-Claude Juncker has criticized the list, stating that it has "no credibility", for failing to include various states of the U.S.A. which provide incorporation infrastructure which are indistinguishable from the aspects of pure tax havens to which the G20 object. As of 2012, 89 countries have implemented reforms sufficient to be listed on the OECD's white list. According to Transparency International half of the least corrupted countries were tax heavens, and TI is criticized of it.

Foot Report

In November 2009 Michael Foot delivered a report on the British Crown Dependencies and Overseas Territories for HM Treasury.[70] The report indicated that whilst many of the territories "had a good story to tell", others needed to improve in detection and prevention of financial crime. It also stressed the view that narrow tax bases presented long term strategic risks, and that the economies should seek to diversify and broaden their own tax bases. The report also indicated that tax revenue lost by the United Kingdom government appeared to be much smaller than had previously estimated (see above under lost tax revenue), and also stressed the importance of the liquidity provided by the territories to the United Kingdom. The Crown Dependencies and Overseas Territories broadly welcomed the report,[71] but the pressure group Tax Justice Network, unhappy with the findings, commented "[a] weak man, born to be an apologist, has delivered a weak report."

Criticism/Disadvantages of Using Tax Havens As Highlighted By Different Stakeholders

Tax havens have been criticized because they often result in the accumulation of idle cash which is expensive and inefficient for companies to repatriate. The tax shelter benefits result in a tax incidence disadvantaging the poor. Many tax havens are thought to have connections to "fraud, money laundering and terrorism." While investigations of illegal tax haven abuse have been ongoing, there have been few convictions. Lobbying pertaining to tax havens and associated transfer pricing has also been criticized. Some politicians, such as magistrate Eva Joly, have begun to stand up against the use of tax havens by large companies. She describes the act of avoiding tax as a threat to democracy. Accountants' opinions on the propriety of tax havens have been evolving, as have the opinions of their corporate users, governments, and politicians, although their use by Fortune 500 companies and others remains wide spread Reform proposals centering on the Big Four accountancy firms have been advanced. Some governments appear to be using computer spyware to scrutinize some corporations' finances.

SECTION FOUR

CONCLUSION

In conclusion, it has been ascertained that most multinationals present in Nigeria are making use of Tax havens to shortchange Nigerian Nation of its tax revenues. It was furthermore noted from the

vast amount of literatures and evidences that most multinational corporations present in Nigeria are from the countries that go for places where tax havens exist – American, European as well as Asian companies, all present in Nigeria make use of Tax havens**.** Apart from the issue of transfer pricing, contract manufacturing as well as cross crediting and sourcing rules for foreign tax credits, OECD-DAC (2010) puts it succinctly as when talking of Tax base issues as : Multinationals and misused transfer pricing techniques

Multinational enterprises (MNEs) are responsible for more than 60% of world trade and roughly half of this exchange of goods and services takes place within individual conglomerates (UNCTAD, 1999). International trade is thus largely an activity between different divisions of the same enterprise operating in different jurisdictions. MNEs may take advantage of the different tax regimes, including tax havens to maximize after-tax profits. One way in which multinational enterprises may try to benefit from their international presence is misuse of transfer pricing, *e.g.* by artificially shifting taxable profits from high tax jurisdictions to low tax jurisdictions. This happens when firm's under- or over-invoice for goods, services, intangibles or financial transactions between entities situated in different tax jurisdictions. African tax authorities may not be able to identify such profit shifting where this occurs and even if they did, they often lack the means and technical capacity to deal with the complexities of the practice. Despite the development of international and domestic guidance, even the world's most sophisticated tax administrations sometimes have difficulties assessing whether the prices at which multinationals carry out cross-border transactions are manipulated, especially for complex financial transactions and those involving significant unique intangibles. African tax administrations already struggle to collect regular corporate tax beyond a few dozen of the largest companies. Auditing capacity is often very limited and relies mainly on information directly provided by the multinationals. Not to mention that the dispute resolution process in any disagreement with a trans-national enterprise can be very costly. Improper transfer pricing is an international problem that affects developed and developing nations alike. The main beneficiaries are assumed to be tax havens and the multinationals. While there are no solid figures measuring the size of the problem, a number of studies have tried to approximate its magnitude. Kar and Cartwright-Smith (2008) estimate that total trade mispricing in 2006 was more than USD 500 billion. Hollings head (2010) reckons that the amount of tax revenue lost by developing countries to misuse of transfer pricing averaged between USD 98 billion and USD 106 billion annually from 2002 to 2006. In Africa, a yearly average of USD 3.8 billion would have been lost between 2002 and 2006. Again, these figures must be treated with some caution since they are based on models for assessing the loss of tax revenues which are still being developed.

Taxing Natural Resources

Vast extractable natural resources – oil, gas and minerals – are already an essential revenue source for many African nations. But the African Development Bank's 2007 *African Development Report* highlighted the widely held belief that African countries get less money from resources than many other countries in the world. There is evidence that African countries are not maximizing the tax revenue they obtain for the resources (Keen and Mansour, *id.*). It is difficult to obtain a clear picture, however. Contracts are often subject to strong confidentiality clauses by the companies, governments, investors and banks involved. There is little transparency and disclosure. Corruption is often blamed for this secrecy. Corruption and secrecy feed off each other. But there is more than corruption involved. Governments argue that they cannot make all details of the extractive industries public and that they have limited influence on companies. Countries compete for the scarce managerial and technical skills needed for resource extraction (Di John, *ibid.*). Yet, shortages of legal and negotiation skills play a major role in driving down tax revenues from natural resources.

Tax preferences creep-up

Tax preferences – also known as tax incentives – grant preferential tax treatment to specific taxpayer groups, investment expenditures or returns, through targeted tax deductions, credits, exclusions or exemptions. Governments may cite various arguments for the use of tax incentives, such as addressing different types of market failures, attracting foreign firms (*e.g.* Comoros, Cameroon) or stimulating exports (*e.g.* Namibia). Tax preferences are also used to increase or decrease the progressivity of the taxation system or to benefit some groups over others for political reasons. In Sudan, for instance, a high proportion of civil servants are exempt from paying taxes, undermining the country's tax base.

Tax preferences are difficult to target and may not yield intended outcomes. Significant tax revenue losses and other unforeseen effects may result instead. Inefficiencies and inequities can also arise where tax relief is targeted to specific groups over others for political reasons. Indeed, tax preferences can undermine the tax base, revenues, and fiscal legitimacy when granted arbitrarily. For example, tax preferences granted to powerful and rich potential tax payers place more of the tax burden on people with less economic and political clout. African governments also lose a significant amount of revenue from corporate income tax exemptions, though the cost is hard to estimate given their often arbitrary nature (Keen and Mansour, *id.*). Yet corporate income tax and other tax revenues are essential for funding infrastructure, education, and expenditures underpinning good governance, which investors repeatedly identify as key considerations when making investment location decisions. Finally, the consequences of exemptions granted to aid-funded goods, services and personnel are also debated by donors and recipients (Box 3).Countries should therefore use tax incentives with care. This includes explaining the rationale for their use and reporting tax revenues foregone by tax incentives (tax expenditure reporting) for transparency and the integrity of the tax system, while at the same time guarding against erosion of the tax base needed to fund economic development.

Box3: Taxation of Aid-Funded Goods, Services and Personnel

Donors frequently secure tax exemptions from developing countries on aid inputs. The exemptions typically include income taxes on aid worker salaries, goods and services; value-added taxes on local purchases; and customs duties and excise taxes on imports. Tax officials in recipient countries consider that such exemptions weaken their tax systems, generate considerable costs and complications and provide opportunities for corruption. Some multilateral donors have already taken action on this issue. The World Bank typically rolls the relevant duties into the total loan (and later debt), allowing them to be met from within the loan amount. This is implemented in different ways, often by setting a government project 'share' or matching payment at the assumed minimum level of taxes. This is an issue of both principle and practice for developing country tax systems. In principle, exemptions should be removed for reasons of economic efficiency and consistency and to help strengthen tax systems. In practice, it is argued that the exemptions:

I. Cause economic distortions (goods and services imported from donor countries may receive preferential tax treatment over domestically-produced goods and services);

II. Provide opportunities for corruption, particularly tax fraud and tax avoidance schemes, both of which have to be policed by tax administrations, straining their scarce resources;

III. importantly, fuel a tax exemption culture which affects overall governance; while taxing government activity obviously generates net public resources, perceptions matter and public servants not paying taxes discourages other tax payers from carrying out their fiscal duty; and

IV. Impose significant transaction costs because of the large number of individually negotiated agreements with each donor country.

Country-level evidence suggests that tax exemptions for aid-assisted projects represent a significant budgetary issue for recipient countries. In Niger, tax expenditures on vouchers—one method by which exemptions may be implemented—amounted in 2002 to about 18% of project financing, and 10% of all tax revenue. In Tanzania, customs exemptions for donors accounted for around 17% of the gross value of imports in 2005. Developing countries argue that removing exemptions would widen the tax base, boost the credibility of both the revenue administration and the donors, simplify tax systems and encourage voluntary compliance by local and multinational taxpayers. From a donor perspective, the process of unraveling the current range of exemptions would be complex and the benefits uncertain. Very few bilateral donors have indicated an interest in debating this topic. Donors are unlikely to accept that developing countries forgo revenue by accepting aid from outside, and would point out that paying taxes on aid inputs reduces the resources available for other projects. There is also skepticism as to whether removing exemptions on aid inputs would lead to a general abolition of exemptions, including on developing countries' own purchases. Itis when the incentives that make countries become tax havens are completely removed and legislation strengthened across board that the issue of MNCs using tax havens to maximize their profits can be eliminated at least on the interim.

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