

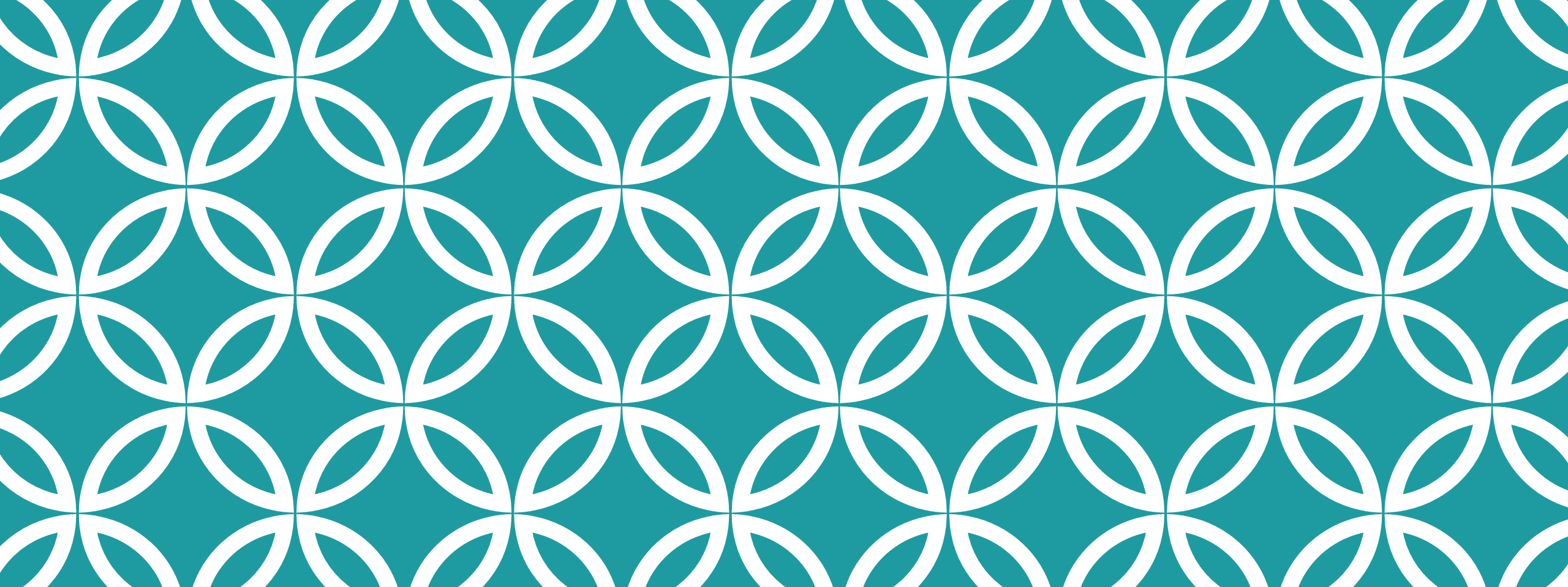
# ILLICIT FINANCIAL FLOWS (IFF) THROUGH COMMODITY TRADE MISPRICING

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# SOME INTRODUCTORY REMARKS

Elisabeth Bürgi Bonanomi

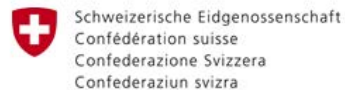
# THE PROJECT

Research project **Curbing illicit financial flows from resource-rich developing countries: Improving natural resource governance to finance SDGs**

Funded through the “Swiss Programme for Research on Global Issues for Development” (r4d programme) by the Swiss Agency for Development and Cooperation (SDC) and the Swiss National Science Foundation (SNSF)

<http://www.r4d.ch/modules/employment/curbing-illicit-financial-flows>

<https://curbing-iffs.org/publications/>



Swiss Agency for Development  
and Cooperation SDC



# THREE BUILDING BLOCKS

## Economics (wp1)

- Quantify trade-related IFFs

## Law (wp2)

- Legal analysis of IFF concepts, drivers and regulatory responses

## Political economy (wp3)

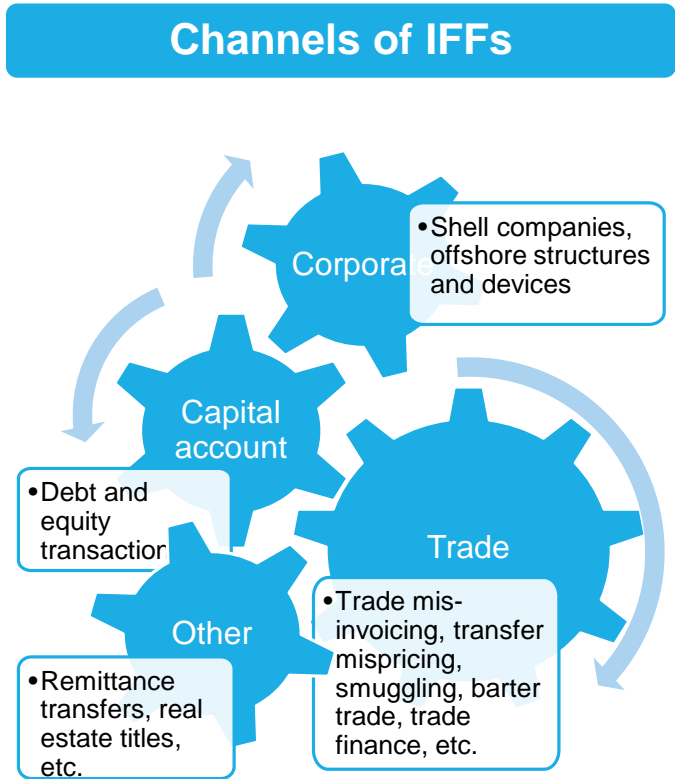
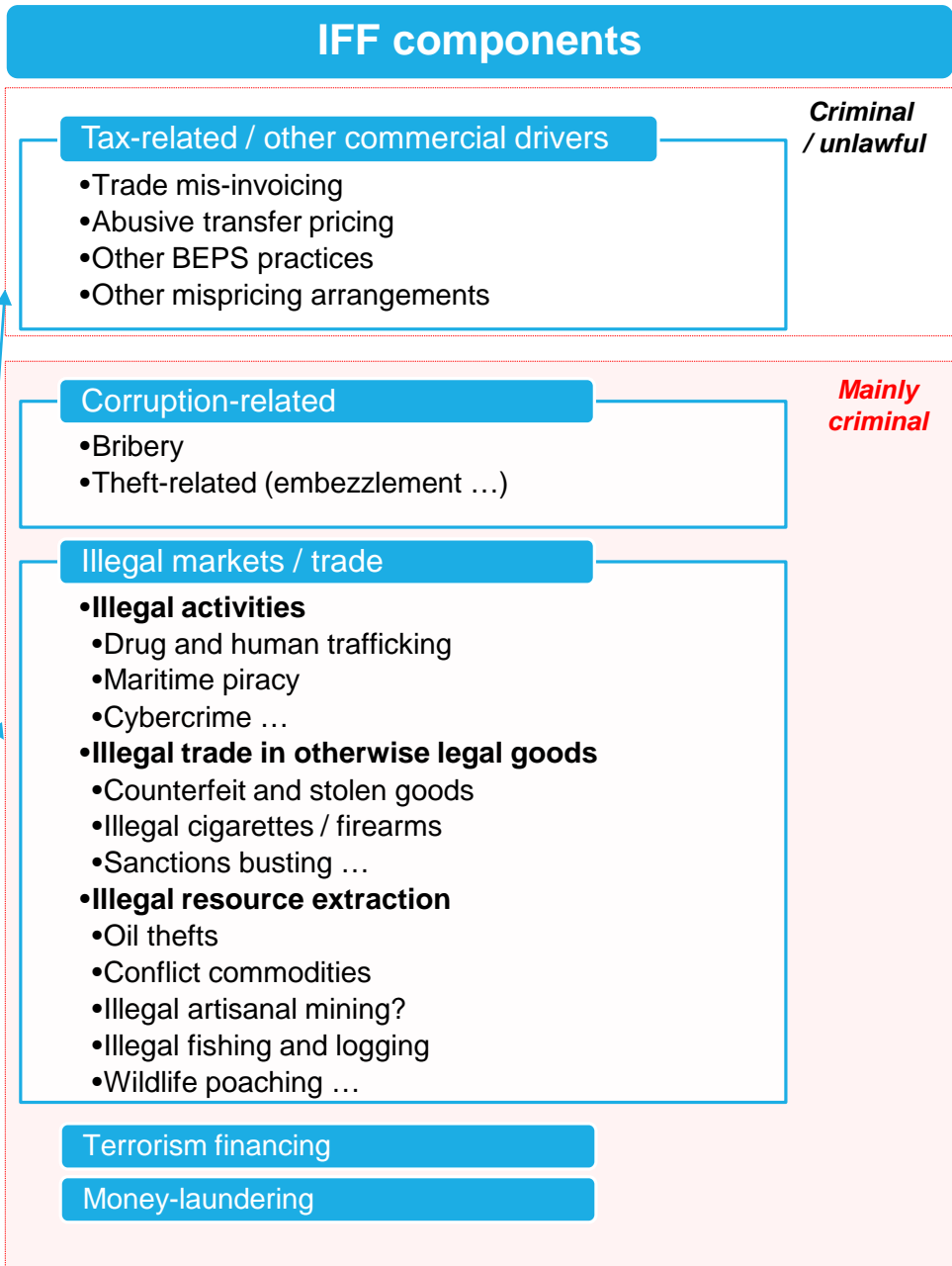
- Political economy analysis focusing on relevant key actors and value chains



# WHAT

We are here

Corruption, money laundering



# IFF CONCEPTS

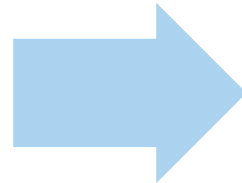
## IFF concept

- Challenge legal / illegal distinction
- Criminal law/ administrative law: mostly some illegality
- Anti-avoidance rules & evolving standards
- From Form to Substance: bring in Sustainability Concerns (legality & fairness)

# REGULATORY ENABLERS OF PROFIT SHIFTING

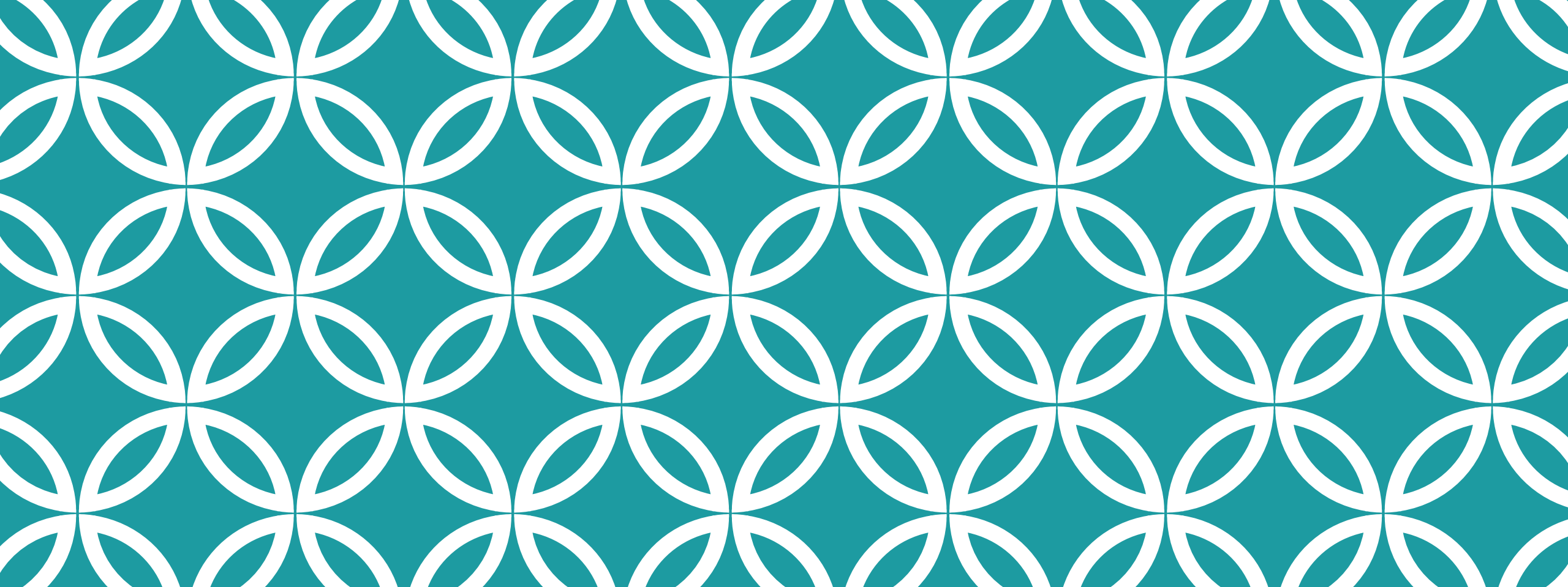
Structural enablers (key tenets of international tax law)

- Constituent entities of a MNE treated as separate legal persons dealing at arm's length
- Mobility of residence (where income from dividends, interests, capital gains, and royalties is taxed)
- Fragmentation



Many technical loopholes and mismatches that MNEs exploit to avoid taxes

- Mismatches in the tax classification of entities and arrangements
- Treaty shopping
- Profit shifting to tax haven subsidiaries
- Excessive interests deductions, etc.



# COMMODITY TRADE MISPRICING

Irene Musselli



# OUTLINE



What do we mean by 'commodity trade mispricing'



Main regulatory responses



Alternative 'pragmatic' options (unilateral)



What Switzerland can do

# WHAT?

Economic terms ...

- Abnormally priced (deviate from 'market prices')
- Deviation not justified (buyer's functions, assets, risks)



Undistorted?

# WHAT?

Legal terms...

Defined differently for different legal purposes (customs law, tax law, accounting law...)

Three main 'legal entry points':

- Trade misinvoicing
- Abusive transfer pricing
- 'Unfair' terms

# TRADE MISINVOICING



Fraudulent, deceit  
(misreporting)

## What:

- Exports and/or importers misstate value, quantity, nature of shipment on customs & other trade forms

## Example:

- Good-quality coffee shipment intentionally mis-stated in export declarations as low quality and under-valued; mineral content of a concentrate misstated, by counterfeiting the mineral valuation results

## Legal status:

- Illegal (often criminal) - customs and tax fraud

# ABUSIVE TRANSFER PRICING (ATP)

## What:

- Related enterprises sell goods and services to each other at prices that do not approximate the prices that unrelated parties would reach ('arm's length prices')

## Example:

- Output side
- Input side

## Legal status:

- May trigger tax adjustment (unlawful in administrative/civil law terms)

# 'UNFAIR' TERMS / 'ABUSE OF POSITION'

## What:

- Imbalances in bargaining power between suppliers and buyers

## When:

- Purchase price at deep discount to spot prices, not justified (assets, functions, risks)
- No misreporting/ no abusive TP

## Legal status:

- May raise issues of unfair terms and abuse of position under contract law and competition law

# OUTLINE



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What Switzerland can do

# TRANSPARENCY

## Tax

- Exchange upon request
- Automatic exchange of bank information
- Exchange of tax rulings ...

## Trade

- Supply chain transparency
- Extension to traders of 'Payment to Government' laws

High on the Swiss agenda  
(CDE working paper)



# OTHER MAINSTREAM OPTIONS

## Corporate social responsibility

- Top level commitment to 'fair taxation'
- Proportionate tax risk assessment and due diligence procedures
- Internal procedures for reporting tax wrongdoing
- Awareness raising and training

Swiss emphasis,  
except from tax



## Transfer pricing law

- Revised OECD Transfer Pricing Guidelines

## Customs law enforcement

- Customs-to-Customs and inter-agency cooperation within and between governments
- Importer profiles and risk ratings, fast-tracked clearance for high-compliant operators
- Blockchain technology, container scanning

# OUTLINE



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What Switzerland could do



## COMMODITY SALES: SIMPLIFIED AND 'PRESCRIPTIVE' PRICING METHODS

Ghana and Laos?

### 'Sixth-method' (tax self-assessment & audit)

- Taxpayers and tax-administrations refer to quoted prices in determining the fair market value of commodity sales in tax self-assessment and audit

### 'Administrative pricing' (directly sets the tax value of commodity sales)

- Government uses calculated prices, rather than transaction prices, to determine income-based taxes and royalties due

### Legislate price terms in product sales contracts (IISD)

- Fixed prices in long-term supply contracts subject to price floor (costs of building and operating the mine over its expected life + equity return)

# PROFIT SHIFTING: SIMPLIFIED PROFIT-BASED METHODS / WHT

Unincorporated  
branch operations  
of MNEs

## 'Deemed' net profits

- Multiply the sales proceeds (easy to calculate) by a fixed deemed profit rate
- China, India ... (but also OECD Digital Economy Pillar 1 proposals)

## Turnover taxation (gross basis)

- Simple tax on gross-income (no deductions)

## Fractional methods

- Affiliate earns a profit margin in proportion to that of the corporate group as a whole ... but can have complex design (Indian's fractional scheme)

## Or alternatively, withholding taxes on outbound payments

- Interest, dividends, royalty, etc (see also OECD Digital Economy Pillar 2)

Possibly  
'unfair'  
features  
... but is  
profit  
shifting  
fair?



# PROFIT SHIFTING: INTERESTING DEVELOPMENTS (MULTILATERAL)

*OECD Work Programme Digital Economy:*

- Pillar 1: Some openings (deemed profits & formulary apportionment)
- Pillar 2: ‘Tax back’ if others don’t
- Emphasis on simplification

*Promising ... but risks ahead: Potentially far-reaching measures diluted (carve-outs, thresholds and reservations); Diluted reform package traded-off for moratorium on potentially far-reaching unilateral or sub-regional measures*

# OUTLINE



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What Switzerland can do

# SIMPLIFIED METHODS

Policy stance (multilateral negotiations):

- Do not oppose / consider sympathetically developing countries' request for simplified methods

At least as part of a concerted solution that preserves level playing field with other headquarter countries

Technical cooperation:

- Technical support to use simplified methods in tax assessment (SDC & SECO)

# TAX TRANSPARENCY

## Ease constraints

- Use of information by recipient countries (eg use CbC data as a basis for tax adjustments; use exchange on request information to investigate trade mispricing, etc.)
- Lift reciprocity / spontaneous sharing of data

## Grassroots technical assistance

- Peer-to-peer, hands-on training
- Synergies SECO, SDC, FTA
- Possibly domestic rule



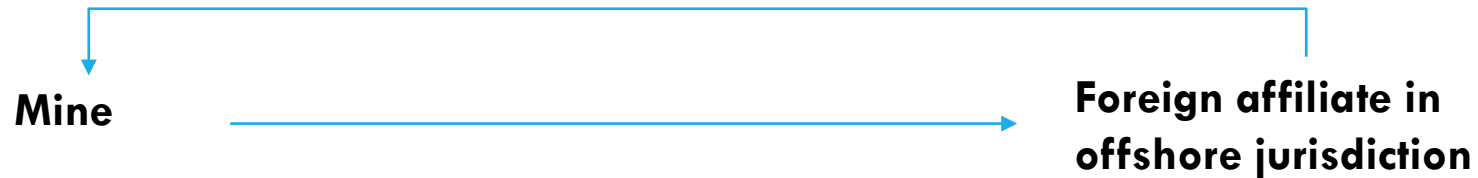
## QUESTIONS AND DISCUSSION

# TP OUTPUT



# TP INPUT (SERVICES)

Loan, technology and know-how, management services



Excessive payments in respect of interest, service charges, management and technical fees, royalty and IP costs

