

# Making Tax Work

A Framework for Enhancing  
Tax Transparency

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## **Making Tax Work: A Framework for Enhancing Tax Transparency**

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## Making Tax Work: A Framework for Enhancing Tax Transparency

### Chapter 1

#### Executive Summary and User's Guide

The objective of the Making Tax Work framework is to establish a basis for enhancing 'tax transparency'. We define tax transparency as a process that supplies the quantitative and qualitative data that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of the tax system. The guide to tax transparency that follows does this by identifying a series of reporting mechanisms and data standards which if implemented by jurisdictions would make their tax systems more transparent to a range of stakeholders. It lays out in detail a range of issues surrounding tax reporting and information standards and the systematic appraisals of tax systems required to enhance and enable tax transparency.

To achieve these goals we suggest ten principles for tax transparency. These are:

1. Everyone in a country has the right to seek, receive and access information on the tax system.
2. Governments should publish clear, measurable objectives and aspirations for the tax system.
3. Those objectives should be supported by detailed budget projections for future tax revenues, along with explanations of those projections and their implications.
4. Governments should operate a consultation process on significant proposed changes in tax policy and seek responses from a wide range of stakeholders.
5. All subsequent tax changes should be implemented with statutory approval.
6. Governments should publish accounts on tax revenues generated at least once a year, reporting on success and failures in achieving stated objectives with reference to numerical data and previously published budgets.
7. All taxes, and their administration, should be backed by law.
8. Taxpayers should have access to clear information and advice to enable them to comply with the tax law of a jurisdiction, as well as a right of appeal against liabilities with which they disagree.
9. Governments should periodically evaluate the performance of their tax system in its entirety using tools such as tax gap analyses and tax spillover assessments.
10. The data underpinning tax transparency should be subject to a verification process, undertaken by an independent agency that would audit, evaluate and report on the accuracy and fairness of that data.

These principles of tax transparency are developed as Making Tax Work proceeds.

In particular, the objective is to show how it is possible for a jurisdiction to work towards the achievement of these goals in stages. This is essential since it is apparent that few, if any, states attain the higher levels of tax transparency that we identify as 'aspirational'. The report identifies four categories, which are developed in more detail throughout the report:

<b>Level</b>	<b>Data requirements</b>
<b>Basic</b>	<ul style="list-style-type: none"> <li>• There is clear government accounting for tax in total, and the basic data required to appraise tax issues is readily available</li> </ul>
<b>Intermediate</b>	<ul style="list-style-type: none"> <li>• There are clear explanations of tax strategies, including on the choice of tax rates and reliefs</li> <li>• Data on international tax cooperation is available</li> </ul>
<b>Advanced</b>	<ul style="list-style-type: none"> <li>• More detailed accounting for each tax is undertaken</li> <li>• Tax gaps are reported on annually</li> <li>• Clear and detailed data on the performance of the tax authority is made available</li> </ul>
<b>Aspirational</b>	<ul style="list-style-type: none"> <li>• The performance of the tax system against theoretically achievable standards is reported upon</li> <li>• Regular tax spill-over assessments take place</li> </ul>

The report assumes that all stakeholders in a tax system, are impacted by and have some stake in the degree to which tax transparency is present in a jurisdiction, as represented by the availability of quality information and the implementation of constituent transparent processes. Moreover, while some stakeholders will want to be able to appraise the operation of the tax system and form judgements on its performance, all stakeholders have a material interest in the latter and in the outcomes the design and operation of the tax system serve to produce in terms of distribution, economic performance, prosperity, levels of inclusion, fairness, societal resilience and sustainability, and any other objectives and values that an individual, or society may choose to prioritize (see Chapter 4). Relevant stakeholders of a tax system are assumed to include:

- The government of a jurisdiction;
- The legislators of that jurisdiction, particularly those outside the government or members of the opposition (in a non-parliamentarian system);
- The tax authority of a jurisdiction;
- The electorate and the residents of that jurisdiction;
- Individual taxpayers within a jurisdiction, whether they are within the electorate, or not;
- The businesses that trade within a jurisdiction, whether incorporated or not;
- Researchers, whether they are academics, journalists, civil society or those from other backgrounds;
- International agencies and actors in other countries.

Chapter 3 of *Making Tax Work* discusses why tax transparency matters and for whom, and so begins to address these stakeholder issues.

In chapter 4 that theme is developed by explaining the role of tax in society and why tax is, as a consequence, an issue of concern to so many stakeholders.

This leads on to chapter 5, where the report begins to discuss the issues that need to be addressed in a tax transparency framework. Together these three chapters are an introduction to the work, and background to the thinking implicit within it.

To build on this foundation, the report presents a Tax Transparency Framework (TTF). This can be found in chapter 6. The TTF can be used to appraise whether a tax system is meeting a

government's stated objectives and whether the tax system is likely to be capable of meeting the aspirations and objectives of other stakeholders. This chapter is as a consequence at the heart of the proposals the Making Tax Work (MTW) report makes.

The Tax Transparency Framework (TTF) developed, works on the basis of an assumption that the stakeholders of a jurisdiction will likely have differing objectives for the tax system and therefore different information needs. Making Tax Work sets out the information requirements needed to meet all those needs as far as possible within an ideal system.

The fundamental underpinning for a system or framework of tax transparency is that a government of the jurisdiction and its tax authority, should state the key assumptions and objectives informing the management and administration of the tax system. Transparency in taxation has to begin with some statement of what tax policy and the design of the system as a whole is intended to achieve. Evaluating the performance and success of a tax system does require a sense of its overarching intent and purpose, while being transparent and explicit about objectives is an important component part of transparency in its own right and government accountability more generally. The TTF advanced in MTW is intended to compare expectations and stated objectives with outcomes. This will involve appraising and reaching evidence-based judgements on the effectiveness of a government and a tax authority in achieving their own stated goals.

This theme is elaborated in chapter 7. This explains how a tax system can be designed to achieve a government's objectives. This is important since many tax systems have no apparent design to them at all, and instead look like the legacy of many historic and unrelated decisions. The promotion of tax system design as an objective in itself is an important element of the tax transparency framework.

Chapters 8 and 9 explore this topic with regard to two particular interest groups who have a special role in any tax system. The special relationship between a tax system and businesses is the theme of chapter 8. Businesses generate many of the tax bases within jurisdictions. They also effectively play a special role as unpaid tax collectors, acting as agents for the government in collecting and transmitting taxes, for which they themselves have no liability, such as income, social security/ national insurances taxes that are automatically deducted from the salary payments of employees, or excise and duty value added taxes levied at the point of sale. Special attention to the role of businesses in tax systems is therefore warranted.

The role of citizen engagement and interaction with the tax system is an obviously important part of tax transparency. Critical dimensions of this such as taxpayer consultations as well as the role of tax agents and whistleblowers, are also addressed in this chapter. This is important for producing tax systems that align effectively with citizen expectations and needs, so they build trust in and understanding of the system, which are crucial components of tax compliance, which in itself is a measure of the success and legitimacy of a tax system, and a key ingredient in a nation's tax morale more generally.

These themes get pulled together in chapter 10, which discusses the nature of tax accounting within government reporting. Without such reporting there cannot, of course, be tax transparency. A number of themes not always touched upon are also addressed. For example, the role of tax reliefs, exemptions and allowances (so-called social 'tax expenditures' STEs or tax spends,) within a tax system are explored. It is also explained why it is important to compare outcomes with expectations as part of any drive for greater tax transparency. This too rarely happens, including in many major tax systems.

Having explored these issues, which cover the basic and intermediate levels of tax transparency, advanced and aspirational dimensions of the framework are then explored in chapters 11 and 12 which respectively deal with tax gaps and tax spillover.

Tax gap analysis is an issue which we explore in more depth than is conventional by extending the concept to explore tax that is not just not paid, but which a government has decided not to collect (foregone revenue mainly due to the provision of reliefs and allowances – social tax expenditures STEs). The aim is to explore the whole range of reasons why tax is not paid within a jurisdiction, and to provide a basis for evaluating the merit, worth and success of various reliefs and exemptions.

Tax spillover analysis, which is discussed in chapter 12 seeks to explain why and how tax systems fail to achieve their objectives, and how certain tax policies and procedures can generate risks (often unintended consequences) and externalities that undermine different tax bases both domestically and internationally. The chapter explains a methodology for undertaking such an appraisal and its rationale. Spillover assessments are the ultimate goal of the tax transparency framework (TTF) as a gold standard form of tax transparency. They identify courses of action for remedying the underperformance revealed by the greater tax transparency they generate.

Chapter 13 explores some existing practice with regard to tax reporting. The examples are necessarily selective and illustrative, but show that good practice is possible, and that stakeholder needs can be met.

Chapter 14 looks at the application of these ideas within subnational government where they can still play a significant role in supporting good management of a tax system.

Finally, conclusions are drawn, where it is noted that tax transparency is not of benefit in isolation. The report defines tax transparency as a public good. Making Tax Work (MTW) understands this as a service that is provided without profit to benefit all members of a society. Similarly, the tax system itself should be regarded as a public good. While few stakeholders pay tax with enthusiasm, many appreciate just how important it is that tax is paid, for all the many reasons noted in the document that follows. If the value of this overall public good is enhanced by greater transparency, with the benefit to society increasing as a result, then this would constitute a societal wide net welfare gain. That is why tax transparency, and the delivery of an appropriate tax transparency framework matters. Making Tax Work sets out in the document that follows pathways and routes for achieving that goal.

## Making Tax Work

### Chapter 2

#### Introduction

The ‘Making Tax Work’ project seeks to explain how tax and tax systems can be made to work more effectively.

Making tax work is, of course, a priority for every government. They do, of course, seek to enforce their right to recover the tax that is owed to them using the laws that they have enacted. However, they are not the only people who might have an interest in a well-functioning tax system within a jurisdiction. We suggest that the following groups also share that concern:

#### **a. All engaged with the political process in a jurisdiction**

It is not just the government in office that has an interest in there being a well-functioning tax system. Opposition and other politicians who wish to hold that government to account also want to appraise the effectiveness of a government in making tax work for the country that they might also wish to govern. They need data on the effectiveness of a tax system to appraise how well a government is managing its obligations, and to work out how they might do better as part of their own political platform to present to an electorate.

Implicit in this process will be the discussion of the politics of taxation. This is an issue addressed in more detail in Chapter 12 of Making Tax Work, but which needs to be made explicit from the outset, whilst also stressing that what is being said is not in any way party political.

Politics is ultimately a process that secures power for some that grants them the right to govern the lives of others within a jurisdiction. That process of governing necessarily involves decision making. All decision making is best when informed by data. It then becomes apparent which decisions are pragmatic and which are informed by the political preferences of those holding power.

Such differences exist within taxation systems. Pragmatically all governments require revenues. Who they charge to tax, at what rates, with what allowances, and with what rigor when it comes to enforcement are all matters that reflect the political decision making of a government, many of which decisions will have impact on the effectiveness of the overall tax system, the efficiency of a tax authority and the overall net outcome of the tax system both within and beyond the jurisdiction.

Political economy emphasizes this fact, and that as a consequence some groups are usually favoured or are prejudiced (or think they are prejudiced, which can amount to much the same thing) as a result of taxation decisions. If a tax system is to work there has to be awareness of

this issue and Making Tax Work suggests ways to supply data that informs this decision process without seeking to influence outcomes. These two are explicitly different objectives, but both, and the important inter-relationship between the two has to be acknowledged in the discussions that follow.

#### **b. The population of a jurisdiction**

As the principal beneficiaries of the government spending that is related to any government's ability to raise tax revenues it is likely that many people within the population of a country will have direct personal interest in the effectiveness of a government's management of a tax system. This is, however, unlikely to be the only interest that they might have in that system. They are also likely to want to know whether:

- The tax that they are expected to pay is fair compared to the contribution required of others within the society of which they are a part;
- All those who should pay do actually do so, as indication of whether the tax system is fairly administered;
- What options for alternative taxes exist within their society;
- Whether their tax system compares favourably with that of other broadly similar jurisdictions;
- How the taxes paid are used.

#### **c. Businesses within a jurisdiction**

Most businesses will have a very particular interest in the tax system of the jurisdiction in which they operate. Those that can decide in which jurisdiction to operate might have a very particular reason for knowing as much as possible about this issue. These themes are explored in more depth in Chapter 8 of Making Tax Work.

Businesses will also want to know about the tax system because they not only have their own tax obligations to settle, but effectively act as tax collectors on behalf of government for a number of other taxes as well.

Businesses are also likely to want to know whether all those who should pay tax within jurisdiction, actually do so, as an indication of whether the tax system is fairly administered and whether they are competing on a level playing field. This is especially important when seeking to tackle issues relating to corruption in general, though more specifically potential tax abuses. Greater knowledge of how taxes are spent is a part of this process and will help to build greater sympathy in the corporate world with the objectives of government finances, especially if this provides an account of the benefits business obtains from the process through various infrastructure gains for example.

**d. Researchers, academics, journalists, other tax authorities and international organizations wishing to learn more of the tax system**

A wide range of other organizations will wish to know about the tax system of a jurisdiction. Some will wish to report on it. Others will wish to appraise its effectiveness, and others still will wish to learn from these efforts. Some will wish to appraise its reliability, not least as a source of information for their own tax system. The needs of these users of a tax system are various, but in general will require data to appraise effectiveness not that different to that required by a government itself to ensure that the tax due within a jurisdiction is actually being collected, and who from and at what rate, with what allowances and reliefs having been given.

Making Tax Work seeks to address the needs of these users of the information that should be created by a tax system as indication that tax really is working as planned.

As a result Making Tax Work will address the numerous issues that any government has to face with regard to tax. It is important to note that there are many such issues. Governments have to decide, for example:

- Who to tax;
- What to tax;
- What tax rates to use (how much to tax);
- What tax reliefs and allowances to grant;
- How they will manage the tax system;
- What checks and balances they will put in place when doing so, most especially when it comes to addressing gaps in the tax system;
- What resources they will allocate to manage their tax system and how they will organize this activity;
- How they wish to use the tax system to influence the economy and society for which they are responsible;
- How they will interact with the tax systems of other governments;
- How they will engage with their own citizens, whether they pay tax or not, as well as the residents of other countries who pay tax in the jurisdiction and the companies, trusts, charities and other organizations with which they are involved, who can all be taxpayers, on all of these issues;
- How accountable they will be for the resulting decisions on tax that they take.

Tax pervades almost all aspects of the relationship between a state and those who live in and deal with it, how the economy is structured, and how people in that place relate to one other. While understanding what issues governments have to decide upon when managing a tax system is an important element of the Making Tax Work it is by no means everything. Making Tax Work also seeks to:

- Explain why governments tax;
- What can be achieved with tax other than simply raising revenue;

- How tax fits into the broader issue of managing an economy;
- Whose interests need to be taken into account when deciding on tax issues;
- How these people need to be made aware of what they need to know about tax;
- What these people should know about tax, including about the way the tax system works on their behalf;
- How their rights are protected with a tax system;
- How they should be consulted with and informed about the way the tax system is working, with what outcomes and on proposed future changes to the system.

Throughout the Making Tax Work project, the question of what people should know about a tax system is a priority. Even the very best tax system is incomprehensible if its operation is veiled in secrecy. Secrecy also undermines the acceptability of any tax system in the eyes of those who are required to pay tax: knowing why they are taxed and what their tax is used for is critical to securing taxpayer acceptance of the payments demanded of them. Transparency also acts as means for those outside of government and the tax authority to hold those in power to account for the actions they have taken. This matters not just to taxpayers, but also to politicians outside government, those in government posts but outside of the tax authority and finance ministry, researchers, journalists, academics, activists, international agencies and others who collectively comprise, with taxpayers, the stakeholders of any tax system. As a result, throughout the Making Tax Work project there will be regular references to the information that government and others need to deliver to ensure that there is transparency within a jurisdiction's tax system. That information makes up what we describe as the Tax Transparency Framework.

## Making Tax Work

### Chapter 3

#### Reasons for tax transparency

Tax transparency is an ongoing process that supplies quantitative and qualitative data that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of its tax system.

As this definition makes clear tax transparency is not static: it is a dynamic process involving ongoing information collection, delivery, scrutiny and appraisal.

#### The purpose of tax transparency

Tax transparency is a public good<sup>1</sup>. The information collection, delivery, scrutiny and appraisal that constitutes tax transparency is intended to improve the functioning of a tax system and its capacity to serve and work for a variety of stakeholders. That tax system is itself also a public good.

Tax transparency is a process that enriches and enables wider deliberation on tax matters and choices. Tax transparency in this sense enables and promotes multi-stakeholder dialogue on the design of and reform of tax systems. In turn this enables societies to discuss and consider collectively how to design and structure the tax systems to best meet mutual needs, cultural norms and their own specific societal and political challenges.

#### Why tax transparency matters

Tax is at the core of the social contract between a state and those who are governed.

The state is entrusted with the stewardship of collective resources that are expected to be used for collective wellbeing. As in any situation where stewardship is involved, good governance requires that those so entrusted are held to account for the decisions that they make.

This process of holding a government to account requires that data be available to ensure that a government's intentions, plans, actions and outcomes are known and can then be appraised.

This process helps ensure that accountability is established. In a democracy this can then lead to informed decision making within that process.

Most importantly tax transparency helps all the stakeholders of a tax system in a jurisdiction determine whether that system is being managed and used in the way that the government of a jurisdiction intends and states as its purpose. It does this by making available data of various forms that enables societal wide scrutiny and debate on the effectiveness and fairness of government tax policies.

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<sup>1</sup>A public good is defined as a commodity or service that is provided without profit to benefit all members of a society, usually by a government.

Making this information and data of this type available enables policies to be assessed and evaluated by cross-sections of the population and others with interest in this issue, including businesses. That in turn increases the likelihood that governments can be held to account for the effectiveness and fairness of their policies. It also increases the information a government has available to it, to assess whether its own policies and the tax system are effective in achieving government objectives. Transparency is a device for building and encouraging the growth of trust between citizens, businesses and their governments on tax matters, particularly in states with low tax morale and distrust of government.

That trust is reflected in citizens' and stakeholders' confidence in their government's capacity and willingness to operate fair and effective policies, and to act with good faith. A pre-requisite for this is that government tax policies be subject to scrutiny based on reliable and useful data and information published by the government. Tax transparency thus becomes essential to building the levels and kinds of trust between governments and citizens that are integral to the social contract, as well as in informing priorities in the tax system and potential reform paths. While many areas of public services are now thoroughly evaluated to see if they are offering 'value for money', the functioning of the tax system itself is rarely one of them, which is problematic given that for most governments the ability to continue funding public services and having some degree of fiscal space and autonomy is often at stake. The Making Tax Work project addresses this deficit.

### To which stakeholders this issue matters

Tax transparency is an activity that can be partaken in by all the stakeholders of a tax system, who are:

- The government of a jurisdiction;
- The legislators of that jurisdiction who are outside the government;
- The tax authority of a jurisdiction;
- The electorate and residents of that jurisdiction;
- Taxpayers within a jurisdiction, including businesses however they are structured;
- Researchers, whether they are academics, journalists, civil society or those from other backgrounds;
- International agencies and actors in other countries.

These are the stakeholders of tax transparency and the intended audience for Making Tax Work.

### The progression of tax transparency

Since tax transparency is a process it is necessarily one that progresses. This is implicit within the discussion within Making Tax Work.

Within Making Tax Work we seek to indicate that there are stages that governments can reach in progressing towards what we call a tax transparency framework (see chapter 6).

Level	Data requirements
<b>Basic</b>	<ul style="list-style-type: none"> <li>• There is clear government accounting for tax in total, and the basic data required to appraise tax issues is readily available</li> </ul>
<b>Intermediate</b>	<ul style="list-style-type: none"> <li>• There are clear explanations of tax strategies, including on the choice of tax rates and reliefs.</li> <li>• Data on international tax cooperation is available.</li> </ul>
<b>Advanced</b>	<ul style="list-style-type: none"> <li>• More detailed accounting for each tax is undertaken</li> <li>• Tax gaps are reported on annually</li> <li>• Clear and detailed data on the performance of the tax authority is made available</li> </ul>
<b>Aspirational</b>	<ul style="list-style-type: none"> <li>• The performance of the tax system against theoretically achievable standards is reported upon</li> <li>• Regular tax spill-over assessments take place</li> </ul>

The progression through these stages, and the acknowledgement that there is a progression to be made, is in itself part of a commitment to a tax transparency framework.

Making Tax Work is organised to recognise this progression. Chapters 1 to 10 cover the basic and intermediate levels of tax transparency, which are the most likely to be achieved in most jurisdictions at present. Chapters 11 to 14 cover more advanced and aspirational dimensions of tax transparency, whilst providing indications as to how short cuts can be made to deliver at last some of the benefits of these aspects of tax transparency without having to cover all the detail referred to in those chapters.

### How this issue can be appraised

Tax transparency requires scrutiny of:

- The tax strategy of a jurisdiction covering:
  - The social, economic and fiscal goals that a government wishes to achieve through its tax policy;
  - How it sees the role of tax within its overall fiscal management of the economy;
  - The government's objectives with regard to redistribution of income and wealth using the tax system;
  - How the government intends to use the tax system to compensate for market failures, most especially on taxing harmful products and providing subsidies through tax reliefs and exemptions;
  - How the government decides what to tax; its philosophy on setting tax rates and how tax exemptions, reliefs and allowance are decided upon;
  - The government's approach to its tax administration, its management and its funding.
- The budget for each period as established by a government and approved by its parliament, including forecast data of all the types that a tax authority should then report upon its accounts as previously noted so that subsequent appraisal of outcomes against expectation is possible;
- Other economic data published by a government for a period, which when compared with tax data, can suggest whether the social, economic and fiscal goals that a government wishes

to achieve through its tax policy have been fulfilled or not e.g. with regard to growth, redistribution, tackling poverty, climate change, etc.;

- Tax legislation and regulation;
- The structure of the tax administration of a jurisdiction and its accountability;
- The legal aspects of the workings of the tax administration including whether or not it is successful at upholding the rule of law, particularly whether it collects the revenue it expects and if it does not, what the extent of the resultant so-called *tax gap* is, whether taxpayers who disagree with the tax authority are fairly and appropriately treated. The latter requires a review of the interaction between taxpayers and the tax authority and the due process and mechanisms for recourse that entails;
- How tax issues are integrated into related areas of administration including company law, accounting regulation, trust law, rules on inheritance and personal data;
- International arrangements with regard to taxation including tax cooperation, automatic information exchange (AIE) of tax data and the approach to international tax agreements.
- The accounts of that tax authority that indicate whether the tax strategy of a government has been delivered, or not, with particular reference to:
  - Tax revenues raised:
    - By tax;
    - By taxpayer, on average, and by bands of income and tax settled;
    - By sector of the economy;
    - By geographic region, if relevant;
    - By gender;
    - By household.
  - Tax revenues foregone i.e. those sums not raised because of the cost of providing tax exemptions, allowances and reliefs analysed by tax and by type, at least;
  - The tax gap i.e. the costs of tax evasion, tax avoidance and tax due not paid as a result of bad debts suffered;
  - The costs of tax collected:
    - By tax;
    - By region;
    - With data to be supplied in respect to staff employed in each of those categories as an indication of the allocation of resources within the tax authority;
    - The average cost of collection of each tax;
    - The overall expenditure of the tax authority.

Tax transparency thus requires:

- A comprehensive commitment to publishing data by a government;
- A willingness on a government's part to both interpret this data and to assist others to do so;
- A commitment to provide missing data on demand;
- A willingness to cooperate with actors outside government who suggest what data they require to meet their own needs;
- The creation of an environment in which data on tax can be appropriately appraised so that the success or otherwise of tax policy can be determined.

### What happens if this issued is not addressed

Without effective tax transparency good governance is likely to become more difficult. The following range of potential risks are created:

- Inappropriate decision making;
- Mismanagement of the national economy;
- Wasted expenditure;
- Corruption;
- Failure to uphold the rule of law;
- The failure of the social contract;
- Political failure and public disquiet.

There are, of course, spectrums of concern within all these areas but these risks are real when there is a failure of accountability. Tax transparency facilitates the forms of accountability that can prevent these issues arising.

## Making Tax Work

### Chapter 4

#### The role of tax in a society and economy

Before exploring the issues and processes surrounding tax transparency and the question of how greater tax transparency can be achieved, it is first necessary to establish vital background context that helps to explain why tax transparency is an important public good and the forms it could and should take. This context relates to the question of how we should understand and think about the role tax plays in both society and economy.

It is common to believe that governments tax economic activity to fund their spending requirements. That is partially true, but the relationship between tax, society and economy is more complex than this implies.

Tax also enable governments to shape the kind of society they want to create. Precisely because different governments, of different political perspectives, representing different societies with differing values, will want to achieve differing outcomes, there is no such thing as an optimal, or even a singular desirable tax system.

In broad terms there are at least five reasons why a government charges tax:

1. *Raise revenue*, either to fund government spending or, alternatively, to reclaim the money that the government has already spent;
2. *Ratify* the value of the currency of the jurisdiction;
3. *Redistribute* income and wealth;
4. *Reprice* goods and services;
5. *Reorganize* the economy through what is called fiscal policy.

Each requires further explanation if the relationship between tax, the society in which it is charged and its economy is to be properly understood.

#### Raising revenue

Many governments, whether at country level, or subnational, regional and local levels, borrow to fund some of their spending. This inevitably means that they are not completely dependent on tax to fund their activities.

Tax revenues are also not *always* required to ensure that governments can repay their loans. In practice many governments, of whatever type, make relatively little in the way of loan repayment. Instead, they make use of loan roll overs as existing loans mature. Stable and secure tax revenues that satisfy creditors that interest payments will be honored, enable governments to make these rollovers.

Consequently, most governments have some choice about the mix of tax and borrowed funds used to finance their spending programmes. Understanding the relationship between these two

sources of funding is critical if the performance and role of the tax system is to be understood. Appreciating the relationship between government deficits and tax revenues is vital if the role of tax in a society is to be fully comprehended. Governments need to explain their choices in this respect, if the stakeholders of a tax system are to understand why this relationship takes the form it does and for what intended purpose.

### **Ratifying the value of a currency**

Most governments are very keen to have macroeconomic control of the economy for which they are responsible. In other words, they want to make sure that their economy runs in the best interests of the people who live within their country for the simple reason that this makes them popular. To achieve this objective a government usually wants control of the currency in issue within their jurisdiction. There are of course voluntary exceptions, like the eurozone and the CFA Franc or Eco zone in West Africa. There are also some countries that deliberately peg the value of their currency against that of another state, most commonly the US dollar. These exceptions apart, however, most countries do issue their own currencies.

That does not, however, mean that their currency is, necessarily, the one most commonly used in their jurisdiction. Nor does that mean it is the one that most people within their jurisdiction have confidence in. It is not uncommon for jurisdictions to have two, effective, parallel currencies in use, with the second very often being the US dollar. There is, however, considerable risk to a country if this situation occurs. This risk arises because it is very easy to disguise transactions taking place in the second currency that is in use in a jurisdiction: this can often encourage growth in the size of the shadow, or unrecorded, economy of the jurisdiction.

There is considerable advantage to a country that can ensure that its own currency is the only, or main currency in use for the transactions undertaken within its jurisdiction. If the amount of tax owing in a jurisdiction is significant, and if it is a legal requirement that this tax be settled in the currency of the jurisdiction in question, then the majority of the transactions in that jurisdiction will also likely be in that currency because the exchange rate risk of using any other currency becomes too great. Tax having to be paid regularly in a particular currency, therefore encourages and incentivizes use of that currency. Tax in short creates a demand for a particular currency amongst a range of actors participating in the economy. Consequently, tax ratifies the value of that currency in use. This issue is little understood, or commented upon, but has a real significance when it comes to managing effective tax systems.

### **Redistributing income and wealth**

If a government wishes to stimulate economic growth within its jurisdiction it is likely that it will wish to limit the diversity of incomes and wealth within that country to help stimulate this outcome, and by far the best way to do this is to use progressive taxation systems. A progressive tax is one that overall charges higher rates of tax on a person as their income or wealth rises. This increase is not just in absolute terms but also as a proportion of that income or wealth. In many countries this is a significant objective of tax policy as a consequence.

### **Repricing goods and services**

Some goods and services are too expensive for everyone to afford in some jurisdictions, but are nonetheless considered essential items. The tax system can then be used to effectively subsidize these items e.g. by cancelling sales taxes that might otherwise be charged on them.

By far the most common types of goods and services that are subject to tax repricing are those items thought to be socially harmful, where it is also believed that the market price fails to reflect the full cost to a society of the use of that product. Examples include tobacco products, alcohol, cars, carbon-based fuels and other similar types of product. The fact that demand for many of these products is what an economist would call inelastic, means that demand can vary little in proportion to price changes, encouraging the use of these items as tax bases. However, it is increasingly common for tax charges on these products to compensate for the fact they generate unseen costs, in the form of pollution or health risks, that are not priced in by the market.

### Reorganizing the economy using fiscal policy

If all government spending was directly funded by tax in exact equal and opposite amount then the amount of tax collected within the economy would have little overall economic impact: the level of government spending would then be the primary fiscal tool available to government for managing economic activity within that jurisdiction. However, as a matter of fact government spending need not be wholly funded by tax, as previously noted. It can also be funded by borrowing of various sorts.

The technical details of how government borrowing and related issues, such as quantitative easing, take place are not important for this Guide. What is important is that it is understood that governments frequently have good reasons for deciding that they want to run deficits, which means that they spend more in cash terms than they collect in tax. Likewise, they can also have good reason to run surpluses, which mean that they raise more in tax than they spend in cash, with the result that they reduce their borrowing or cancel some of the money that they have injected into the economy<sup>2</sup>.

In particular such options are chosen when a government wants to stimulate economic activity (which usually requires that deficits are run i.e. spending exceeds tax revenue) or dampen down the scale of activity in an economy, usually to control inflation (which requires that surpluses be run i.e. tax revenue exceeds spending), albeit that the relationships are not always as clear as economists sometimes suggest.

In addition, fiscal policy can also be used in association with decisions about the tax system to encourage particular types of activity e.g. investment in new types of industry. Or, it can be used to subsidise some parts of the population e.g. those on low income. Alternatively, it may be decided to use tax policy to create social transformation, such as the delivery of environmental change. All of these policies can be linked to the decisions made about whether to run a surplus or deficit, or not.

Fiscal policy is, then, not just about choosing whether to run deficits or surpluses but is also about deciding how those deficits and surpluses might be created with the aim of helping to achieve a particularly desired outcome within a society. From the point of view of this Framework the important point that has to be appreciated is that tax has a role in the process.

### Why this issue matters

It is vital that the reasons why a government might tax is understood. Tax is not simply an issue that relates to the raising of revenue to pay for government expenditure. Tax can itself be used

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<sup>2</sup> Baker, A and Murphy, R (2020) Modern Monetary Theory and the Changing Role of Tax in Society, Social Policy and Society, 19:3, July, pp.454-469.

as a tool to shape society, or to achieve objectives governments and electorates agree to prioritize by shaping incentives, prices and redistributive patterns in accordance with the 5Rs. A full appreciation and understanding of tax policy requires an explicit acknowledgement of this. Accordingly, delivering tax transparency requires governments to be as clear as possible in stating the intended objectives of their tax policies.

This is especially true given the focus on the role of tax policy within the Tax Transparency Framework (TTF) of Making Tax Work. Those seeking to understand a tax system and how it is performing will be unable to reach fully informed judgements if they believe the only issue facing a tax system is its revenue raising capacity and they use this criterion alone. Revenue raising may be insufficient to explain why progressive income tax rates are present in a country, for example. This may be a function of a desire to reduce, or mitigate inequality in a jurisdiction. Similarly, many tax reliefs, allowances and exemptions are created for social purposes, or to discourage certain economic activities. Clarity in such objectives can build appreciation, acceptance and understanding of how tax can be used for such purposes, enabling societal debate not only about the appropriateness of targeting certain objectives, but also in monitoring tax systems' success in delivering these objectives. This is itself a vital component of enabling and enshrining tax transparency as a governmental and societal norm. In other words, this approach is based on a recognition that tax systems are not standard public administrative systems like any other. Rather, they are not only the life blood of other public services, but also have an enormous power to shape society and social relations as a whole, creating a need to explicitly announce and specify the objectives to be attached to various tax policies.

It is also important to emphasize that all such policies need to be subject to regular review. This is why Making Tax Work places emphasis upon a government stating the objectives that it has for its tax system, and encourages appraisal of that tax system against those stated objectives. It is this process of comparison that allows the appropriateness of the design of the tax system to be appraised against the objectives it was meant to fulfil.

## Making Tax Work

### Chapter 5

#### The key objectives of a tax transparency framework

Having established what tax transparency might be and having suggested what information might need to be scrutinized as part of that process, and how we should think about the multiple roles and functions tax in society can perform, it is important to establish what a tax transparency framework might look like. As noted in Chapter 3, this is a progressive process that can be developed in stages.

Such a framework requires the following be known:

- Who the key users of the tax transparency framework might be;
- What those key user's information needs might be;
- What secondary users of the tax transparency framework might expect from it;
- How the information needs of those secondary users might be met.

This section tackles these issues.

#### Who are the key users of a tax transparency framework?

The key stakeholders of a tax system are:

- The government of a jurisdiction;
- The legislators of that jurisdiction who are outside the government;
- The tax authority of a jurisdiction;
- The electorate and residents of that jurisdiction;
- Taxpayers within a jurisdiction, whether they are within the electorate, or not;
- Researchers, whether they are academics, journalists, civil society or those from other backgrounds;
- International agencies and actors in other countries;

These stakeholders are likely to be the key users of a tax transparency framework but their needs will differ, and some are likely to have greater demands than others of that tax transparency framework.

In saying this it has to be understood that a tax transparency framework is a dynamic system involving ongoing information collection, delivery, scrutiny and appraisal that supplies the quantitative and qualitative data that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of that tax system.

In this dynamic environment the government and, most especially, the tax authority of a jurisdiction are likely to have access to most of the information they already require with regard to their management of the tax system of a jurisdiction. They might be called the originators of data. This gives them a special role inside the tax transparency framework. They should:

- Understand that this is their role;
- Appreciate the obligations that this imposes upon them;
- Understand how the data that they generate might be used;
- Train people in the use of that data and be willing to explain the data;
- Encourage critical appraisal of that information;
- Encourage feedback and provide platforms whereby users of the data can participate in discussions and put forward additional information needs.

International standards on this issue will assist this task. So too will frameworks encouraging the role of data interpretation. The tax gap and tax spillover frameworks, outlined in later sections, are both designed to assist in these tasks. Spillover assessment is something that gives a government and its stakeholders a much better overview or panoramic of how a tax system is functioning in practice. It is a device for enhancing tax transparency to a gold standard level.

The remaining stakeholders of a tax transparency system can be split into two main groups, who might be described as primary and secondary users. Primary users are likely to include:

- The legislators of that jurisdiction who are outside the government or members of the opposition (in a presidential system);
- Civil servants and others in government, outside of either the revenue office, or the primary fiscal agency;
- Researchers, whether they are academics, journalists, civil society or those from other backgrounds;
- International agencies and others in countries other than the jurisdiction being reviewed.

They are described as the primary users of tax data because these groups are likely to have the most complex information needs from a tax system.

The secondary users, who do require information but in more accessible format, and in ways that are not likely to lead to further analysis on their part are:

- The electorate and residents of that jurisdiction;
- Taxpayers within a jurisdiction, whether they are within the electorate, or not;
- People in countries other than the jurisdiction being reviewed.

### The information needs of the primary users of tax transparency data

It is likely that the questions of most relevance to the primary users of tax data will be:

1. Does the stakeholder have access to the data noted to be desirable in chapter 3 and the actual data for the jurisdiction's national income and its composition so that the role of tax in the economy can be understood? (**Basic**)
2. Does the stakeholder have access to data on the budgeted and past actual income and expenditure of the government as a whole, broken down in sufficient details so that:
  - a. the source of all income can be reasonably identified;
  - b. all revenue expenditure (charged as an expense in government accounts in accordance with generally accepted accounting principles) can be explained;

- c. capital expenditure is explained;
- d. the government's surplus or deficit is clearly stated, as is the source of its funding and what the terms of that funding are so that the source of deficit funding, if it is being used, can be compared as to cost and appropriateness to the use of taxation for that purpose;
- e. any contingent liabilities e.g. pension costs, not provided are noted (generally accepted accounting principles apply).

Both income and expenditure must be recorded to show:

- The fiscal balance that the government is trying to achieve;
  - How the taxpayer benefits from the process. **(Basic)**
3. Does the jurisdiction appropriately budget and account for its theoretical taxable income, its total tax expenditure or tax spends (i.e. exemptions, allowances and reliefs that reduce tax yields) and its anticipated tax gap (i.e. tax evasion, tax avoidance and tax bad debt)? These calculations enable actual and anticipated tax yields to be identified, understood and evaluated. **(Aspirational)**
  4. Is that budget accompanied by an explanation of the tax strategy that the government is pursuing when setting it so that it can be understood in the relevant context? Is that tax strategy stated sufficiently clearly to explain why particular taxes, exemptions, reliefs, allowances and rates have been chosen for use? **(Intermediate)**
  5. Are appropriate lines of responsibility identified for all sources of income and expenditure so that proper accountability can be demanded for them? **(Basic)**
  6. Are appropriate distinctions between capital and revenue income and expenditure identified in the government's accounting systems? **(Basic)**
  7. Are appropriate accounting policies adopted for use in the jurisdiction's government accounts? **(Basic)**
  8. Are appropriate and timely annual accounts prepared for each government ministry or department as well as for the government as a whole? (This is part of the continuum of tax transparency, as spending and taxation should be seen as intimately interconnected). **(Basic)**
  9. Do those annual accounts compare outcomes with budgets so that variances can be established and accountability for them be upheld? **(Basic)**
  10. Is the actual tax gap reported on annually? **(Advanced)**
  11. Is a tax spillover analysis undertaken on the tax system on a regular basis to appraise why and how tax gaps are likely to arise? **(Aspirational)**
  12. Is detailed information for the revenue collected from each tax available to stakeholders so that they can understand:
    - a. How many people are believed to be liable to make payment of a tax either as principles in the case of direct taxes or as agents in the case of indirect taxes;
    - b. How many people actually pay each tax;

- c. How much tax of each type is paid in bands that illustrate the relative contributions made by those of differing incomes, wealth or level of expenditure, as appropriate, with details of the bands in question being disclosed;
- d. What value of allowances, reliefs and exemptions are provided with regard to the tax in question and who benefits from them split between the bands used to explain the relative contributions made;
- e. What the tax gap for the tax is, split between evasion, avoidance and bad debt;
- f. How much of the tax authorities' total resource is spent on collecting the tax in question and how many people are employed in that process; **(Advanced)**

13. Is information available on the operations of the tax authority including data on:

- a. The number of tax returns requested or expected for each tax;
- b. The number of tax returns submitted for each tax;
- c. The number of penalties imposed by the tax authority for non-compliance during each period, with explanation to be provided by tax and by cause;
- d. The number of tax penalties paid by tax and by cause during the period;
- e. The numbers of appeals against tax authority decisions made during each period by tax and by broad type, with indication being provided as to the number of such appeals accepted declined and settled after dispute with the aggregate proportion of disputed sums recovered being noted; **(Advanced)**

14. Is all the information that a taxpayer needs to be tax compliant available to them in readily accessible and free to access format? This will include:

- a. Free access to all tax legislation of the jurisdiction in freely available and free software formats;
- b. Free access to budget legislation on the same basis to enable appreciation of the connection between taxation and expenditure outputs;
- c. Free access on the same basis to all the guidance of the tax authority intended to assist tax compliance;
- d. Free access to tax authority advice on a personal basis, if required by the taxpayer to make sure that they can pay their proper taxes owing;
- e. Free access to the jurisprudence and judicial interpretations and court sentences on the relevant taxes. **(Basic)**

15. Are the international tax agreements of the jurisdiction available to a stakeholder for them to inspect in readily accessible and free to access format? **(Basic)**

16. Is data on the information exchanged with other tax jurisdictions made available for review in a readily comprehensible format? **(Intermediate)**

It is appropriate to note that this list should be considered to represent 'ideal' data i.e. that which should be supplied in a well-functioning system. Few tax systems reach this standard at present.

The numbered items noted above might be split between categories of desirability as follows:

Basic requirements	1, 2, 5, 6, 7, 8, 9, 14, 15
Intermediate requirements	4, 16

Advanced requirements	10, 12, 13
Aspirational data	3, 11

The development of a full system of tax transparency is therefore itself a process, that a jurisdiction can pass through in stages. This can either be appraised through the check list grid above, or via chart 5.1 on the next page that offers an at a glance listing of the requirements on a 1-4 scale category (basic, intermediate, advanced and aspirational). Where a government regularly meets the criteria in the basic category and that data is considered accurate, timely and reliable by a majority of independent experts, then transitioning through to intermediate requirements should be straight forward and relatively easy to achieve. From that position, reviewing the performance of the tax authority and more detailed breakdowns by tax becomes achievable and can help develop the understandings of government authorities themselves. Developing a tax gap analysis methodology requires more thought and will depend on the specifics of the data in the basic and intermediate categories for that particular country, but once the other two elements of the advanced category are realized, tax gap analysis that establishes the gap between projected and actual revenue collection in a given year, also becomes feasible. Finally, theoretical taxable income projections and detailed spillover assessments evaluating how different taxes interact and complement or conflict one another, and with the tax systems of other countries, are achievable off the back of and complementary to, analysis of revenue agency performance and procedure, tax gap data, and more detailed breakdowns of individual taxes. Spillover assessments are a gold standard of tax transparency that report on tax system performance and risks, and suggest targeted reforms to improve that performance. The chart below sets out these sequences.

**Chart 5.1 Categories of Tax Transparency and Their Requirements**

<b>Basic</b>	<ul style="list-style-type: none"> <li>National income and composition</li> <li>Past budgets broken down - income and expenditure</li> <li>Responsibility for lines of income and expenditure</li> <li>Clear distinction between capital and revenue in government accounting</li> <li>Timely adequate accounts for each government department</li> <li>Accounts compare outcomes with budgets</li> <li>Tax payers able to access information to enable tax compliance</li> <li>International tax agreements of a jurisdiction widely available</li> </ul>
<b>Intermediate</b>	<ul style="list-style-type: none"> <li>Clear explanations of tax strategies, including choice of reliefs.</li> <li>Information exchanged with other jurisdictions - available and accessible</li> </ul>
<b>Advanced</b>	<ul style="list-style-type: none"> <li>Tax gap is reported on annually</li> <li>Revenue collected by each tax and breakdowns</li> <li>Clear detailed data on performance of tax authority</li> </ul>
<b>Aspirational</b>	<ul style="list-style-type: none"> <li>Theoretical taxable income = total tax expenditures + anticipated tax gap data</li> <li>Regular tax spillover assessments</li> </ul>

## The quality of tax transparency data

The quality of the data supplied as part of the tax transparency process is important. Seven qualities matter. Data should be:

1. *Timely*, meaning that it is available for decision making purposes. In most cases this will mean that an information cycle is established that requires that the information for a year is published before the budget process taking place during the following year is in progress. Interim data to inform the decision making process should be supplied during each budget cycle, subject always to the caveat that it will be replaced by better quality data in due course. The following might be an example:

Year 1 ends	31 December Year 1
Year 1 tax transparency data is all published by	31 July in Year 2
Budget information for year 3 is published by	31 October in Year 2
Year 3 Budget is approved by	31 December Year 2 (and ideally, earlier than that)
Year 3 commences	1 January Year 3

This should ensure that information is available on time to inform decision making at the time that those decisions are required to be made.

2. *Relevant*, meaning that it meets stakeholders' needs. This means that it meets at least the basic requirements noted in the previous section, and ideally is somewhat more advanced than that;
3. *Reliable*, meaning that there should be a quality control or audit process in use during its preparation. The aim should be that data supplied should be as accurate as possible, meaning that it is not contradicted by other data sources. The differences between interim reporting, where standards may not be as reliable as in final data, should always be highlighted if such information is made available. The adoption of tax transparency standards as a basis of appraisal should assist this process. The objective is to ensure data cannot be manipulated for political purposes. This requires that the integrity of the data needs to be established. This may require involvement from an outside panel of independent experts, representative of a wide range of stakeholder groups;
4. *Comprehensive* meaning that all required information is included and no data that might be of use to stakeholders is suppressed;
5. *Comparable*, meaning that the data can both be compared over time and with data from other jurisdictions. The adoption of a consistent reporting framework complying with an agreed standard would assist this process;
6. *Understandable*, meaning that the data is supplied in a way that a user can comprehend, is accompanied by adequate and appropriate explanation, and is published in a range of formats to assist this;

7. *Usable*, meaning that interpretation is encouraged by providing the information in free to access, readily accessible and in free data, machine readable formats.

### Secondary uses of tax transparency data

The information needs of the primary users of tax transparency data have been described. The desirable qualities of the information they need have also been explained. But, as previously noted, there are also secondary stakeholder users of tax transparency data. Three issues differentiate these secondary users from the primary users.

Firstly, although the secondary users want information to appraise what is happening within the tax system it is very unlikely they will require the detail of primary users. For example, whilst primary users will want information on how and why the total for each tax is made up, secondary users might well be happy to know figures in total. In addition, while primary users may want to understand how the tax gap calculations were arrived at, and what the composition of each part of that tax gap is, secondary users are more likely be happy with headline figures.

Secondly, it is unlikely that most secondary users will seek to personally interpret the tax transparency data they are supplied with. They will, instead, expect at least an initial interpretation to be included in the information supplied to them. This might trigger further interest from them, requiring interpretation on their part. In a reasonable system of tax transparency that is seeking to meet secondary users' needs, consultation should determine those needs and the data supplied. That will most often be in the form of broken-down totals or timeline data either in total or percentage form so that trends in data can be readily seen.

Thirdly, and as a consequence, the information to be supplied to the secondary users must anticipate reasonable questions they are likely to want answered, and to therefore provide information on these issues. A single or, a very limited range of reports are likely as a result to meet the needs of secondary users but the quality of that reporting must be high if the reasonable expectations of those stakeholders that make up this secondary user group are to be met. These are issues that will be referred to in more detail later in this report.

### Why disclosure of timely and high-quality tax information matters

This issue matters because tax transparency is a process. No single report, account, set of data, information or budget will ever, by itself, represent the totality of the tax transparency process. It is, instead, the supply of information from across the tax system that will create an effective tax transparency framework and process so that governments and tax authorities might be held to account for their effectiveness, in managing the tax system.

### What happens if this issued is not addressed

If the noted information is not supplied it is likely that a government and its tax authority will not be properly held to account for their management of the tax system of that jurisdiction. A less effective tax system in the jurisdiction in question is a probable consequence. This can be problematic if that gives rise to a failure on the part of the government to deliver its tax strategy. If that strategy, reflects priorities such as the redistribution of income and wealth, the repricing of market failure, the delivery of economic policy and the creation of an effective fiscal policy then enhancing tax transparency will likely increase the capacity to deliver those objectives, as transparency should also increase the information available on the realization of those objectives, highlighting what is working and what is not. The Making Tax Work project therefore

encourages greater tax transparency with a view to improving government's prospects of delivering on their tax policy objectives.

**Questions to ask about this issue when appraising whether or not the expected transparency framework is met**

- Is the government generally accepting of the need for tax transparency, including efforts to improve available tax data and evaluation of the performance of the tax system?
- Has the government committed (e.g. through legislation) to deliver data required to hold it to account for the management of the tax revenues of a jurisdiction?
- Has the government understood the different needs of primary and secondary users of tax transparency data, by producing basic headline and more detailed technical readings of data?
- Are procedures designed to meet the separate needs of primary and secondary users of data?
- Are the government's tax data commitments (point 2 above) upheld by law?
- Is government performance on the release of tax data monitored and reported upon?
- If the mechanisms for generating tax transparency can be shown to be incomplete, is there evidence that efforts are being made to remedy the deficits?
- Is the government encouraging feedback and providing platforms whereby users of the data can participate in discussions and put forward additional information needs?

## Making Tax Work

### Chapter 6

#### The Tax Transparency Framework

The Tax Transparency Framework is a high-level statement of policy.

The object of the Tax Transparency Framework is to set out those reports that should exist within a tax system if it is to meet the practices and standards of transparency that are required to assist all potential stakeholders attain the level of desired understanding about the ways in which the tax system is operating.

The Tax Transparency Framework is not an instruction manual. Nor is it intended to cover all the points that might arise when appraising tax transparency within a jurisdiction. It is intended to set out the minimum information required, with the aim of assisting those working to appraise and evaluate the levels of tax transparency in a jurisdiction, whether these levels are adequate and how they might be further enhanced, for example by moving to the advanced and aspirational categories set out in the previous chapter.

The Tax Transparency Framework set out in the following chapter explains:

- why the framework has been created in the form it has;
- what it is seeking to achieve, and;
- how that goal can be achieved using the data that the Tax Transparency Framework suggests should be made available to the stakeholders of any tax system.

#### The Tax Transparency Framework

##### A. Introduction

1. The proposals and standards developed here are to be referred to as the Tax Transparency Framework (TTF).
2. The TTF sets out the information required to appraise the tax transparency of a tax jurisdiction and its tax authority.
3. Tax transparency is defined as *the process that supplies the quantitative and qualitative data that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of its tax system.*
4. Tax transparency is required to meet the information needs of the stakeholders of a tax jurisdiction and its tax authority. The stakeholders are those both in and outside of government as noted in previous chapters.
5. The information needs of the stakeholders of a tax authority are considered to be that information which enables them to:
  - a. Understand what the tax system of a country involves and consists of;

- b. Appraise themselves of the law that has to be complied with and the practice of the tax authority in interpreting that law;
- c. Determine why that system has been chosen;
- d. Consider the budget setting process for the taxes that a jurisdiction seeks to collect and the decision-making implicit in that exercise and the reasons for it;
- e. Appreciate the costs of potential tax bases not taxed because a tax base has been left outside the tax system altogether or because of exemptions, allowances and reliefs that have reduced the value of a tax base that is otherwise subject to tax; (this as we have explained in the previous chapter is a more advanced form of tax transparency).
- f. Review the actual taxes generated as reflected in the accounting of the government for each financial year, and to evaluate trends therein and comparisons with the budget for that year as well as the amounts lost in each year to tax evasion, tax avoidance and unpaid taxes declared but not settled;
- g. Comprehend for each tax:
  - i. The number who might be liable to pay the tax;
  - ii. The number actually paying the tax;
  - iii. The amount paid by taxpayers, split into groups, bands or other rankings relevant to the tax base in question, together with the cost of the allowances, reliefs and exemptions that it is thought that each such group might enjoy;
  - iv. The total amounts of tax paid;
  - v. The breakdown of this data by relevant social criteria e.g. gender, age, legal status of the person paying (e.g. company, trust, individual, etc.), geographical location and residence status;
  - vi. Comparable data over time; (again the above falls into the more advanced category).
- h. Understand the total value of the resources provided by a government to a tax authority so that it might undertake the task of tax collection within its jurisdiction;
- i. Recognize the basis on which the tax authority has allocated resources to the task of collecting tax and to appraise the effectiveness of those actions by evaluating the record of the tax authority in collecting revenue relative to the criteria noted during a specified period and, by comparing budgets with outcomes, over time;
- j. Consider the effectiveness of penalties placed on taxpayers who are deemed not to have complied with their legal obligations, both as a deterrent, and through compliance levels as revealed in the ability of the tax authority to collect penalties levied. This also requires a consideration of what appeals processes are in place to ensure that a taxpayer has opportunity to challenge the decisions of a tax authority when they consider that the law has been inappropriately applied. (h-j advanced).

## B. Data requirements

For each annual accounting period a jurisdiction shall produce:

- a. A statement of tax objectives (this could take the form of a short policy note, a foreword/ executive summary, or a whole separate document) for the period explaining:
  - i. The total revenue that the government seeks to collect for the period in question;
  - ii. Why this sum has been decided upon, and with regard to which policy objectives;
  - iii. What assumptions have been made in preparing this revenue estimate and what the risk within those assumptions might be;

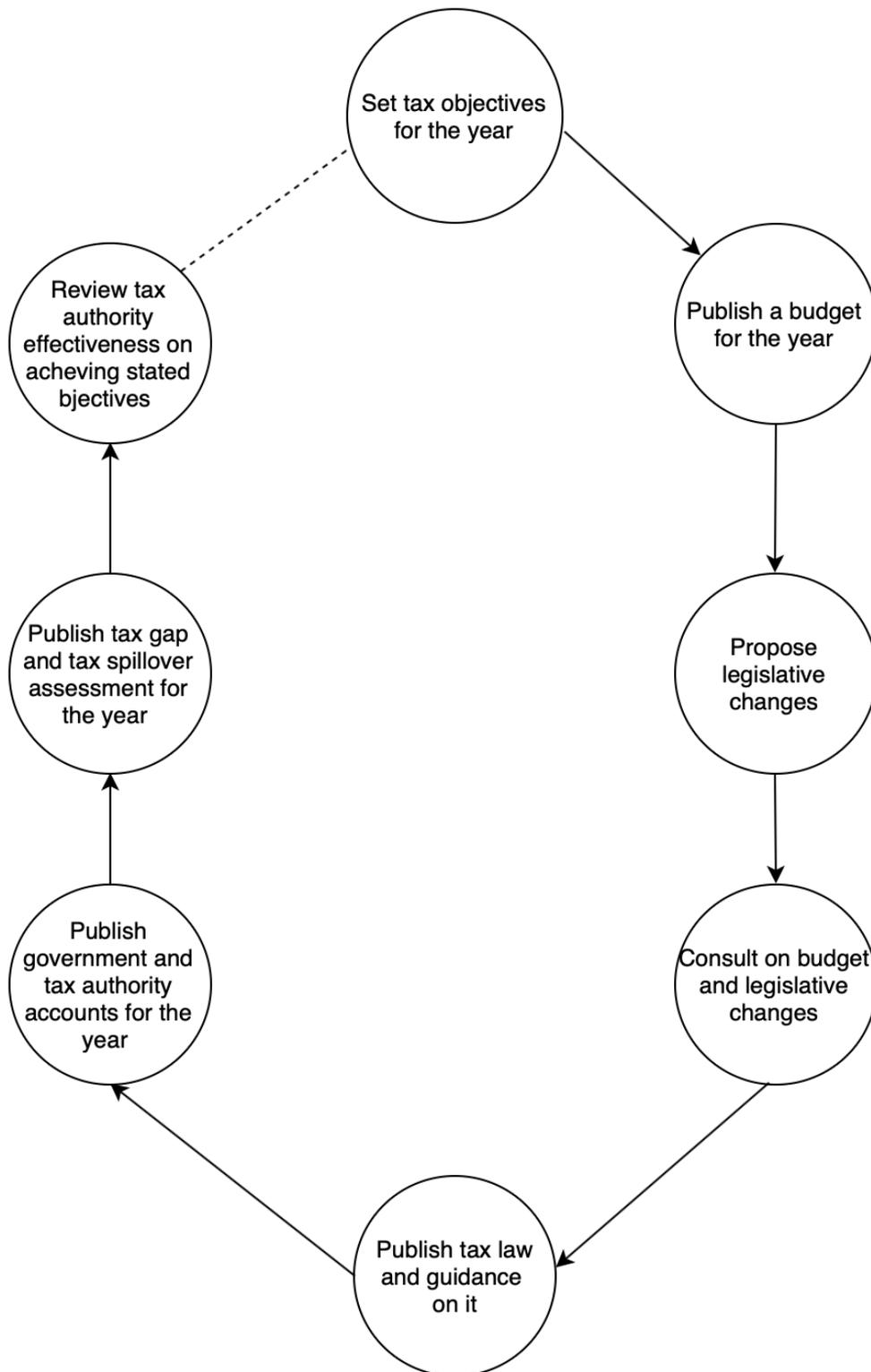
- iv. What social, economic and fiscal policy objectives are also to be reflected in the tax system for the period, noting the changes in these that have arisen since previous periods;
  - v. The overall level of resources to be provided to the tax authority in the period and the reason for deciding upon this sum;
  - vi. Any proposed changes to tax procedure or practice that might have material impact upon the operation of the tax system during the course of the period;
  - vii. How relationships between the tax systems, the tax authority and other agencies that might interact with the operations of the tax system, whether nationally or internationally are to be managed. This might, for example, require that a tax authority publish lists of those authorities with whom it has successfully exchanged information on taxpayer incomes arising of interest to each other in a year.  
(The above are all basic requirements with the last one moving into the intermediate category).
- b. A budget for the year stating tax revenues to be collected, in total, and in summary by tax and stating for each tax:
- i. The expected nature of the tax base for the period (e.g. volume of sales, number of people in the working population, etc.,) and reasons for change from the previous period including those arising as a result of policy decisions to extend or contract the tax base;
  - ii. What the proposed rates of tax are and a specification of the occasions when they will apply, noting the reasons for any change from the previous period;
  - iii. What reliefs, allowances and exemptions are to be given during the year; what each is worth and what changes are planned from previous years with detailed notes being provided as to the reasoning for such changes and their expected budget consequences;
  - iv. What the total expected revenue for the tax is;
  - v. Any doubts or uncertainties with regard to the budget that should be noted.  
(The above are a combination of intermediate and more advanced requirements.)
- c. Proposed legislative changes for the period:
- vi. Proposed changes to legislation should be published early enough for stakeholders with interest in the issue to make comment on the proposals to legislators before the changes are decided upon by the legislature. The process for engaging should be prominently advertised to encourage comment;
  - vii. Each change should have an accompanying explanation, providing detailed reasons for the change and what the implications of not making it might be to ensure that all stakeholders can understand the implications; (Under TTF the above fall into the intermediate category).
- d. The applicable tax legislation for the period in a readily accessible format that is free to access;
- e. The tax authority's guidance on what the tax law means in practice and how it will be applied during the period, together with their instructions on how the taxpayer is expected to comply with those requirements. This might, for example, require the

publication of guidance notes on particular laws or transactions that taxpayers find troublesome to apply. Alternatively, it might involve the publication of clearances provided to taxpayers on certain transactions, perhaps on an anonymized basis. In many cases this will simply require the maintenance of an effective website so that the taxpayer has their obligations explained to them in plain language. That material should also be available in printed form for those without internet access.

- f. An annual account prepared either by the government or its tax authority of the actual tax collected for the year in a format that makes comparison with the budget for the period and provides information on the following:
  - i. Tax income in total;
  - ii. Tax income by tax;
  - iii. A detailed breakdown by tax indicating:
    - The actual tax base for the period;
    - The actual number of taxpayers in the period;
    - The amounts of tax paid by groups of taxpayer banded as appropriate for the tax in question e.g. by income, or level of spend, or by wealth, or geographic area;
    - The actual value of tax allowances, reliefs and exemptions provided during the course of the year;
  - iv. The tax gap (gap between projected revenue and that actually collected) by tax for the year split by cause as follows, giving indication as to reasons for the loss arising, where possible:
    - Tax evasion
    - Tax avoidance
    - Unpaid tax (bad debts suffered by the tax authority)
  - v. The cost of collecting this tax, providing a breakdown in the costs of the tax authority for the year. This should be presented in the first instance in a format commonplace for any government department within the jurisdiction. It should also indicate the allocation of costs by tax, including the number of employees allocated to each tax and those officials engaged in investigations of those suspected of not settling their tax liabilities;
  - vi. All data should be compared in every case to the budget for the year and the prior year, with variances being shown;
  - vii. Narrative explanation of all major variations between actual income, budgets and prior years with indication given as to planned intended actions resulting therefrom; (the above fall into the advanced category).
  
- g. A summary account explaining the full accounts in straightforward terms so that as many people as possible have an opportunity to understand the tax system of the jurisdiction, how much tax it collects, what taxes contribute to that total and who pays how much; (Basic)
  
- h. A tax spillover analysis for the period that appraises the risks inherent in each major tax (at least the top five taxes by revenue for each period) plus other taxes on a rotating basis and all major aspects of the tax administration that might contribute to the effectiveness, or otherwise, of the tax system including the tax, company and trusts administrations of the jurisdiction as well as its overall tax morale; (Aspirational).

- i. A review of the effectiveness of the tax administration in investigating and settling claims and appeals in a period including the following, by tax:
  - i. The number of appeals against tax liabilities arising during the year,
  - ii. The total amount of tax liability disputed during the year;
  - iii. The number of such appeals settled during the year;
  - iv. The amounts agreed to be payable on the appeals settled during the year, and the amounts originally demanded in those cases;
  - v. The number of appeals outstanding at the year-end;
  - vi. The amounts originally claimed to be due on the appeals outstanding at the year-end date;
  - vii. The years to which those appeals relate;
  - viii. The amount that taxpayers agree to be due in the cases disputed, by year. (Advanced category).

This cycle might be summarised as follows, although it would be more complex than shown and might include more stages of consultation:



### C. Dates for data to be supplied

Tax transparency requires that data be timely. An example of a timescale for the provision of tax transparency is as follows, but could be adapted if a jurisdiction did not work on a calendar year basis:

Year 1 ends	31 December Year 1
Year 1 tax transparency data is all published by	31 July in Year 2
Budget information for year 3 is published by	31 October in Year 2
Year 3 Budget is approved by	31 December Year 2 (and ideally, earlier than that)
Year 3 commences	1 January Year 3

### D. Ancillary data

To support the Tax Transparency Framework a jurisdiction shall publish on a timely basis national economic data required to appraise the effectiveness of the tax authority including:

- National income accounts in accordance with the generally accepted international framework;
- Population data, including data on:
  - Population by age;
  - Population by location;
- Economic data, including:
  - Employment data, including by type and by sector;
  - Family and individual income data;
  - Savings, wealth and other data;
  - Asset data e.g. numbers of houses, cars, and other key economic indicators.

This data is required to enable better analysis of tax revenue data.

## Making Tax Work

### Chapter 7

#### Choosing the Tax Base

The tax base refers to the range of transactions and activities that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base would involve relatively few transactions and activities. How government decisions shape and structure tax bases rarely receives the attention it deserves. This decision-making involves four issues. The first is which available tax bases (such as income, wealth, sales, land, and so on) are taxed. The second is what allowances, reliefs and exemptions are provided that effectively reduce parts of the tax base. The third is who is subjected to these taxes. The fourth are decisions governments reach on where to set tax rates. This section looks at these issues as a means of bringing discussion of them into the public domain.

These decisions are part of the basic tax decision making process of any jurisdiction. As such the information referred to in this chapter is part of what might be considered basic tax transparency data.

#### 1. Introduction

As previously noted, there are at least five reasons why a government charges tax. These are, in no particular order of priority, to:

1. Raise revenue to suit the government's needs;
2. Ratify the value of the currency of the jurisdiction;
3. Redistribute income and wealth;
4. Reprice goods and services;
5. Reorganize the economy through what is called fiscal policy.

The reason for noting this is to make clear that any decision on the tax bases that the government might decide to charge to tax is not an issue that solely relates to the amount of tax that might be raised as a result. Many other factors need to be taken into consideration. This makes the process of understanding the resulting decision making more complex, but also enlightens debates on tax policy that could be catalysed and informed by a full system of tax transparency.

## 2. The available tax bases

The range of tax bases that a government might consider include:

<b>Broadly described tax base</b>	<b>Possible tax bases within the broadly defined tax base</b>
Wealth	<ul style="list-style-type: none"> <li>• Wealth, land and buildings, investments, savings, and significant physical property e.g. artwork and similar items</li> </ul>
Transactions related to wealth	<ul style="list-style-type: none"> <li>• Gifts</li> <li>• Profits on sales of assets</li> <li>• Land taxation</li> <li>• Financial transaction taxes</li> </ul>
Sales	<ul style="list-style-type: none"> <li>• General sales taxes</li> <li>• Specific sales tax</li> <li>• Value added taxes</li> <li>• Levies</li> <li>• Excise duties</li> <li>• Tariffs</li> <li>• Charges for services supplied</li> <li>• Royalties e.g. in the extractive industries</li> </ul>
Income	<ul style="list-style-type: none"> <li>• Employment income</li> <li>• Profits from trade</li> <li>• Pensions</li> <li>• Rents</li> <li>• Investment income</li> <li>• Income from trusts and settlements</li> <li>• Social security charges</li> <li>• Profit from the sale of assets</li> <li>• The receipt of gifts</li> </ul>
Financial transactions	<ul style="list-style-type: none"> <li>• Bank levies</li> <li>• Financial transaction taxes</li> <li>• Transaction fees e.g. stamp duties</li> </ul>
Land	<ul style="list-style-type: none"> <li>• Wealth taxes</li> <li>• Land value taxes</li> <li>• Rents</li> <li>• Development taxes</li> <li>• Land occupancy charges</li> <li>• Service fees</li> </ul>
Tourism	<ul style="list-style-type: none"> <li>• Entry charges</li> <li>• Airport duties</li> <li>• Air travel taxes</li> </ul>
The environment	<ul style="list-style-type: none"> <li>• Carbon taxes</li> <li>• Taxes on waste</li> <li>• Air travel taxes</li> </ul>

### 3. How to choose a tax base

Just because a tax base exists does not mean that it is right or correct to tax it. That process is a multi-stage exercise that needs explanation by any government seeking to be tax transparent. The stages are:

- a. Deciding why it is appropriate to tax the base in question, which is an exercise that requires consideration of the five reasons for tax previously noted, only one of which relates to the ability of the tax base to raise revenue;
- b. Defining the tax base: consideration of the exemptions, reliefs and allowances to be given is not a straightforward exercise;
- c. Making sure that it is possible to find what is to be taxed. This is important: if the tax base cannot be accurately located then there is no point trying to tax it. Most especially, tax injustices can arise when some people are taxed, while others evade liability because of the ease with which a tax base can be hidden from view;
- d. Ensuring that the tax base can be counted. Unless a tax base can be measured in monetary terms it is almost impossible to charge a tax.

### 4. Weighing up the options

Applying the logic noted so far to the various tax bases that have also been noted to exist suggests that an appraisal along the lines of that shown in the following table might help explain the choices made by tax authorities in determining those bases that they wish to tax. A transparent tax system would confirm these findings:

Tax	Revenue	Ratification	Redistribution	Repricing	Reorganising	Allowances	Finding the tax base	Counting the tax base
<b>Wealth tax</b>	Low	Low	High	Low	High	Complex	Hard	Hard
<b>Wealth related taxes:</b>								
Gifts	Low	Low	High	Low	High	Complex	Hard	Possible
Profits on assets	Low	Low	High	Moderate	Moderate	Complex	Hard	Possible
Land tax	Moderate	Moderate	High	High	High	Easy	Easy	Easy
Financial transaction taxes	Moderate	High	High	Low	High	Easy	Easy	Easy
<b>Sales related taxes:</b>								
General sales taxes	High	High	Low	Moderate	Low	Moderate	Moderate	Easy
Specific sales taxes	Moderate	High	Moderate	High	High	Moderate	Moderate	Easy
Value added taxes	High	High	Low	Moderate	Low	Moderate	Moderate	Easy
Levies	Moderate	High	Low	High	Moderate	Moderate	Moderate	Hard

Excise duties	Moderate	High	Low	High	Moderate	Moderate	Moderate	Hard
Tariffs	Moderate	High	Low	High	Moderate	Moderate	Moderate	Hard
Charges	Moderate	High	Low	High	Moderate	Moderate	Moderate	Easy
Royalties	Moderate	High	Moderate	High	Low	Low	Moderate	Hard
<b>Income related taxes:</b>								
Employment income	High	High	High	Moderate	High	Complex	Moderate	Easy
Profits from trades	High	High	High	Moderate	High	Complex	Hard	Hard
Pensions	High	High	High	Low	Low	Moderate	Easy	Easy
Rents	Moderate	High	High	Moderate	Moderate	Complex	Hard	Hard
Investment income	Moderate	High	High	High	High	Complex	Hard	Easy
Trusts	Moderate	High	High	High	High	Complex	Hard	Easy
Social security	High	High	Low	Moderate	Moderate	Moderate	Moderate	Easy
Profits on assets	Low	Low	High	Moderate	Moderate	Complex	Hard	Possible
Gifts	Low	Low	High	Low	High	Complex	Hard	Possible
<b>Financial transaction taxes:</b>								
Bank levies	Low	High	Moderate	Moderate	Moderate	Moderate	Easy	Possible
Financial transaction taxes	Moderate	High	High	High	High	Complex	Moderate	Easy
Stamp duties	Moderate	High	Moderate	High	Moderate	Easy	Moderate	Easy
<b>Land taxes:</b>								
Wealth taxes	Moderate	Moderate	High	High	High	Easy	Easy	Easy
Rents	Moderate	High	High	Moderate	Moderate	Complex	Hard	Hard
Development taxes	Low	Low	High	High	High	Complex	Hard	Hard
Occupancy charges	Moderate	Moderate	Low	Moderate	Moderate	Easy	Easy	Easy
Service fees	Moderate	Moderate	Low	Moderate	Moderate	Easy	Easy	Easy
<b>Tourism</b>								
Entry charges	Moderate	Moderate	Low	Moderate	Moderate	Easy	Easy	Easy
Airport duties	Low	Low	Low	Moderate	Moderate	Easy	Easy	Easy

Air travel taxes	Low	Low	Low	High	High	Easy	Easy	Easy
<b>Environmental taxes</b>								
Carbon taxes	Moderate	Moderate	Low	High	High	Hard	Hard	Hard
Taxes on waste	Low	Low	Low	High	High	Easy	Easy	Easy
Air travel taxes	Low	Low	Low	High	High	Easy	Easy	Easy

The ratings or indications provided are merely indicative. They will vary from country to country. What, however, the process suggests is that the taxes for a jurisdiction can be appraised in this way. By ranking taxes in this way the overall effectiveness of a tax authority in choosing its tax bases can be compared to its stated objectives and this can become a viable constituent part of tax transparency. To assist this process it would be possible to substitute a relatively simple numerical ranking, from no more than one to five, for the more descriptive ones offered in the above table. This would assist and enable a comparison process.

The same process could be extended to major allowances and reliefs, particularly with regard to the taxes that are significant in revenue terms. So, for example, with regard to income taxes various commonplace allowances, such as:

- an annual personal allowance,
- a marriage allowance,
- child allowances,
- deductions for pension costs,
- mortgage interest allowances, and
- allowances for the costs of commuting to work, uniforms, work-related membership fees, and the like.

All of the above should be appraised for these purposes. It would also be possible to appraise the more esoteric allowances that most jurisdictions provide, alongside such things as reduced rates for investment income.

These processes would necessarily be tailor-made to particular jurisdictions, which is why an example is not included here, but could be undertaken in a fashion similar to the table noted above with the overall objective of making sure that the actual systems in operation aligned with the stated objectives of the tax authority and the government of the day. An (entirely fictitious) example might be:

Allowance, exemption or relief	Revenue impact	Ratification	Redistribution	Repricing	Reorganising	Allowances	Finding the tax base	Counting the tax base
Annual personal income tax allowance	High	Low	High	Low	High	Simple	Easy	Easy
Marriage allowance	Moderate	Low	Moderate	Low	Moderate	Simple	Easy	Easy
Child allowance	High	Low	High	Low	High	Moderate	Moderate	Possible

Pension cost allowance	High	Low	Low or negative	High	Moderate	Complex	Moderate	Possible
Mortgage interest allowance	High	Low	Moderate, and may be negative	High	High	Moderate	Easy	Possible
Allowances for travel to work	Moderate	Low	Low or negative	Moderate	Moderate	Complex	Complex	Hard

## 5. Who might be taxed?

Determining a tax base does not resolve all the issues involved in the design of a tax. Deciding who will actually be subject to the tax is also necessary and is not always straightforward. A great many variables are involved in this process, and arrangements are rarely consistent between jurisdictions. So, for example, income taxes on trading are frequently different depending on whether the trade is undertaken by a person in their own name, or within a company. There can be further differences depending upon whether the trade is also undertaken by a trust, or charity. The point is illustrative, but important.

The principle decisions to be made on who might be subject to a tax usually depend upon the following issues, but can vary from country to country:

Factor	Consequence
Legal status	Companies, trusts, foundations, charities, partnerships and other structures may be subject to different taxes than natural people might be.
Age	The young and the elderly may be subject to differing tax regimes from the rest of the population.
Marital status	Allowances may be available to married persons not available to others.
Gender	Many countries have required that a single person within a married relationship have responsibility for its tax declarations and this has frequently denied women equal representation within tax systems.
Residence status	Whether a person is usually, occasionally or only temporarily resident in a country frequently has a significant impact upon their taxable status within a country, with differing rules applying in each case.
The source of the income	Similar types of income derived from sources within or from outside the jurisdiction can have very different tax treatments.

Considering these issues is important. The purpose of tax transparency is to ensure that a government's objectives for the tax system are fulfilled, and few governments deliberately set out to create loopholes within their tax systems that can be abused by those who wish to avoid their obligations (although the possibility of government capture by well-organized interests groups is real). If, however, inappropriate decisions are made on those who might be taxed, loopholes can arise.

For example, incentives can be created to incorporate, at cost to society.

Alternatively, marriage and even children could be encouraged, or discouraged, by the tax system when many might think that decisions on these issues should be taken for other reasons.

In some cases it is clear that human rights are impacted by the tax system. Most commonly, but not entirely, the rights impacted are those of women. For example, there still remain tax systems where women are denied the right to declare their own incomes and must do so as part of a family unit for which their husband is responsible.

Prejudice towards, or against, migrants and other minorities can also create stresses in society which it is unlikely that a tax system would wish to exacerbate. The failure to address issues in the languages that migrants might use is one example of this prejudice, often increasing their risk of making tax error for which they could be penalised.

For all these reasons understanding why some people and entities are taxed, while others are not, is important because perverse incentives to undermine the tax system can arise if consistency on these issues is not present, which makes this an issue of tax transparency that should be monitored and reported on.

## 6. Deciding on rates

It is important to recall that the raising of revenue is not the sole purpose of taxation. The finance minister of French monarch Louis XIV, Jean-Baptiste Colbert, supposedly once said that “the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.” Many governments still have this attitude in the 21<sup>st</sup> century but as has been noted, revenue raising is only one of (at least) five reasons a country has to tax.

Without ignoring the other reasons, in almost every single case when tax rates are being considered there are issues relating to income and wealth distribution, product repricing and economic reorganisation to consider, although as noted previously, the significance given to each of these issues might vary considerably depending upon that tax under review. So, for example, redistribution plays little role when considering most tariff rates, which are usually flat rate charges, but is deeply significant when considering income tax rates where multiple rates of tax can be used depending on the total income of the person involved.

This said, the aim of the tax system is usually to be progressive overall whilst considering the other objectives also noted. This does not mean that each tax must, itself, be progressive. Progressiveness is, for example, a very difficult objective to achieve with regard to general sales taxes and value added taxes. This is because almost by definition the wealthy do not spend all of their income, whereas those on low incomes, who also tend to have little wealth, frequently spend almost everything that they earn. As a consequence, sales taxes are almost invariably regressive in proportion to income, which is the only acceptable basis on which progressiveness and regressiveness can be defined. To address this issue those taxes that can be progressive, - income tax, capital gains taxes, wealth taxes, some aspects of land taxation, and sales taxes targeted at products or services mainly consumed by those with higher income, can be used to compensate for the lack of progressive tax rates in general sales taxes, value-added taxes, tariffs and excise duties.

What this does, however, mean is that there is no fixed formula for appraising how tax rates must be set for any jurisdiction, or for any tax within a jurisdiction. Instead it is only possible to

offer some suggestions for the questions that might be considered when considering this issue, which are:

- a. What has the government said its objectives with regard to the total tax take are? Are those objectives being fulfilled, implying that at least to some extent appropriate tax rates are being charged?
- b. Does the government have stated intentions with regards to the other objectives for taxation e.g. redistribution? If so, does it specify these in a formal sense? For example, does it specify a target Gini coefficient, which is a statistical measure of economic inequality, both before and after tax, with the difference between the two being a measure of the impact that the tax system has on this issue? Is the government's goal with regard to reducing economic inequality achieved? Measuring this variation in Gini rates provides an opportunity to appraise this.
- c. Does the government in question state any other objectives for the tax system that might be capable of delivery through the setting of higher or lower tax rates e.g. the encouragement of employment by the use of low social security charges? Is actual policy consistent with these stated objectives? Another policy area in which this issue might be significant is with regards to the repricing of products that are carbon intensive e.g. fuel and air travel. Are tax rates consistent with any stated objectives in these areas?
- d. Does the government state its intention with regards to the overall tax rates that should be paid by each decile of income earners as the indication of its objectives with regard to progressivity?

In the absence of stated objectives, alternative indicators e.g. broader political statements, might have to be used as indicators of intent in this area. In the absence of detailed national accounting information on income distributions or in the absence of information on taxes paid by decile, either based upon survey data or tax return information, this type of analysis can be very difficult to achieve. Care should be taken from placing too much emphasis on published headline tax rates because these can be significantly distorted by the availability of tax reliefs, allowances and exemptions, many of which are only of use to those on higher incomes in many tax systems.

## 7. Designing allowances and reliefs

Tax rates do not by themselves determine the potential yield from a tax. In a simple world of single tax rates that yield (Y) could be expressed as:

$$Y = B \times R$$

B is the value of the tax base and R is the tax rate. However, as has already been noted, tax rates need not be consistent across the whole tax base if progressive tax systems are to be created, whilst not all the tax base is usually subject to tax because of the availability of tax reliefs, allowances and exemptions (A). So, even if there was just one tax rate this formula would have to be modified to read:

$$Y = (B-A) \times R$$

A would in this case represent the value of those tax reliefs, allowances exemptions that are provided by a government. The value of those allowances, reliefs and exemptions when multiplied by the appropriate tax rates becomes the tax expenditure gap, which is explored in the tax gap section of this Guide. Because the cost of these reliefs can be significant (in the UK

for example, they amount to more than 36% of total potential tax revenues or 55% of actual tax revenues)<sup>3</sup> the design of them has a significant impact on the overall effectiveness of any tax system.

As with tax rates there is, however, no consistent basis for comparing tax reliefs and allowances between jurisdictions. Each country has to design its own tax system to suit its own particular social and economic needs. It cannot be presumed that what is appropriate in one jurisdiction, is necessarily appropriate in another. Discretion and a degree of cultural sensitivity will need to be exercised in evaluating and appraising this aspect of a tax system, but it should be a necessary component part of tax transparency. This does not mean that general rules for undertaking such a review cannot be suggested. The following guidelines are appropriate:

- a. As noted elsewhere within this report, a government should have a stated tax policy which should cover its policy on tax allowances, reliefs and exemptions;
- b. Each allowance, relief or exemption should have a stated policy reason for its existence. That should state what economic, social or fiscal objective it serves, and how that will be assessed;
- c. The estimated cost of the allowance, relief or exemption should be stated, and the basis of the calculation should be provided;
- d. A date by which the allowance, relief or exemption will be subject to review should be specified to ensure that such allowances, reliefs and exemptions do not continue without review once first introduced;
- e. This data should be cross referred to tax gap data and reporting;
- f. The potential for abuse within the relief, allowance or exemption should be identified and the methods adopted to mitigate such risks should be specified, while recognising that this is an area where differences of interpretation are possible.

If this information is provided in a freely accessible format it should be possible to appraise the tax allowances, exemptions and reliefs of a jurisdiction.

## 8. Working out how to collect the tax

Having a tax system that works well on paper is one thing: having one that works well in practice is another. The practical design of a tax system is, therefore, a matter of considerable practical importance from the perspective of tax transparency.

As has been noted in previous sections, it is inappropriate to assume that the design of a tax system that is suited to one country is necessarily suited for another. Tax systems must always be adapted to local situations, cultures and preferences. There is, as a result, no one size that fits all with regard to this issue of tax system design: local considerations have to be taken into account. That being said, there are some guidelines as to good practice which should generally apply in any country and which can be used as part of efforts to achieve tax transparency:

- a. Is the tax legislation of a jurisdiction readily available, and free to access?

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<sup>3</sup> Baker, A., & Murphy, R. (2020). Modern Monetary Theory and the Changing Role of Tax in Society. *Social Policy and Society*, 19(3), 454-469. doi:10.1017/S1474746420000056

- b. Are the interpretations that the jurisdiction's tax authority makes of that legislation readily available and free to access so that people know what legal requirements they are expected to comply with?
- c. Does the tax authority provide clearly written, free to access and readily available guidance to the taxpayers on the obligations with which they should comply if they are to make a settlement of all their tax liabilities as required by law?
- d. Is the documentation supplied by a tax authority for the purposes of declaring tax liabilities free to access, easy to understand, available for completion in formats that are accessible to all within the community (including those not able to read and those who suffer other communication difficulties) and online for those who have the opportunity to make declaration this way?
- e. Is the tax authority able to identify all those who should make a declaration of tax liabilities e.g.:
  - i. all those likely to be of working age;
  - ii. all businesses;
  - iii. all companies;
  - iv. all partnerships;
  - v. all trusts;
  - vi. all charities?
- f. Are the requirements for registration for other taxes e.g. value-added taxes, land taxes, tariffs and excise duties, and so on, readily available to those who might be required to comply with them?
- g. Does the tax authority have standard procedures for reminding those who might have obligation to pay tax that they have a duty to do so e.g. by sending them tax returns for completion and then chasing letters or other communications?
- h. To what extent does the tax authority assist the process of tax payment by requiring tax deduction at source before a person receives taxable income e.g. of the following types:
  - i. income from employment;
  - ii. interest;
  - iii. other investment income;
  - iv. rents.

There is compelling evidence that tax deduction at source considerably improves the rate of tax compliance in many tax jurisdictions;

- i. To what extent does the tax authority require businesses and other entities to act as agents for the collection of tax e.g. with regard to sales taxes, tariffs, excises and other fees and charges? There is, again, considerable evidence that this can increase the overall rate of tax collection.
- j. How efficient is the tax authority at seeking to recover tax liabilities that it thinks to be due and owing and when the taxpayer has failed to declare them?
- k. Are appropriate checks and balances in place to ensure that a tax authority cannot demand tax liabilities that they think to be owing when there is no evidence to support that claim? How robust, efficient and fair are appeal procedures against estimated tax assessments? Is the appeal process independent of the tax authority and free of corruption?
- l. How rigorous is the tax authority in seeking to recover tax liabilities declared but not paid and does it undertake this activity on a timely basis to enhance the chance of recovery?

The extent to which these suggestions are complied with will have a significant impact upon the overall effectiveness of a jurisdiction's tax system and as such should be considered as part of an overall appraisal of tax transparency.

## Making Tax Work

### Chapter 8

#### The role of businesses in tax transparency

Businesses have a special role to play in tax transparency. This is partly because of their important role in the mixed economies that are found around the world, where their function as generators of value added and profit is an issue of particular interest when it comes to taxation. It is also because businesses do in many economies have a significant role to play as collectors of both direct and indirect tax liabilities, in which role they are effectively agents of government. The fact that limited liability entities (and some other forms of entity capable of creation under statute law) are also mechanisms that can be abused to create opacity also requires that attention be given to them when considering tax transparency. These differing dimensions, and the need to manage them, need to be considered in a tax transparency framework.

#### The business as the generator of economic activity

The business sector within any economy generates a significant part of many of the tax basis that a government will wish to subject to taxation. The tax bases which will largely arise within the business community are:

- Sales revenues, whether of generic or specific type (e.g. oil revenues or other sources within the extractive industries, carbon taxes, and other targeted taxation charges);
- Employment income (including from self-employment);
- Business profits;
- Dividend income;
- Business property taxation;
- Capital gains arising from the sale of interests in businesses;
- Wealth taxes on the benefit of owning interests in business entities.

In many jurisdictions these will form the majority of the taxation revenues arising to a government. This fact, in itself, does imply that the proper recording of the activities of business undertakings is critical to the creation of a tax transparency within any jurisdiction.

#### The business as tax collector

In addition to its role as the generator of many tax bases, in many jurisdictions business entities are given the task of being unpaid tax collectors on behalf of the government of the jurisdiction in which they are located. In particular, they are often responsible for the collection of:

- Indirect taxes e.g. on sales;
- Taxes arising upon employment;
- Taxes due upon profits;
- Withholding taxes due upon a variety of payments including interest, royalties and dividends;
- Taxes due on particular types of income e.g. that from the extractive industries.

### The business as a supplier of information

On occasion businesses are also responsible for supplying information to governments that might help determine the tax liability of others. These occasions include:

- The supply of data on employees' income;
- Information on payments made e.g. of interest, royalties and dividends;
- Details of share and property transactions;
- Data on sales made as an agent e.g. from an internet platform.

Some of this information supplied might be with regard to those persons resident within the jurisdiction where the business is itself located, and some might be for exchange with tax authorities in other jurisdictions. Businesses can, as a result, be integral to the ability of a tax authority to fulfil its international obligations.

### The consequences for tax transparency of the significance of business within any jurisdiction

As is apparent from the issues noted, the ability of a government to secure relevant, reliable, timely and comprehensive data from businesses within its jurisdiction is critical to its overall success in managing the tax system for which it is responsible, and so in turn for the adequacy of its tax transparency.

The size of the tax gap within any jurisdiction is likely to be heavily related to the success of this relationship between a tax authority and the businesses that it has to regulate. If there is lax business regulation then it is very likely that the scale of the tax gap in a jurisdiction will be higher than would otherwise be the case.

This same failing would also likely lead to significant problems in managing the overall macroeconomy of the jurisdiction because in the absence of relevant and reliable data on the scale of that economy it is likely that inappropriate decisions might be made. Almost every aspect of macroeconomic management, including on the role of tax within the economy, is therefore dependent upon the success of this relationship. Determining a successful basis for this relationship is, therefore, key to tax transparency.

### The appropriate relationship with business

If business plays such a significant role within tax then any government has to plan an appropriate relationship with it as part of its tax transparency agenda. The commitment does, however, have to be mutual. A government does have to commit to being transparent with business. In turn, business has to be committed to being transparent with government.

It is, however, stressed that this is not a situation without mutual advantage. Governments do, of necessity, require taxation revenues. Many businesses, like individuals, see this as an imposition upon them, whilst accepting the inevitability. What, however, business also requires is what is commonly described as a 'level playing field'. What this means is that business expects that if tax is to be paid then that tax will be imposed fairly on all businesses operating within the marketplace so that no one business can secure a competitive advantage as a consequence of either abusing tax law, or as a consequence of official favour. This is an approach entirely consistent with the economics of market competition. Since only government can create this level

playing field it is in the interests of business to cooperate with government in pursuit of this goal. There is, then, not just a mutuality of obligation within the idea of tax transparency, but a mutuality of benefit as well.

The suggestions that follow on the appropriate relationship between government and business are built on this understanding.

### The obligations of a government with regard to tax

If a government is to be transparent about its obligations with regard to tax with business then it must:

- Follow the recommendations made elsewhere in Making Tax Work with regard to the management of its own tax budgeting and accounting. It is impossible for a government to expect business to be open, transparent, and accountable to it if it does not reciprocate with its own transparent accounting for the tax revenues that it manages. A government must set an example by following best practise.
- To expect from business only that information that is strictly necessary for the purposes of ensuring that tax compliance takes place<sup>4</sup>. This might require considerable effort on the part of the tax authority to ensure that systems of tax declaration are made as simple as possible to encourage maximum compliance.
- Be open as to its legislative plans, and to be open to consultation upon them for reasons explained elsewhere in Making Tax Work. Businesses may not vote, but they are managed, owned and staffed by people who might well do so and the way in which legislation might impact upon them is an issue on which they have a right to be heard.
- Make sure that business has access to all the information that it needs to comply with the requirements of a jurisdiction's tax system. Most of those tax systems will be complex. It is beholden on a government to make them as simple as possible and at the same time to provide every assistance that it can to ensure that businesses have best chance of complying with the requirements that the law expects them to fulfil. Investment to achieve this goal is an essential part of a plan for tax transparency.
- To impose penalties only when it is appropriate to do so, and there is evidence of clear fraudulent intent. Too many tax systems impose penalty upon innocent error, and this is very unlikely to encourage tax compliance, or tax transparency.
- To allow reasonable deadlines for compliance.
- To afford appropriate opportunities for appeal against taxes that it is thought are unfairly imposed, and to do so in a manner that the business is likely to be able to afford to use.
- To provide a well-trained, cooperative and efficient tax compliance service in its tax authority to manage the agreement of the tax affairs of businesses;
- To provide easy mechanisms for tax settlement on a timely basis.

### The broader obligations of government

Any government has to appreciate that business does not exist to pay tax, however important the tax obligations that it gives rise to might be. In addition, a government must appreciate that

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<sup>4</sup> Tax compliance is defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

accounting systems are also not designed solely to support the payment of tax and that they have other, as significant, purposes. It is as a result important for a government to appreciate that the tax obligations that it imposes must fit into a broader range of obligations that a business has to its management, its owners, its staff, to third parties and to the societies in which it operates. Measures that are inconsistent with these other obligations are unlikely to assist the delivery of an effective tax transparency framework.

This point being noted it is important for the benefit of all these stakeholders, but most especially staff, third parties and civil society, that some of the requirements that a tax authority will impose upon business be complied with. So, for example, it is important that a government does establish and publish the information below with regard to any business, however large or small, so that those who engage with it can appreciate with whom they are trading, and so have and means of recourse against it. Likewise a tax authority will require this information. In short, the information below relates to business transparency for the purposes of tax, that place on public record issues of beneficial ownership and help to ensure fair transparent procedures are contributing to a level playing field where business taxation is concerned.

- A register of all businesses including details of:
  - The business name;
  - The person or entity that owns the business;
  - The place at which they may be contacted;
  - Other contact details e.g. phone, email and website;
  - The nature of the trade;
- In the case of limited liability entities trading within a jurisdiction the following additional information:
  - The name of the entity;
  - Its registered number;
  - The country of incorporation if not within the jurisdiction itself;
  - Its registered office;
  - Its place of business, if different;
  - The identify of its directors or other senior management;
  - The identities of all persons owning more than 5 percent of the entity;
  - The identity of the person (whether human or legal) controlling the identity if such a person exists;
  - The issued capital of the entity;
  - The constitution of the entity;
  - The accounts of the entity that give a true and fair view of its trading and financial position including:
    - A narrative explanation of the trading activity undertaken during a period;
    - An income statement or profit and loss account;
    - A statement of affairs or balance sheet;
    - A statement of cash flow or source and application of funds;
    - Notes as necessary to provide sufficient information to understand these reports including tax due and paid;
    - An explanation of the accounting framework used to prepare the accounts in question;
    - Such additional information (not required for public record) as tax authorities require.

These requirements will need to be adapted to suit circumstances in each jurisdiction. If, for example, some form of self-employment is commonplace in a country and the tax system is such that few if any of the resulting enterprises would create a tax liability then demanding registration by those businesses may be unnecessary. A threshold for registration, probably based in turnover, might instead be appropriate in that case.

It would seem that no such exemption should apply in the case of limited liability entities though. The creation of such entities is deliberate, and such is their significance in the tax base of any jurisdiction that it is essential that their registration be required.

It is also essential that the other data noted to be required from limited liability entities be registered in public record. Limited liability creates the risk of moral hazard from the transfer of trading losses onto the creditors of companies and society at large. This risk has to be mitigated by the provision of data on the activities of companies.

That risk also needs to be mitigated by the imposition of an audit requirement on limited liability entities. Whether that be required for all entities or only for those above a chosen size is a matter for each jurisdiction to decide upon. The risk of fraud increases if any exemption is offered.

Any such audit is, however, only useful if the accounting framework on which it is based meets the need of the stakeholders of the reporting entity. Whilst there are examples of generally accepted accounting frameworks that might be used as models for this purpose (e.g. International Financial Reporting Standards and local variants based on this designed for smaller and more local companies in places like the UK) many of these standards quite explicitly state that they are not intended for tax use and that tax authorities must make their own accounting adjustments if they wish to secure accounting data for their purposes.

This suggestion by those standard setters is unfortunate since it implies that a second set of accounts should in effect be prepared for tax accounting purposes when that would impose a wholly unnecessary burden on business. It is also unnecessary when there is no reason why accounts cannot be made fit for tax purposes. When one of the primary users of the accounts of smaller entities, the world over, is tax authorities the preparation of an accounting standard likely to meet their needs which would simultaneously be both simple to prepare and understand whilst also meeting the needs of management, shareholders and other stakeholders would seem to be long overdue. Only UNCTAD has got close to considering this issue<sup>5</sup>, but its work does not attract the attention that it deserves, and there are some improvements that could be made to it. In the absence of any other standard their work could, however, provide a current basis for required reporting for the smaller enterprises that will dominate financial reporting in most countries.

The accounting framework adopted must be designed to give greatest likelihood that tax bases are properly identified. This will, for example, require disclosure of, in addition to the information required by those standards that focus solely on shareholder or business-owner need:

- A description of the business;
- Revenues, analyzed by type if there is a range of activity undertaken;

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<sup>5</sup> <https://isar.unctad.org/financial-reporting/>

- Payroll costs;
- Interest, royalties and other similar items paid;
- Profit before tax;
- Dividends;
- Asset purchases and disposals;
- A list of the business premises used;
- Details of all subsidiary entities;
- Details of related party entities.

This data will significantly increase the likelihood that tax is paid.

This data, plus appropriate financial reporting information, will also help inform the macroeconomic understanding of the economy of the jurisdiction.

Most importantly by being on public record this data will also help business mitigate its own bad debt risks, which can be vital to business and economic stability. In this way data required for tax transparency can be used to provide critical information for business decision making and so add value to the business community. This might also increase the effectiveness of capital allocation decisions within the economy in question. The spin off from a drive for tax transparency are likely to be a much stronger private business sector within a jurisdiction.

### **Business and other taxes**

In their role as unpaid tax collectors businesses interact with government on a wide range of taxes, as already noted. It is, therefore, essential that business is as aware of its obligations with regard to these taxes as it is of its obligation to pay tax on its profits.

Without singling out any one tax for special consideration, the essence of making these taxes work is to ensure that the data due with regard to them can be collected and submitted by business in the simplest form possible. Taxes are rarely simple, but the need to ensure that tax can be paid accurately and on time has to be taken into consideration when complexity is introduced into any tax system. In some countries online payment systems might help this process considerably, but they have to be designed to match local IT infrastructure and as yet are unlikely to be generic as a result. If paper forms are required instead the means to return them on a timely basis must be made available. In all cases tax authorities must make support available to those required to comply with these systems to provide them with maximum chance to do so effectively. This might be considered a key part of tax transparency.

### **Mitigating tax abuse**

All the positive aspects of the relationship between business and government having been noted, it is an undoubted fact that there are some businesses that seek to abuse this relationship, and who seek to pay less as a consequence in tax than they might owe if they were wholly tax compliant. Both tax avoidance and tax evasion are commonplace within the business sector<sup>6 7</sup>.

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<sup>6</sup> Internal Revenue Service Commissioner Charles Rettig told a Senate committee hearing on Capitol Hill on April 13 2021 that noncompliance rates are less than 5% when the IRS has information from third party sources that it can use to check taxpayers' filings. Without such information, only 45% of unreported income ends up taxed. <https://www.wsj.com/articles/the-1-trillion-tax-evasion-opportunity-11618955569>

<sup>7</sup> See Chapter 11 for further discussion of these issues.

The measures taken to tackle this abuse are issues of concern within a Tax Transparency Framework. This is because an effective tax system requires public confidence that all are being treated equally within the tax system, and both tax avoidance and tax evasion act to undermine that confidence. As a result measures to tackle such abuse are essential if confidence in the tax system is to be maintained. This in turn requires that there is publicity about those measures, or the steps taken will not have the desired deterrent effect. As such tackling tax abuse is a key component in a Tax Transparency Framework.

Within large companies much of this abuse comes from the arbitrage that is commonplace between tax and accounting rules, with income and expense recognition frequently being different in each meaning that they can be played off against each other. Alternatively, the abuse is based on manipulation of international tax rules e.g. transfer pricing abuse, which remains commonplace despite the introduction of counter measures such as country-by-country reporting<sup>8</sup>. The availability of sufficient staff to use data supplied from such reporting mechanisms is now key to eliminating this abuse, as its effective dissemination to all countries that need it, which OECD processes do not guarantee. These abuses are generally best described as tax avoidance. Given the attention given to them in recent years, which is still ongoing<sup>9</sup>, it is resource mobilisation within tax authorities to tackle the issue at a domestic level that is of most importance with regard to these issues.

Amongst smaller entities the abuse usually arising is more appropriately described as tax evasion. The non-reporting of income by small and medium sized entities appears to be commonplace. Expenses may also be overclaimed. However, at least as significant as either issue is the simple non-declaration of income by a corporation, altogether.

The latter issue was common when easy access to incorporation within widely recognised tax haven jurisdictions was matched by an almost complete veil of secrecy that was deliberately maintained by these locations to hide the activities of these companies from view, justifying their description as secrecy jurisdictions<sup>10</sup>. Recent measures taken by the OECD to require automatic information exchange from such places<sup>11</sup> has lifted significant parts of this veil of secrecy. It may now be the case that many tax authorities might receive more information on the activities of entities owned by their tax resident persons in locations such as the Cayman Islands than they do with regard to the entities that those same persons own that are incorporated in their own jurisdiction. The main challenge left with regard to tax haven entities is now having the resources available within the tax authority to use the information supplied from offshore.

The threat of non-disclosure of income does now come in three parts in that case:

- a. Under declaration of income by an entity that does, however, make a return and which is registered within the jurisdiction;
- b. Total non-compliance of an entity trading within the jurisdiction but which chooses not to disclose any of the relevant information to tax authorities;
- c. Non-compliance, whether partial or absolute by entities incorporated in a third party jurisdiction where information collection and sharing arrangements are weak.

<sup>8</sup> <https://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.htm>

<sup>9</sup> See, for example, <https://www.nytimes.com/2021/04/07/business/economy/biden-tax-plan.html>

<sup>10</sup> We define secrecy jurisdictions as places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain with that regulation being designed to undermine the legislation or regulation of another jurisdiction and with the secrecy jurisdictions also creating a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so.

<sup>11</sup> <https://www.oecd.org/tax/automatic-exchange/>

There are a number of ways to tackle this issue.

The first is the maintenance of an effective business register of the type already described in this chapter. These are not commonplace, and are frequently hard to access, or are outsourced to private sector entities such as Chambers of Commerce that have little incentive to maintain them or enforce disclosure requirements. It is also quite common for these registers to be maintained by local and regional governments, which also makes both enforcement hard and access to reliable information in a format that is easy to match with taxpayer records difficult. Central registers in the form suggested, with a string enforcement regime is essential to tax transparency in any jurisdiction as a result.

Second, pressure needs to be brought to bear on third party jurisdictions where information collection is far from complete. For example, whilst the UK has well in excess of 4 million companies in existence only around half of these actually file tax returns each year, with the rest having provided assurance that they are non-trading, without being expected to provide any evidence to support that claim. In addition, around 400,000 companies are removed from the UK register of companies each year, mainly because of their failure to supply legally required returns, including accounts, for which legal failure there is no effective legal follow up barring dissolution of the companies in question. No one knows how many of these entities might have traded before they are dissolved because there is no mechanism to find out. Automatic information exchange from the UK is likely to be incomplete as a result. It is very unlikely to be alone.

Third, appropriate measures need to be taken to tackle tax evasion by corporations registered within the jurisdiction. The most effective means for doing this is to extend the idea of automatic information exchange. This would require that a jurisdiction demand the annual automatic exchange of domestic information from banks, accountants, lawyers and other financial intermediaries to tax authorities take place with regard to the legal entities to which they have supplied services during a year. The data to be exchanged would be:

- a. The name and registered number of the corporation to which they have supplied services;
- b. The address at which they correspond with that entity;
- c. The names and full addresses, dates of birth and nationalities of those persons who they have accepted as having authority to take action with regard to the account;
- d. The names and addresses, dates of birth and nationalities of those persons who they have identified as the beneficial owners of the company in question as required by money laundering regulations;
- e. If a bank:
  - i. The number of the accounts that they maintain for the company;
  - ii. The numbers of any other accounts that they know are maintained for the company, and who those accounts are maintained with;
  - iii. The total sum deposited in the accounts of the company that they maintain during the year; and
  - iv. The aggregate year end balances on those accounts.

The aim is straightforward. It is to provide the 'smoking gun' information that a corporation would know was then available to a tax authority to make enquiry as to its affairs if data is not supplied by it. The power of a tax authority to investigate should be backed up with the right

to remove the protection of limited liability from officers and members of the company to ensure that the moral hazard created by limited liability is negated. Tax transparency necessarily requires that opacity be removed.

### The international dimension of business activity

Most of the comment made so far in this chapter has deliberately focused on domestic taxation issues related to business taxation. This is because this aspect is likely to be the biggest contributor to revenue from this source in most jurisdictions. International dimensions need only complicate this to a relatively limited degree since most entities to be subject to tax in a jurisdiction, even if engaged in international activity, will actually be resident within it since this is normal business practice now.

International dimensions arise because of:

- The ownership of local business activities by persons resident in other jurisdictions;
- International transactions, most especially with related parties;
- Financial flows, whether of investment, capital returns including interest and dividends, with third parties located outside the jurisdiction;
- The identification of related parties outside the jurisdiction, most especially in tax havens.

These issues have in recent years all been subject to significant attention for the OECD, in particular. There is little point in reiterating their progress on tackling abuse on these issues here. What is important is that in the interests of creating an effective tax transparency framework that a jurisdiction:

- Participate in the Organisation for Economic Cooperation and Development's automatic information exchange programmes to the greatest degree possible;
- Participate in information exchange on country-by-country reporting by multinational corporations as organised by the OECD.

These programmes do not eliminate the risk of illicit financial flows, but they mitigate it. That is the best that can be hoped for within a tax transparency framework at present.

## Making Tax Work

### Chapter 9

#### Citizen engagement with tax transparency

One of the surprising developments within tax in the last twenty years has been the increasing engagement of civil society with this issue. Many of the demands for tax transparency now being made have originated within the tax justice movement, and the various organizations, NGOs, CSOs and charities that have been linked to it, but goes beyond this to cover groups seeking to reduce corruption and prevent basic human rights abuses. The result has been an increased political awareness of this issue.

This development needs to be reflected within the tax transparency agenda. When once tax was primarily preserve of those with a technical, professional or business interest in it (the latter principally as significant taxpayers, as referred to in chapter 8) it is now necessary to presume that the audience for tax related issues also includes a wide range of interests within civil society and politics, reflecting concern right across the social and political spectrums of many societies.

This chapter considers ways in which this issue should be addressed and ways in which this engagement can be advanced, as well as considering the ways in which the interests of taxpayer confidentiality and the special role of the tax whistleblower, which has emerged as an issue during this period, need to be protected. The role of tax advisers and their intermediary status within many tax systems also needs to be considered.

#### Civil society, tax consultations and tax authority management

Civil society now plays an active part in the development of tax thinking. Nowhere has this been more evident than in the development of the international tax agenda, much of which (including automatic information exchange, beneficial ownership disclosure and country-by-country reporting) are all based on demands made by civil society<sup>12</sup> by 2005, even if they have taken somewhat longer to deliver. This suggests that the traditional view that the management of tax within a jurisdiction is an issue only of primary concern to its government and a limited number of professionally qualified persons is now likely to be wrong. Two consequences follow.

The first is that the input of civil society organizations into tax consultations should be welcomed. An effective Tax Transparency Framework is dependent upon this happening. However, it is very often the case that civil society organizations, while able to identify the problems with a tax system, do not have the resources or relevant detailed expertise, to submit to tax consultations. Unless this issue is addressed it is almost inevitable that tax consultation processes will result in bias towards some groups in society as they will be heard more often than others, with resulting biases in the tax system itself potentially arising as a consequence. It is suggested that this issue needs to be addressed in a jurisdiction seeking to secure balanced opinions on its tax system. Since securing funding to partake in such processes is often hard, a tax authority seeking to eliminate such distorted consultations should make grants available for those who might need them to be able to make a submission. Care in selecting recipients will be important,

<sup>12</sup> [https://www.taxjustice.net/cms/upload/pdf/tujyc\\_eng\\_web\\_file.pdf](https://www.taxjustice.net/cms/upload/pdf/tujyc_eng_web_file.pdf)

with a particular bias being shown towards those groups in society whose interest might not otherwise be heard. Tax transparency would require that the recipients of all such grants must have their details published, linked to the resulting submissions with an account of how the funding was used.

Second, if it is the practice of the tax authority to encourage external participation in its own management (and in the interests of tax transparency this is to be encouraged) then representation from civil society should be actively sought. This will have a significant impact upon the perception of the openness of the tax authority.

### Right to taxpayer confidentiality

While Making Tax Work addresses the issue of tax transparency it is important to note that it should be presumed that all taxpayers have a right to confidentiality with regard to their affairs unless specific circumstances require otherwise. The key qualification to this are a number of exemptions detailed below.

#### *Corporate and Limited Liability Exemptions*

As noted in Chapter 8, registers of businesses are necessary to ensure that those undertaking trade can be identified. This should not be considered a breach of taxpayer confidentiality.

Nor is the disclosure required with regard to the affairs of limited liability entities referred to in the same chapter considered a breach of taxpayer confidentiality. The use of limited liability entities, and the protections that they afford, are a privilege that provides protection to those taking advantage of them. This justifies the disclosure of the information referred to in chapter 8.

#### *Exceptional Transactions and Sweetheart Agreement Exemptions*

The undertaking of exceptional transactions that might as a consequence be identifiable within the national accounts of a jurisdiction should also not automatically be considered a breach of taxpayer confidentiality, even if a taxpayer can be recognized as a result. The above applies to cases or countries where it is commonly argued that tax data cannot be published, because a few or even one company dominates a particular type of tax revenue e.g. in the extractive industries. The need for national accounting data with regard to taxation is usually of higher priority than the demand for taxpayer confidentiality in such cases.

The making of agreements for the settlement of tax outside the normal course of tax legislation is also an occasion when taxpayer confidentiality should be suspended<sup>13</sup>. Such issues again commonly arise in countries where certain large players in extractive industries dominate, but they have also been present in advanced countries, for example in the last two decades in agreements between Goldman Sachs and the United Kingdom's HM Revenue & Customs, and the notorious secret agreements between Apple and Ireland. If such agreements are reached then they do in effect become a specific variation in the law and there should be a duty placed on governments to publish the facts surrounding such matters, and to disclose the parties to them.

#### *Criminal and Dispute Settlement Exemptions*

The right to taxpayer confidentiality should also be considered to be foregone in the event that a criminal prosecution of a taxpayer is considered necessary.

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<sup>13</sup> These appear most prevalent in the case of the extractive industries

A state should also reserve for itself the right to publish details of large non-criminal tax settlements reached with taxpayers who have entered into contractual agreements to settle tax disputes relating to past tax affairs. The publication of such information is in the public interest to deter others from undertaking tax abuse in the various ways in which it is possible, even if prosecution did not result. Such disclosure is a necessary part of a tax transparency framework, but a taxpayer at risk of having their affairs disclosed in this way should be given prior notice of a tax authority's intention to publish their details.

The above exemptions aside, the state does have a duty to protect taxpayer confidentiality and to prosecute those who might breach this duty, subject to the points made in the next section on whistleblowing.

### Whistleblowers

Corruption is an unfortunate fact of life and no tax transparency framework will eliminate it. In that case mechanisms to identify its existence are essential within a tax transparency framework.

Whistleblowing is one such mechanism, but is one that carries particular risk for the whistleblower. Their situation does require particular consideration in that case.

Whistleblowers might come from within the tax authority itself, revealing the existence of corrupt officials, or they might come from beyond it, where their actions might reveal the activities of a corrupt taxpayer.

Care has to be taken with all information provided by a whistleblower. The possibility that they might themselves be corrupt and are appearing to whistleblow when they have other motives is a possibility. However, in general the risk from whistleblowing is so high that very few would undertake it lightly. As such there is a duty in all tax authorities to provide mechanisms to both permit whistleblowing and to protect the identity of a whistleblower, to ensure their personal safety, and to reward their efforts and the risk that they take in the public interest. Of these the first two are paramount, with the third an additional issue, although not insignificant in itself. Each requires consideration.

Attitudes towards the payment of rewards to whistleblowers for information that they supply that results in the recovery of tax legitimately owing is always a sensitive matter. In some jurisdictions such payments are considered routine. For example, in the USA it is customary for the Internal Revenue Service to pay up to 30% of the tax recovered as a result of information provided by a whistleblower and there is a well-structured whistleblowing program that encourages such disclosures to be made<sup>14</sup>.

In contrast, the UK makes such payments exceptionally, and without any formal programme being in place. Payments rarely exceed a tiny proportion of tax recovered from investigations in each year. News reporting suggests that the idea of whistleblowing with regard to tax remains unpopular within society<sup>15</sup>.

<sup>14</sup> See for example discussion on this here <https://constantinecannon.com/practice/whistleblower/whistleblower-types/whistleblower-reward-laws/irs/>

<sup>15</sup> See <https://www.cityam.com/snitches-get-riches-hmrc-payments-to-tax-evasion-whistleblowers-up-63-in-2019-20/>

The point both positions make clear is that these tax authorities both know that whistleblowers can provide information that is of use to them but that there is no settled opinion on how to manage this issue.

On balance a tax transparency framework does need to formalize a whistleblowing program. There should be secure mechanisms available for the supply of data, whether by post, in person, by telephone or online. In every case there must also be secure arrangements made to protect whistleblowers. They act in the public interest and as such should enjoy the protection of the state. That such protection is provided should be made clear to those contemplating disclosure.

The provision of information through third parties who will be provided with legal privilege when passing on that information should also be considered. Such persons would normally be lawyers, though other authorized tax agents might be considered for this role (see the separate section in this chapter on the role of these agents). If that is the case, the possibility of making disclosure through such a route, with an added layer of security for the whistleblower being supplied, should be made known. The privileged status of these agents should be protected in law.

The payment of a fee for whistleblown information supplied has always to be at the discretion of the tax authority. There is a conflict between the rights of the whistleblower, who may well need to know that compensation is on offer to justify the economic and other risks that they take by whistleblowing, and the right to privacy that the taxpayer about whom disclosure has been made enjoys. This means that disclosure of the scale of any settlement made to the whistleblower may be inappropriate. Instead, a scale of rewards, ranging from minor to significant, with a range of payments to be made depending on the status given to the size of the recovery made may be more appropriate than a payment directly related to the size of recovery achieved by the tax authority. This being said, in the case of substantial settlements the compensation to be paid should be significant, but insufficient to encourage corruption or malicious disclosure. Abuse of the disclosure scheme for profit should be capable of prosecution, and agents would need to be aware of this when assisting those making disclosures if this route is permitted, but those agents should always be exempt from prosecution if they acted in good faith.

The special case of whistleblowers who make disclosure of activities within the private sector that draws attention to tax abuse of which the tax authority might never have been aware but for the whistleblower's actions and who take the risk of disclosing their own identities in the course of drawing attention to this abuse requires careful consideration in every jurisdiction. A taxpayer has the right to confidentiality. A taxpayer does not, however, have the right to abuse the tax system of a jurisdiction. As such, so long as it can be shown that the whistleblower acted in the public interest and that the actions that they disclosed either did, or could have, rightfully resulted in additional tax being due (this second provision being necessary to protect the right of the taxpayer, who is usually entitled to enjoy privacy with regard to their affairs, including whether or not a tax settlement is owing) then the whistleblower should be granted automatic protection for prosecution or legal claim for damages from the person with regard to whose affairs they have whistleblown, and the state must enact legislation to guarantee this. The whistleblower should also be exempted from prosecution for theft of the whistleblown data in such cases.

### **The role of professional advisers**

Few tax systems can operate without the assistance and cooperation of professional tax advisers. While it should be the aim of a tax authority that an individual taxpayer should be able to fulfil their tax declaration and payment obligations without the assistance of professional

advisers this is rarely going to be true for larger businesses and those with complex financial affairs.

The role of the tax adviser, whether acting solely in an advisory capacity, or as agent for the submission of tax returns, or as advocate in the settlement of tax disputes, is not one that should be ignored by any state. That is partly to protect the tax authority from abuse by unscrupulous tax advisers, but at least as much to ensure that those who seek to use the services of a tax agent are also protected from abuse.

For this reason a register of tax advisers should be maintained by a tax authority, and be published and be updated regularly.

Those seeking to offer advisory services should prove they are competent to do so. This might be by professional examination. Alternatively, it may be appropriate for those seeking to offer advice solely to smaller enterprises and private individuals to be examined on their competence by the tax authority itself. The amount of effort expended in doing so would be amply rewarded by time saved dealing with incompetent agents, whilst public trust in the system of tax advisers would increase significantly as a consequence.

Tax advisers should be respected by the tax authority, and be afforded the same confidential treatment that is provided to their clients. However, in exchange for the privileged access to clients that they will secure as a consequence of being included on the list of recognised tax agents approved by the tax authority they should be required to provide ethical undertakings<sup>16</sup>, the breach of which might result in their prosecution or removal from that list.

Without being exhaustive, that list should include undertakings:

- not to sell tax avoidance products;
- to always make full disclosure with regards to their clients' affairs so that the information provided to a tax authority is always sufficient to properly determine the tax liability that the client in question might owe; and
- to refuse to act on behalf of clients who they become aware have made mistakes in their previous tax disclosures, whether deliberately or otherwise, and who refuse to make disclosure of them. The whistleblower provisions noted elsewhere in this chapter should apply to tax agents in this circumstance and the public should be made aware that tax agents are required to make such disclosures, which would also leave tax agents at risk themselves if they failed to make such disclosures when they were aware of them.

It would be entirely reasonable for a state to require that tax agents dealing with the more complex clients should have professional indemnity insurance with regard to the activities that they undertake and that they also undertake continual professional training, which they should evidence.

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<sup>16</sup> An example of a Code of Conduct that might be appropriate is available here [https://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code\\_short.pdf](https://www.taxjustice.net/cms/upload/pdf/AABA-TR-Code_short.pdf)

## Making Tax Work

### Chapter 10

#### Tax transparency in government accounting

One of the most important objectives of tax transparency is ensuring that those who must make decisions on tax policy have the information that they need. In this context it is, of course, vital that a government and a tax authority have such data. It is also important that those who hold them to account are also in possession of this information. Legislators, taxpayers and the residents of a jurisdiction need access to the accounts of both their government and its tax authority to ensure they can fully appraise what is happening within the tax system, and therefore reach judgements on whether it is being appropriately managed.

This section consequently focuses on the accounting requirements of a government and its tax authority. It pays particular attention to the information that legislators might need and works on the basis that if they have the data that they need then it is likely that other stakeholders might have access to it as well.

The information described in this chapter is considered to be basic to an effective system of tax transparency: every country should aspire to have the information that this chapter refers to.

#### 1. Basic information requirements

If the legislators of a jurisdiction who are not in government are to hold the government to account then there is some information that they must have. This data relates to the normal budgeting and reporting cycle of a government. It is comprised of:

- A comprehensible budget for a period;
- Comprehensive government revenue reporting for that same period preferably during it, but most definitely after that period has ended;
- Appropriate reporting on government expenditure during that same period;
- Support information to appraise the information supplied with regard to revenues received (and expended, although that is not the primary issue of concern here) so that the appropriateness, or otherwise, of the sums declared can be appraised;
- An audit report for a period, including an expression of opinion on whether the tax authority has fulfilled its obligations during the course of the period in question.

Each of these issues is considered in more depth in the sections that follow.

#### 1. Budgets

The essential qualities that the budget and related accounting data that the legislators of the jurisdiction should receive for review must have are that they should be were discussed in Chapter 6. The suggestions made there are not repeated here.<sup>17</sup>

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<sup>17</sup> Numerous guidelines have been published, setting international information standards, including:

- International Monetary Fund (IMF)'s Fiscal Transparency code and manual
- International Public Sector Accounting Standards Board's Handbook on International Public Sector Accounting Pronouncements 2016
- IMF's Government Finance Statistics manual 2014

## 2. Government revenue reporting

Appropriate accounting for government revenues requires that:

- a. All sources of revenue, including those from natural resources, including those not expected to be derived from tax, be reported in sufficient detail to ensure that:
  - The source can be identified;
  - The source is explained;
  - If the matter is of an unusual or non-recurring nature then sufficient detail to enable that it be understood is provided;
- b. If any revenues relate to the sale of assets it should be stated if this relates to a material portion being sold, or if the asset is sold in total, and include information on:
  - What is being sold;
  - Its original cost;
  - The reason for sale;
  - The revenues being foregone over the following ten year period as a result of the sale;
  - The use for the anticipated proceeds of sale;
- c. The key accounting policies with regard to the reporting be disclosed;
- d. Comparable data for the previous two periods be supplied plus restatements, if appropriate;
- e. A comparison with the budget be supplied, with variances being indicated;
- f. Key variations from outcomes in previous periods and budgets be explained.

With regard to tax revenues, in particular, it is necessary to have the following data (and past data and budget data on the issues in question, so that comparison can be made):

- g. The theoretical yield expected for each tax for each period: this is the anticipated yield assuming that there are no allowances and reliefs provided for offset against liabilities in respect of the tax base in question and there is no tax abuse. The assumptions underpinning these calculations should be published;
- h. The cost of all the major reliefs and allowances that reduce the theoretical tax yield. These are what are technically described as 'tax expenditures'. They make up what is also called the 'tax policy gap'. These tax expenditures represent the amount that the government

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- United Nations' System of National Accounts 2008
  - European System of Accounts 2010

Other tools including those used for transparency compliance monitoring, include:

- Global Initiative for Fiscal Transparency's High level transparency principles
- Fiscal Transparency Evaluation (framework for evaluations provided by fiscal transparency code)
- Public Expenditure and Financial Accounting Framework 2001
- Organisation for Economic Co-operation and Development's Best Practices for Budget Transparency and Budget Transparency Toolkit
- International Budget Partnership's Open Budget Survey

decides to give away in tax reliefs, exemptions and allowances to promote social, economic, industrial and other policy objectives. The justification for each relief, exemption and allowance should be specified to justify its continuing provision. The sum for each year needs to be compared with prior years and budgets;

- i. The actual anticipated revenue from each tax should be stated. This sum is the theoretical yield less the cost of reliefs, exemptions and allowances and less the tax that will not be paid, whether because of tax evasion, tax avoidance or the taxpayer not making settlement. These last three items make up the tax compliance gap. The tax compliance gap should be stated separately for each tax and its anticipated breakdown between tax evasion, tax avoidance and taxpayer non-settlement should be specified. The reasons for the assumptions made should be stated.

### 3. Necessary data on those the government expects to tax

Tax cannot be collected unless a number of criteria are met. These are that:

- a. The tax base can be properly defined;
- b. The tax base can be located;
- c. The ownership of the tax base can be identified;
- d. A legal claim can be successfully made to require that the tax be paid;
- e. The tax can be recovered from the taxpayer if they refuse to make settlement.

Appraising the effectiveness of a tax system involves establishing whether:

- i. A tax authority has correctly identified the risks that exist in the definition of its tax base. Regular reports should be required in this issue. These reports will focus on efforts made to tackle tax avoidance, since that is the most likely form of attack on a tax base, rather than abuse that arises from ignoring it. There are a number of ways in which this data can be collected, but the most effective mechanism agreed upon by many tax authorities is a legal requirement that those using tax avoidance arrangements be required to register them with the tax authority and then notify their use on tax returns. An example of such a scheme is the UK's Disclosure of Tax Avoidance Scheme's (DOTAS) rules. These are not commonplace throughout the world as yet, but should be encouraged as best practice when there is no alternative in place, which is rarely the case. As the UK's HM Revenue & Customs note:

*Under DOTAS certain people must provide information to HMRC about avoidance schemes within 5 days of the schemes being made available or implemented. Usually the person providing the information will be the promoter of the scheme - the person who designs or markets the scheme. But you must still notify HMRC if you're a user of a scheme (usually the promoter's client).*

*The legislation imposes a number of tests to determine if disclosure is required. Briefly these are:*

- *Are there arrangements which are expected to provide a tax advantage?*
- *Is getting a tax advantage expected to be one of the main benefits?*
- *Does the scheme fall within one of a number of descriptions, called 'hallmarks'?*

*There are 8 hallmarks aimed at new and innovative schemes, marketed schemes and targeting specific schemes, for example, loss schemes.*

The existence of such a scheme permits the appraisal of risk in this area.

- ii. The tax authority has in place all appropriate data that might identify those with liability to pay tax. Basic data on matters such as the following is essential for this task:
  - population, its age and gender profile and likely location;
  - ownership and tenureship of land;
  - national income, and its likely distribution;
  - identity of all companies both existing and trading within the jurisdiction;
  - identity of other possible income earning entities e.g. foundations, trusts and charities;

Such measures are necessary to tackle tax evasion.
- iii. The tax authority has in place all appropriate data sharing agreements that might identify those with liability to pay tax. They might include:
  - Participation in country-by-country reporting information sharing for tax purposes;
  - Participation in OECD standard automatic information exchange agreements with as wide a range of jurisdictions as possible;
  - The creation of equivalent domestic information exchange from sources such as banks, credit card providers, payment platforms such as PayPal, trading platforms such as eBay, financial services providers and those other agencies that might help identify those with taxable sources of income or gains;
- iv. In the context of the above noted issues it is very important that there is an effective company registry for the jurisdiction that maintains records on:
  - the identity of all limited liability entities, trusts, foundations, charities, and other arrangements formed as a result of statutory provisions that trade or undertake potentially taxable activity in the jurisdiction whether incorporated within it or elsewhere;
  - The beneficial ownership of such entities;
  - The accounts of all such entities;
- v. In the event that the tax liabilities of limited liability entities are not paid there are mechanisms available to breach the protection of limited liability so that in the event of abuse those persons permitting such abuse are liable for the tax owing.

Annual reporting on these issues should be a normal part of tax authority reporting to enable the parliament to which it is accountable to hold it to account.

#### **4. Government expenditure reporting**

This issue is addressed in chapter 6.

## Making Tax Work

### Chapter 11

#### Tax gaps

A framework for tax transparency can be assisted and deepened by the appraisal of tax gaps. This is data that is not readily accessible, but requires the application of an appropriate methodology to generate estimates (the same also applies in the case of tax spillovers assessments). The kind of data generated is intended to facilitate, catalyze and enhance societal understanding and policy debate about the performance of a tax system. Tax gap data for a jurisdiction is an estimation of the difference between the tax revenues that its tax authority could potentially collect and the tax revenues it actually recovers during the course of a specified period (often this is an annual tax gap). Tax gap analysis seeks to establish and calculate this difference.

Relatively few countries publish tax gap analyses at present<sup>18</sup>. Most countries that do so are in Europe or North America. Approaches to doing so vary at present. Within a Tax Transparency Framework tax gap data can inform and spark policy debate, as to how a tax system can be improved in terms of the level of additional revenue that might be collected.

Within the tax transparency framework tax gap analysis is, as explained in chapter 5, an advanced technique. The more basic elements of tax disclosure by government, as previously documented, are required to provide the necessary data for a tax gap analysis to be undertaken. A note is added at the end of this chapter on the more limited form of tax gap exercise undertaken on VAT or other sales taxes alone, which can provide a useful indicator of the scale of some tax gap issues at a less advanced level than the overall suggestion for aggregate tax gap analysis made in this section.

There are five tax gaps that can be measured:

- Tax base gaps;
- Tax expenditure or tax spend gaps;
- Tax evasion;
- Tax avoidance;
- Tax known to be owing but not settled i.e. unpaid tax.

Tax base gaps represent the cost of tax bases that a jurisdiction decides for its own reasons not to tax. Wealth is a common tax base that is not taxed, but there are many other examples.

Tax spend / expenditure gaps represent the cost of the exemptions, allowances and reliefs granted within tax bases that are otherwise subject to tax.

The tax evasion gap is the tax cost of the illegal non-declaration of income, that should be taxed, by a taxpayer or the tax cost of their illegal claim for a tax exemption, allowance or relief to which they are not entitled.

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<sup>18</sup> See Murphy, R. 2021. 'Reappraising the Tax Gap'. Chapter 4 In Unger, B. et al, 'Combating Financial Fraud and Empowering Regulators' 2021, Oxford: Oxford University Press.

The tax avoidance gap is the tax cost arising from a taxpayer arranging their affairs in such a way that they pay less tax as a result of their manipulation of the tax laws of a jurisdiction in a way that the tax authority of that jurisdiction thinks is contrary to the spirit of the laws in place.

The unpaid tax gap is the tax cost of sums known to be owing to the tax authority that are not paid e.g. due to the insolvency of a taxpayer before payment can be collected.

The total tax gaps of a jurisdiction relate to each other and can be appraised like this:

Total potential tax collectible within a jurisdiction	T
Less: Tax base gaps	(B)
Less: Tax spend gaps	(S)
Theoretical tax due in accordance with the law of a jurisdiction during the course of a period	D
Less: Tax evasion gap	(E)
Less: Tax avoidance gap	(A)
Less: Unpaid tax gap	(U)
Tax actually collected	C

It is important to note that a tax gap can be appraised for any individual tax or for the tax system as a whole.

Tax spillover analyses (which are the subject of a separate section within this Guide) explain the ways in which the design or administration of a tax system, as well as related aspects of law, can contribute to the creation of tax gaps. Tax spillover analyses identify ways in which tax gaps arise and can subsequently be addressed.

### Why tax gap analysis is important

Tax gaps are a critical issue for those with an interest in seeking to understand:

- The effectiveness of the management of a national economy;
- The success of a government in delivering its social, economic and fiscal priorities through the tax system;
- The efficiency of a tax authority;
- The effectiveness of the rule of law in a jurisdiction;
- How a tax system can be improved to enhance the probability of tax compliance on the part of those who should be paying tax within a jurisdiction.

As explained when considering the role and purpose of tax there are many more aspects to the impact of tax within a national economy that go beyond revenue raising. Tax, as noted, has at least five functions:

- Raising revenue
- Ratifying the value of a currency by requiring payment of tax in a national currency that incentivizes its use for most transactions in a jurisdiction;
- Redistributing income and wealth;
- Repricing goods and services;
- Reorganizing the economy through fiscal policy.

Measurement of tax gaps is, then, not just about determining whether or not the government has succeeded in raising the revenues that it planned: tax gap measurement is also about appraising the success, or otherwise, of a government in fulfilling whatever other objectives it has chosen for itself.

That said, the primary focus of most tax gap analysis focuses on revenue management. This section focuses on this issue, but then notes alternate ways in which the resulting data might be used for other purposes.

### Considering the various tax gaps

There is not one tax gap, but five. Each has significance for appraising the decisions made by a government in managing its tax system. Each is now considered in turn.

#### 1. Tax base gaps

The range of potential tax bases available to any government have been noted in the section on choosing the tax base.

The tax base gap estimates the amount of potential tax foregone by a government as a consequence of choosing not to tax one or more of those bases.

It is stressed that this means that the tax base gap does not relate to exemptions granted **within** a tax base, but that it does instead refer to the **total exclusion** of a possible tax base from taxation. So, for example, the exemption of **one part of income** from tax **does not** create a tax base gap: that cost would instead be included in the tax spend gap. The **total exclusion** of income from the tax base would, however, **create** a tax base gap.

Examples of potential tax bases that are commonly excluded from tax within jurisdictions include:

- Many aspects of wealth taxation;
- Land value;
- Gifts.

There are, however, many other taxes that are excluded from the tax base of at least some countries, including on income, sales and capital gains.

The first task when appraising the tax base gap is to determine which tax bases are excluded from taxation: overall, this should be one of the easiest tasks in tax gap appraisal.

The more complex task is to estimate the tax lost on this base. This is harder for three reasons:

1. The base is, by definition, not taxed, so estimates of its value are not always readily available. Resort has, in many cases, to be made to estimates. These are commonly based on one or all of these sources:
  - survey data;
  - data from national income accounts, and;
  - third-party sources e.g. on average land values.

2. There is no established tax rate for a base that is not taxed. This is problematic. This issue can be addressed by:
  - Considering rates applied in countries with broadly similar economies that do charge the base in question. Data from sources such as the OECD<sup>19</sup>, EU<sup>20</sup>, World Bank<sup>21</sup>, KPMG<sup>22 23 24</sup> and other equivalent firms, help for this purpose;
  - Considering the rates used in other areas of tax within the jurisdiction that may be of broadly similar type;
  - Using a 'standard' rate of tax for the jurisdiction, e.g. its basic rate of income tax applied to the affairs of most taxpayers as a proxy for a rate to be applied to other tax bases if that is reasonable in the case being considered.
  
3. The number of potential taxpayers is hard to appraise when no attempt to collect data on them has been made because the potential tax being considered is not actually collected. However, survey data and information from other data sources e.g. on home and land ownership and wealth, or from national income accounts for sales and income bases, can be used.

What has, inevitably, to be understood is that any estimate of value of the tax bases not subject to tax using any of these methodologies will always be subject to quite wide degrees of variation in the estimates that can be made. In the interests of transparency it is important in that case that:

- As much transparency as possible on the bases of estimation made, is provided;
- All sources for data are noted so that replication of estimates made can be undertaken;
- Estimates are published as ranges;
- It be made clear that the resulting reported tax gaps are published as a basis for discussion and not as a forecast for revenue that might be generated.

This is not to belittle the significance of undertaking this work. The range of tax bases that will be subject to estimation for this tax gap will vary widely between states. That, though, is precisely the reason for considering this gap. It facilitates comparison between states. It also encourages debate on how a government and tax administration is to fulfil its various objectives for the tax system. In addition, it makes clear that thinking beyond the boundaries of the existing system is at least possible, even if no action follows. In effect this tax gap challenges the idea of there being 'no alternative'. It is almost always true that alternatives to existing arrangements do exist, and tax gap analysis can catalyze and inform debate on the nature of those alternatives.

<sup>19</sup> <https://www.oecd.org/tax/tax-policy/tax-database/>

<sup>20</sup> [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/taxation\\_trends\\_report\\_2019.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2019.pdf)

<sup>21</sup> <https://www.doingbusiness.org/en/reports/thematic-reports/paying-taxes-2020#:~:text=Paying%20Taxes%202020%20a%20joint,fourteen%20year%20of%20the%20publication.&text=The%20overall%20Paying%20Taxes%20score,scores%20of%20the%20four%20components.>

<sup>22</sup> <https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>

<sup>23</sup> <https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/individual-income-tax-rates-table.html>

<sup>24</sup> <https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/indirect-tax-rates-table.html>

## 2. Tax spend gaps

The concept of tax spends, or tax expenditures, is remarkably poorly understood even though the sums that these terms describe are frequently very large.

Tax expenditures come in a very wide variety of forms that can be described as:

- **Tax allowances** e.g. the annual tax-free allowances that are often provided in many taxes, and most especially those related to income, that ensure that the first part of the sum declared for a particular tax base by a taxpayer for a tax period is not taxed at all. These allowances are usually provided for one of two reasons:
  - To enable those on low income (or those only benefitting from only a small part of a tax base not related to income) to not pay tax in an effort to reduce inequalities in income;
  - To eliminate the need for disclosure to a tax authority of small sums that might give rise to little or no tax being due, saving administrative costs that might exceed any tax payable.
  
- **Tax reliefs.** These come in a wide variety of forms, of which some of the more common for income include:
  - A deduction from income for contributions to approved pension schemes, and sometimes to life assurance arrangements;
  - A deduction from income for contributions to approved charities;
  - Interest cost deductions to subsidize a taxpayer's purchase of their own home;
  - The cost of professional and trade union subscriptions;
  - The cost of uniforms and other items that an employee has to personally provide to enable them to undertake their work;
  - A deduction from income for certain types of savings made, usually when they are considered to have high risk.

There are numerous other examples in taxes on income and all other tax bases. These reliefs are usually provided to encourage a particular form of behaviour e.g. saving, house purchase, high risk saving in start-up enterprises or charitable giving, or to standardize the tax deductions available for the costs of working.

- **Tax exemptions.** There are a wide variety of these exemptions, including:
  - Exempting certain forms of income from tax e.g. exempting from income taxes some types of income derived from savings, companies or trusts, while exempting income arising from outside a country is also quite common;
  - Exempting certain forms of capital gains from tax e.g. on the sale of private businesses or on the sale of a person's home;
  - Exempting capital gains or dividends earned by companies from corporation tax;
  - Exempting gifts made before death from inheritance taxes, estate duties or other such changes;
  - Exempting some forms of sales income from value added or goods and services taxes e.g. rents, food, financial services, education and healthcare;
  - Exempting some types of mineral from royalty charges whilst subjecting others to that levy.

The variety of exemptions available knows almost no limit: those noted are purely indicative of some common types spread across a range of taxes. These exceptions are usually provided to:

- Simplify the tax system;
  - Encourage some activity e.g. small business investment;
  - Exempt from tax items most especially used by those on low pay;
  - Tacitly recognize the practical difficulty of taxing some sources of income and gain which can easily be evaded.
- **Deferrals of tax** are also commonplace, especially in business taxation. Examples include:
    - Deferrals of capital gains owing if the proceeds of sale of one asset are reinvested in a new or replacement asset;
    - Deferral of tax due on profits because sums have been invested in new plant and equipment;
    - Deferral because income earned overseas have not been remitted to the jurisdiction of residence.

Deferrals are not as commonplace as allowances, reliefs and exemptions but can be of significance for some taxpayers. Deferral arrangements often attract tax avoidance activity. Deferrals are usually intended to assist the cash flow of businesses and to encourage the reinvestment of profits in productive activities although they can also recognize the difficulty of taxing some bases e.g. unremitted profits, where data has historically been very hard to secure.

- **Reduced (and enhanced) tax rates** are offered by governments for a wide variety of reasons. Many have a tax cost although some will also have a positive impact on tax revenues.

Reduced rates are very common in the case of sales taxes, where the European Union has, for example, noted that many countries give away up to half their tax bases by offering exemptions or reduced rates. Reduced rates can in such cases be applied to:

- Housing;
- Rents;
- Domestic fuel;
- Some foodstuffs;
- Books and other equivalent media.

Reduced rates are also commonplace on some forms of income, and most especially those from unearned sources derived from savings and investments including:

- Interest;
- Dividends;
- Rents.

Reduced rates also arise in corporate income tax and often apply to:

- Smaller companies;
- Capital gains;
- Dividend income;
- Income from sources outside the country.

Reduced rates can also be applied for land taxation e.g. in the case of:

- Places of worship;
- Charities;
- Some types of business property;
- Properties in development and enterprise zones.

It is also important to note that taxes can also be applied at higher rates than the normal, or standard rate that applies in most cases where the tax is levied. There are a number of reasons for this:

- To create a progressive tax system, whether on income or wealth, in particular;
- To discourage the consumption of certain goods or services that are either considered to be socially or environmentally harmful;
- To apply a higher rate of tax to luxury goods;
- To challenge monopoly rights e.g. on the sales of tech companies where there appear to be few competitors.

Reduced and enhanced rates of tax are usually intended to increase the progressivity of the tax system but in some cases e.g. reduced rates for saving, can also be used to encourage or incentivize activities.

### The transparency challenge of tax spend gaps

In a great many countries tax expenditures, whether they are reliefs, allowances, exemptions or tax rate variations, have a material impact on the overall tax yield of a jurisdiction. It has been estimated that in the UK, for example, in the tax year 2018-19 the value of total allowances and reliefs might have been £425 billion when tax collected was £769 billion<sup>25</sup>. For every pound of tax collected in that country this meant that £0.55 was given away in allowances and reliefs.

As a consequence it is essential that tax expenditures be estimated if the tax system of a country is to be properly understood and appraised. Since those expenditures are also usually very strongly indicative of the way in which the tax system is being used by a government to deliver its social, economic and fiscal policies they also require appraisal as they are likely to have a significant impact on the income and wealth distribution within a country. Appraising the cost of tax expenditures does, however, require that a wide range of data to either be published, ideally by the responsible government, or that it be procured by other means. The information likely to be required for this purpose is:

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<sup>25</sup>Baker, A and Murphy, R (2020) Modern Monetary Theory and the Changing Role of Tax in Society, *Social Policy and Society*, 19:3, July, pp.454-469. <https://www.cambridge.org/core/journals/social-policy-and-society/article/modern-monetary-theory-and-the-changing-role-of-tax-in-society/B7A8B0C7C80C8F7E38D20BE4F5099C83/core-reader>

- The exemptions available within all tax bases;
- All allowances for all taxes;
- All reliefs for all taxes;
- The range of tax deferrals available by tax;
- The range of rates for all taxes.

In addition, the following must be estimated:

- The nominal gross likely value to an average taxpayer (by decile or other band if income, if it is possible to estimate it) of those parts of the tax bases that have been subject to tax exemption, allowances, reliefs and deferral arrangements;
- The number of taxpayers enjoying each tax relief;
- The resulting cost of each tax allowance in terms of tax foregone;
- The amount of tax charged on taxpayers by band determined by that appropriate to the tax base being considered e.g. income; value of gains, sale made, etc.
- The number of taxpayers by tax rate band;
- The value of tax foregone or additional tax raised as a result of tax rate variations.

The way in which each of these sums might need to be published will vary by tax base, allowance, relief or rate: open mindedness and flexibility is required when approaching this issue and it is not possible to be prescriptive as to the data required in each case for this reason.

What has always to be borne in mind is the intended use for this data. In the first instance it should be used to appraise:

- The cost of the tax expenditure, relief, allowance, deferral or rate deviation in terms of revenue foregone and what might alternatively be done with that sum. Substituting estimates of alternative tax expenditures for those actually made so that social, economic or fiscal policy outcomes would closely align with stated government objectives, would assist calculation of possible trade-offs;
- The identity, by income, wealth, or taxpayer type (e.g. location, type of entity, business sector, etc.) that benefits from the tax expenditure;
- How much each type of taxpayer benefits from tax expenditures;
- Whether the tax expenditures achieve their stated benefit.

Thereafter this analysis can be extended in a number of ways, for example by asking:

- What are the likely distributional impacts on income and wealth of the tax expenditures?
- Are any industries or sectors benefitting ahead of others from tax expenditures?
- Are there regional implications to tax expenditures?
- Do the tax expenditures align with other aspects of government policy?
- Do the tax expenditures impact on the supposed affordability of other government programmes?

This is not the limit to the required analysis. It would also make sense to analyze trends in tax expenditures over time. These might reveal patterns concealed by more static forms of analysis.

Furthermore, data on tax expenditure should be analyzed to see whether there is evidence of prevalent tax avoidance. This might be revealed by analyzing changes in tax exemptions, reliefs, allowances and rates to assess whether they result in any significant change in the overall composition of the tax base. The most important aspect of analysis of the tax expenditure gap is to consider the impact of tax expenditures on such tax avoidance activity.

### The tax spend gap and the tax avoidance gap

Care has to be taken to understand the nature of tax avoidance when considering its relationship to tax expenditure.

If a taxpayer arranges their affairs in a way specifically allowed or encouraged by tax law (for example, they pay part of their income into a pension fund and save income tax) they are not avoiding tax, even though they may pay less tax as a result. If the law permits this activity and the taxpayer reduces their income by paying it into a pension (which is very likely to mean that they defer their right to enjoy the income in question,) then this would not qualify as tax avoidance. In such a case, presuming all rules had been complied with and all required evidence is supplied, a tax authority would be obliged to provide the relief the law encourages.

This does not necessarily mean that the outcome of this activity is desirable or socially useful: a recent study of UK net financial wealth suggested that more than eighty per cent of UK wealth of this sort might be saved in tax incentivized savings accounts of various sorts, with pension fund investment predominating<sup>26</sup>. This does not indicate that tax avoidance is taking place, but it does suggest that tax spending might be significantly changing behaviour. This might be an issue worthy of consideration in its own right and is a reason for examining the breakdown of the tax expenditure gap.

The critical point is that tax avoidance is not about the use of tax reliefs, allowances and exemptions in the way that a government prescribes. The cost of that activity belongs in the tax spend/ expenditure gap. Tax avoidance is more complex than straight forward use of reliefs.

The UK's HM Revenue & Customs notes<sup>27</sup>:

*Tax avoidance involves bending the rules of the tax system to gain a tax advantage that Parliament never intended.*

*It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter, but not the spirit, of the law.*

In that case much of tax avoidance is about the abuse, or manipulation of tax expenditures. Doing so remains strictly within the law, meaning that the taxpayers undertaking this activity are likely to avoid a penalty for their actions, and yet they are falling within the realm of tax avoidance. Examples of tax avoidance might include:

<sup>26</sup> <https://www.cambridge.org/core/journals/social-policy-and-society/article/modern-monetary-theory-and-the-changing-role-of-tax-in-society/B7A8B0C7C80C8F7E38D20BE4F5099C83/core-reader>

<sup>27</sup> <https://www.gov.uk/guidance/tax-avoidance-an-introduction>

- Incorporating a company simply to take advantage of lower corporate income tax rates than they would pay on personal income, subject to income tax rates;
- Seeking to re-categorize income as capital gains to take advantage of lower tax rates that are often charged on capital gains, if they are subject to tax at all;
- Seeking to re-categorize income arising from work as income derived from investment to avoid higher rates of personal income tax often due on earnings from labour as a result of social security charges and payroll taxes;
- Seeking to represent income arising within a country as income arising from outside it to defer or cancel tax arising on that income;
- Suggesting a trade exists to claim an expense deduction that could not be offset against employment income;
- Shifting income and assets into tax havens and charging for their use to related operations in higher tax jurisdictions to reduce the overall level of corporate income tax due within a group of companies;
- Changing the nature of a sales transaction to apply a more favourable sales tax rate or exemption to that transaction.

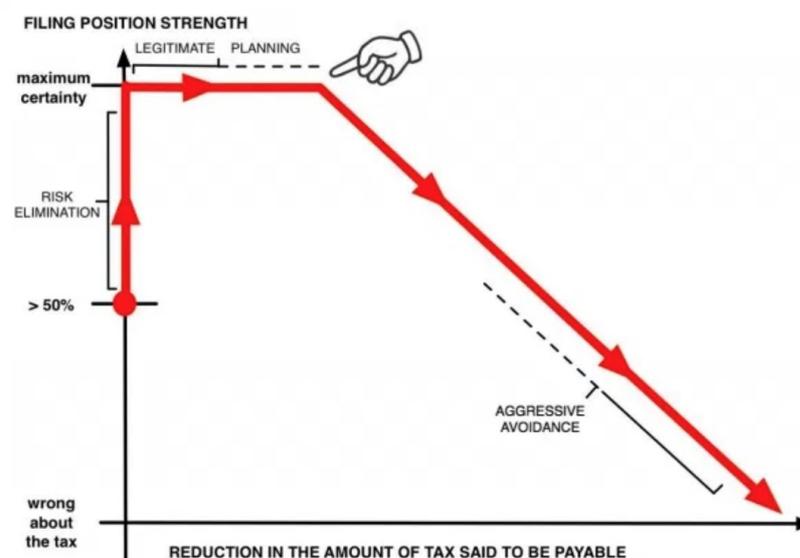
Many examples are available.

### What differentiates tax avoidance in the tax expenditure gap and in the tax avoidance gap

When it would seem possible for tax avoidance to be categorized as either part of the tax expenditure or tax avoidance gap a way of identifying which category a particular type of behavior should fall, is required.

The mechanism to differentiate these behaviours has been defined by UK based tax barrister David (now Claire) Quentin<sup>28</sup>. If there is no risk of the transaction being challenged by a tax authority - because it is tax compliant - then even if it reduces the amount of tax to be paid by a taxpayer it cannot be tax avoidance because it is wholly within the spirit of the law. In these circumstances the tax saved would be a consequence of a permitted tax expenditure.

This is explained in this chart from Quentin:



<sup>28</sup> <http://jota.website/article/view/142>

A person who is uncertain of the law is represented by the red circle on the vertical axis. If they take advice from their tax authority or a professional tax advisor they might considerably reduce their tax risk by increasing the certainty that their affairs are legally compliant: this explains the red line up the Y, vertical, axis. They might then make certain other choices that reduce the amount of tax that they might pay that are also legally certain e.g. they might pay into a pension or claim permissible tax reliefs for expenses that they have actually incurred. Both are permitted if relevant rules are complied with, and less tax is paid as a result. This explains the horizontal red line across the top of the chart.

However, a point is then reached where further reduction in tax paid is not possible without uncertain tax positions being adopted of the types noted previously: e.g., a transaction is represented as something that it might not be, or which is at least open to either legal or factual challenge. This is where the line begins to slope downwards.

Thereafter, uses are made of the law which are clearly open to doubt as to their legal validity: many marketed tax avoidance schemes are of this type.

The inflection point where tax expenditure becomes tax avoidance is clearly marked by the pointing finger on the chart. As a person descends down the slope on the right-hand side of the chart the uncertainty in the position that they have adopted increases until what is described as aggressive tax avoidance is being undertaken.

It is thus risk that differentiates claims that are part of the tax expenditure gap from tax avoidance. If there is a risk that the transaction might be challenged by a tax authority because the use made of the law is not obviously compliant with the spirit of that legislation, or because risks in the interpretation of that law have been knowingly taken with the aim of securing a tax advantage, or because the facts that supposedly underpin a claim do not truly represent the economic substance of the transactions that have actually been undertaken, then the behaviour in question is tax avoidance.

The taking of tax advice itself is not an indication of tax avoidance taking place. In most countries tax law is complex and open to interpretation and most people need guidance and advice to ensure that they comply with its requirements. As a consequence, seeking tax advice to make sure that tax law is complied with, meaning that accidental non-compliance is avoided, is a perfectly acceptable thing for any taxpayer to do and a right and proper function for tax advisers to fulfil. It is their job to explain how the tax system, including tax expenditures, work. It is for government to decide whether to provide opportunities for reducing taxes due as a result of permitting tax reliefs, allowances and exemptions, or not.

### 3. Tax evasion

Tax evasion arises in a number of situations. One way in which it occurs is when the misrepresentation that a tax relief is being appropriately used becomes so extreme that actual misrepresentation takes place. That misrepresentation of the truth is as much tax evasion as other forms of that activity are.

More generally, tax evasion involves the deliberate falsification of a declaration relating to a source of income to escape claims arising that the tax due on it should be settled. This suppression of data might include:

- Deliberately understating the value of a source of income on a tax return;

- Omitting a source of income from a tax return;
- Omitting to make a tax return at all;
- Making sure that the income or other tax base that might give rise to a liability is recorded in an entity whose existence can itself either be hidden from view (e.g. it is in a tax haven and ownership data concerning it is suppressed) or it can be dispensed with before tax is due (e.g. a limited company that can be deliberately dissolved without the means to settle its tax liabilities, or even the records to show that they might exist);
- Over claiming a tax relief, allowance or expense on a tax return when the conditions to claim that relief have not been met e.g. the expense has not actually been incurred.

Evidence suggests that tax evasion is considerably more commonplace than tax avoidance in countries, whether so-called developed or developing economies are considered<sup>29</sup>. Conditions that tend to encourage tax evasion are:

- The use of more than one currency within a jurisdiction - permitting a taxpayer to keep more than one set of records and only declare one;
- The absence of direct tax reporting by those making payment of income to a person. Research, mainly undertaken in the USA<sup>30</sup>, suggests that if a source of income is known by a taxpayer to have already been reported by a third party to their tax authority then the chance that they will appropriately declare that income on their tax return increases considerably. Direct tax reporting includes:
  - Direct reporting of wages paid by an employer to a tax authority, whether or not tax is deducted from them;
  - Direct reporting of sales made by a business through tills connected directly to a tax authority;
  - Direct reporting of income paid by a savings institution to an investor, whether or not tax is deducted at the time the payment is made;
  - Direct reporting of asset sales to a tax authority by those who broker them e.g. lawyers on property sales, stockbrokers on share sales, investment managers with regard to investment assets, and so on, again whether or not tax is deducted at the time that the transaction takes place;
  - Direct reporting of income paid to persons resident within a jurisdiction by those arranging that payment from outside the country, as is now becoming more commonplace under international automatic information exchange arrangements;
  - Country-by-country reporting by multinational corporations that makes clear where and to what extent a group trades and how that is influenced by intra-group transactions.

Other examples do, of course, exist.

- The existence of banking secrecy within a jurisdiction that prevent a tax authority from making an enquiry to establish the nature of a source of income and its potential taxable beneficiaries;
- A lack of resources available to a tax authority to investigate cases of tax evasion and to make an example of them;
- A significant cash economy;

<sup>29</sup> For example, [https://www.socialistsanddemocrats.eu/sites/default/files/2019-01/the\\_european\\_tax\\_gap\\_en\\_190123.pdf](https://www.socialistsanddemocrats.eu/sites/default/files/2019-01/the_european_tax_gap_en_190123.pdf)

<sup>30</sup> For example, at [http://darp.lse.ac.uk/papersdb/Slemrod\\_\(JEP07\).pdf](http://darp.lse.ac.uk/papersdb/Slemrod_(JEP07).pdf)

- The significant use of internet trading platforms operated from outside the jurisdiction that permit transactions taking place within it to be hidden from view, which is usually easier to achieve when multiple currencies are in use;
- A lack of basic data e.g. on the number of people within a jurisdiction; the number of companies operating within it; who the beneficial owners of those companies might be; what businesses might be in operation; who owns land and other assets within the jurisdiction and who might be in employment, or not.

Tax evasion requires opacity if it is to succeed. It follows that tax transparency is a mechanism that can help tackle this issue.

#### 4. Tax avoidance gap

The nature of this tax gap has already been discussed when considering the tax spend gap, above. As such further discussion is not required again here.

#### 5. Unpaid tax gap

The unpaid tax gap is a measure of the bad debt suffered by a tax authority. What it represents is that tax that is known to be due by that authority which it has been unable to collect for reasons that might include:

- The insolvency of the taxpayer;
- An inability to trace the taxpayer after a liability has been declared to be owing;
- The outright refusal of the taxpayer to make settlement of tax due when the sum involved does not make it worthwhile pursuing legal action for its recovery;
- A lack of resources to pursue recovery of tax owing through a legal system, whatever the sum involved;
- Corruption, meaning that an official has been bribed to ignore the tax debt that is owing and instead writes it off;
- Error in recording debt that means that the liability cannot be proven with sufficient confidence to pursue recovery action.

Other possibilities do, of course, exist.

Since this tax gap always arises within the books of the tax authority only they can prepare an estimate of this tax gap. Sound accounting on their part is a pre-requisite of its proper estimation.

#### Why this issue matters

Tax gap measurement appraises the credibility of a tax system at a number of levels, all of which ultimately impact upon the effective net yield that a tax authority can deliver to its government. The different tax gaps relate to each other in totality but are quite different in their interpretation.

The tax base and tax spend gaps appraise the design of the tax system of a jurisdiction. As has been noted, there will be varying degrees of estimation required in the course of the preparation of data on these tax gaps. This does not, however, undermine their usefulness. This data, which is largely hidden from view in many jurisdictions at present, reveals the priorities implicit in the

design of a tax system. The availability of data on these issues is critical to inform debate on tax policy.

The tax evasion, tax avoidance and unpaid tax gaps are measured for a different reason. They primarily measure the efficiency of a tax authority in delivering an effective tax system and collecting revenue as prescribed by the legislation of a jurisdiction. In the process the attitude of the population of the jurisdiction towards tax compliance<sup>31</sup> in its various forms is revealed.

These various interests in tax gap data might be summarized as follows:

<b>Tax gap</b>	<b>What it indicates</b>	<b>Who it appraises</b>
Tax base gap	The cost of the decisions taken to not tax some available tax bases within the jurisdiction	Those engaged in the political processes concerning tax, and those who advise them
Tax spend gap	The cost of tax reliefs, allowances and exemptions made available within the tax bases that are subject to tax	Those engaged in the political processes concerning tax, and those who advise them
Tax evasion gap	The cost of deliberate abuse of the tax system by taxpayers	<ul style="list-style-type: none"> <li>• The government to the extent that it relates to appropriate resource allocation to the tax authority</li> <li>• The tax authority to the extent that it measures their ability to collect tax from those not willing to pay voluntarily;</li> <li>• The taxpaying community to the extent that it indicates their lack of will to pay what is due.</li> </ul>
Tax avoidance gap	The cost of arrangements created very largely by tax avoiders intended to undermine the intention of tax legislation within a jurisdiction with the aim of reducing taxpayers' liabilities within the scope of the law	<ul style="list-style-type: none"> <li>• Those professional people who design tax avoidance systems and the inclination of their clients to use them;</li> <li>• A government to the extent that it fails to put in place arrangements to stop this abuse;</li> <li>• The tax authority for failing to detect, address or challenge such arrangements.</li> <li>• The taxpaying community to the extent that it indicates their lack of will to pay what is due.</li> </ul>
Unpaid tax gap	The cost of tax declared to be due but not paid.	<ul style="list-style-type: none"> <li>• The tax authority for failing to collect tax owing;</li> </ul>

<sup>31</sup> Tax compliance is seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

		<ul style="list-style-type: none"> <li>• A government for failing to put in place systems to assist the tax authority to collect tax owing.</li> <li>• The taxpaying community to the extent that it indicates their lack of will to pay what is due.</li> </ul>
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**To which stakeholders this issue matters**

In the case of most tax gaps most stakeholders will have a concern. That is because non- collection of tax is likely to be of significant interest to most stakeholders of a tax system, including those who would rather not pay.

**What happens if this issued is not addressed**

The problem of not having tax gap data within a jurisdiction is that this means that all discussion on tax policy and practice must be based on guesswork.

Whilst it is not suggested that tax gap data will ever be perfect compiling it and making it available, allows for more informed decision making on issues ranging from the choice of tax bases, the effectiveness of tax spends and the efficiency of the tax authority.

In addition, tax gap data helps a government decide on the appropriate level of resources to allocate to a tax authority and the likely yield it can hope to secure by spending in this way. It also assists the tax authority to allocate those resources to those areas where increased yield is most likely.

**Why this issue may not be addressed**

It is commonly thought that the tax gap of an economy is hard to estimate because of the significance of the ‘shadow economy’. This, is true of all jurisdictions to varying degrees: very few are thought to have shadow economies of less than ten per cent of their gross domestic product, and shadow economies of in excess of twenty per cent of gross domestic product are quite common. It is, then, an established part of tax gap estimation that this problem will be encountered. Precisely because of this two methods of estimation of tax gaps exist.

The first is a top-down basis method. This does, in effect, take information from the estimation of gross domestic product for a jurisdiction and then estimates the tax that might be due on that gross domestic product. This method has to take into consideration the current tax system of the jurisdiction, accounting for the reliefs, allowances and exemptions in force. This approach is particularly relevant to the first and second tiers of the tax gap. These estimates (and they will always be estimates, not least because gross domestic product is itself an estimate) will inevitably have to be considered broad indicators rather than precise data. However, this does not diminish their usefulness when it is remembered that almost all macroeconomic data used by governments is subject to the same flaws.

The second basis of estimation is a bottom-up method. This data usually starts from within the tax jurisdiction. For example, the data for the unpaid tax gap (tier 5) should be published by a tax authority each year, as a matter of course. It would also be reasonable to expect that any

tax authority should create and calculate a measure of the tax unpaid as a result of tax avoidance schemes that they wish to challenge. Not having this information, would effectively mean allocating resources inappropriately. Such figures should be published as an approximation to the tier 4 tax gap, i.e. that for tax avoidance.

If actual tax collected is added to the totals for the unpaid tax gap and the tax avoided tax gap, and this number is then subtracted from the figure for the total tax base less the tier 1 (tax base) and tier 2 (tax spends) tax gaps, the result should be an estimate of the tier 3 tax gap for tax evasion. The figure will not be precise, but the scale of the issue being challenged can then be estimated, and a plan to tackle it can be prepared. The estimate will not be perfect, but is still required to identify the scale of tax evasion and for providing a basis for future actions to tackle tax evasion.

### **An alternative method of tax gap appraisal based upon sales taxes alone**

Whilst there can be considerable advantages to preparing a full tax gap analysis, as is apparent from the description within this chapter, much of the information required for this purpose is within the advanced scale of tax transparency data. This necessarily means that tax gap analysis of the type described will remain beyond the reach of many jurisdictions for some time to come.

However, not all is lost in these cases. A reduced form of tax gap analysis can be undertaken in very many countries where the data does not meet the standard required for the broadly based tax gap analysis noted in this chapter. This reduced form of tax gap analysis focuses entirely upon tax gaps within value added taxes or other sales taxes. It is the form of tax gap analysis used by the European Union to estimate the VAT gap that it has published for a number of years<sup>32</sup>.

This version of the tax gap does require that there be reasonable GDP estimates on an income basis for the country estimating this tax gap, but it is stressed that even reasonable estimates of GDP on this basis will do. The process then requires that the likely VAT to be recovered from the economy on the basis of the sales makeup of GDP is estimated. This analysis is important because by no means all elements within GDP will have VAT charged on them due to decisions taken on the VAT tax base e.g. the exemptions to be granted. This potential yield is then compared with actual VAT recovered in a period, with known bad VAT debts taken into account. This leaves an estimate for the total sum lost to tax evasion and avoidance, with the tax base and tax spend gaps having already, in effect, been allowed for in the estimation of VAT due on GDP.

Although the resulting estimate of the tax gap is approximate the resulting figure does provide important evidence on the potential scale of the untaxed economy within a jurisdiction. In itself this is a powerful indicator for economic management that a country can seek to control over time, and as such a tax gap on this basis should be considered by any jurisdiction meeting the criteria noted.

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<sup>32</sup> See [https://ec.europa.eu/taxation\\_customs/business/tax-cooperation-control/vat-gap\\_en#heading\\_0](https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/vat-gap_en#heading_0)

## Making Tax Work

### Chapter 12

#### Tax spillovers

Tax spillover is a relatively new concept. It largely originates from an International Monetary Fund (IMF) Fiscal Affairs research paper in 2014<sup>33</sup>. Further academic work has been undertaken by the current authors, with the support of a range of NGO groups largely based in Europe, to create a new spillover assessment framework.

Tax spillovers are the impact, reductions in corporation tax, or other tax competition strategies designed to lure mobile capital and investment, can have in the form of knock-on effects and largely unintended consequences, that undermine other parts of the tax base, or tax policy and administration in the same country, or in other countries. In short, tax spillovers are the intentional and unintentional externalities generated by policies designed to increase the tax competitiveness of a particular jurisdiction, or locale, and they can be both domestic and international in nature. Spillover effects as the IMF research showed can reduce the revenue raised by a country through a particular tax such as corporation tax. They can also make revenue raising procedures more difficult to execute, or create incentives for private actors which damage the overall tax base and functioning of the tax system as whole. These cannot be fully captured in terms of estimations of lost revenue, as behaviours and declining administrative effectiveness are hard to quantify. Qualitative reporting of the difficulties and tensions can help to identify how widespread certain practices are, as well as the kind of threats they pose, as a supplement to more quantitative estimates of lost revenue. In this sense, spillover assessments can help to identify the potential sources and causes of lost revenue, - or the leakages, risks and vulnerabilities both within and without of tax systems, that in turn contribute to tax gaps. Spillover assessments are therefore complementary to and follow on from tax gap analyses, enabling more precise identification of the sources of tax gaps. This is why spillover assessment are aspirational as something that gives a more rounded reading of how tax systems are performing on the ground, based on a pooling of the experiences of a range of actors with the tax system, undertaken by trained assessors operating within a distinct and systematic assessment framework.

Within the tax transparency framework tax spillover analysis is also considered an aspirational goal because no jurisdiction is currently engaged in the kind of systematic evaluation process this entails, as yet. However, that is not to understate the significance of tax spillover analyses. Whilst it could be claimed that such analyses would require significant work to be undertaken if they were produced with the depth of analysis commonplace in reports from the likes of the IMF, World Bank and Organization for Economic Cooperation and Development, the authors of Making Tax Work have prepared them in less time, and believe that the resulting insights they offer on a qualitative basis are still of considerable value. Moreover, trained assessors with resources and a budget could be more systematic in their data collection and the resulting appraisals. Qualitative assessments should not be viewed as an alternative to quantitative assessments prepared by agencies such as the IMF, but rather supplement those by helping identify and give a fuller more rounded understanding of the sources, causes and consequences of such spillovers.

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<sup>33</sup> Keen, M. J., Perry, V., Mooij, R. D., Matheson, T., Schatan, R., Mullins, P., & Crivelli, E. (2014). Spillovers in international corporate taxation. IMF Policy Paper. <https://www.imf.org/external/np/pp/eng/2014/050914.pdf>

While perhaps of greatest use when undertaken by, or with, the cooperation of a jurisdiction's tax authority it is also important to note that their assistance is not essential for tax spillover analysis to be useful. It is entirely possible for other agencies, whether they be political oppositions, civil society organizations, trade unions, or possibly most usefully the staff of International Organizations with experience of qualitative assessment methods and with either their own skill in tax, or access to such skills, to prepare tax spillover analyses<sup>34</sup>. Such exercises can be of great value in directing a range of actors thinking and work on effective taxation reform, enhancing tax transparency within any jurisdiction and in deepening policy dialogue on practical tax reform in a jurisdiction.

Where an independent team of assessors, such as one attached to an international organization, conduct a spillover assessment, it should be noted that the publication of the resulting assessment report, with its qualitative commentary can increase tax transparency in a jurisdiction, including improving public and government understanding of the performance of a tax system and any particular weaknesses, or vulnerabilities it displays. In addition to this, a spillover assessment can be a remedial as well as a diagnostic tool, in that it can identify the kind of targeted reforms that would address existing weaknesses.

Governments and revenue agencies can benefit, and have incentives to enter into a spillover assessment. For revenue agencies spillover assessments can often strengthen the case for enhanced resources in terms of improved revenue collection and in investigating and preventing abusive practices. Likewise, spillover assessments can provide governments with a reading of how the tax system overall coheres and performs, and how its revenue raising performance could be enhanced by addressing weaknesses and vulnerabilities, without necessarily raising existing rates, but by targeting administrative weaknesses and loopholes. Spillover assessments, like other forms of tax transparency will also enable a government to better understand how a tax system is performing in relation to the particular overall objectives it has prioritized and set for taxation.

The tax spillover assessment framework the current authors have created is a risk assessment tool. It is intended to help provide an explanation of how tax gaps arise and their sources. It does so by appraising the way in which one part of a tax system within the jurisdiction can undermine another part of the tax system within that same jurisdiction or the tax system within another country. The framework also appraises whether the tax system of the jurisdiction under consideration is vulnerable to spillover risks posed by the tax systems of other jurisdictions. The assessment framework identifies the areas of greatest risk within a tax system, while the documentation process used in the appraisal methodology makes it relatively straightforward to identify which issues need to be addressed to improve the quality of the tax system itself.

Tax spillover assessment requires the collation of information about a tax system and a series of interpretations about its operation, including how widespread certain practices are. By presenting this information and the justifications for the verdicts reached it increases available information about tax systems, contributing to both informed public debate and greater transparency, as a desirable part of a tax transparency regime.

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<sup>34</sup> Baker, A., & Murphy, R. (2019). The political economy of 'Tax Spillover': A new multilateral framework. *Global Policy*, 10(2), 178-192. The World Bank has experience of a similar qualitative methodology through the corporate governance ROSCs. Baker, A. (2012). The 'public interest' agency of international organizations? The case of the OECD Principles of Corporate Governance. *Review of International Political Economy*, 19(3), 389-414.

## Introduction

In a recent peer reviewed paper the current authors,<sup>35</sup> extended the IMF definition of spillovers as the effects one country's tax rules and practices have on other countries, by identifying that potential harmful spillovers were far more widespread than simply being confined to headline rates of corporation tax. Tax spillovers can also arise from domestic sources. A country's corporate tax policies and practices can undermine its own income tax base and procedures and vice versa, by creating incentives and opportunities for individuals to move income into corporate structures. Tax spillovers can occur both within a jurisdiction and between jurisdictions, as well as between different taxes. In particular, they can be created by administrative disorder and regulatory arrangements, as well as distortionary low taxation rates. The qualitative evaluation framework proposed involves posing a range of questions about the potential relationships between different taxes within a jurisdiction and with other jurisdictions, through a structured assessor's questionnaire, as well as sub questionnaires for stakeholders. The intention is to deliver a broader, but more precise, evidence driven sense of the risks and vulnerabilities particular tax regimes generate and face in their entirety. This section of Making Tax Work uses this understanding of tax spillovers, to show how tax spillover assessments are a tool for enhancing tax transparency and understanding, for the benefit of multiple stakeholders including governments and revenue authorities.

## Reasons for undertaking a tax spillover assessment

Tax spillover assessments of a comprehensive and qualitative nature can help governments realize their objectives by giving them enhanced information on the following:

1. How to raise additional tax revenues without increasing tax rates, or extending the tax base;
2. Weaknesses in the functioning of tax law and how and where tax rule enforcement could be made more effective;
3. Potential targeted measures to improve overall fiscal management of the economy;
4. Whether incentives and other arrangements to encourage particular behaviours built into the tax system are delivering on their original intended objectives, or whether they are having distorted, unintended consequences, such as exploitable legal loopholes, or creating incentives that undermine other parts of the tax base;
5. The extent of tax compliance, including whether groups and individuals are paying their appropriate and correct share of taxes owing, or whether the burden falls inappropriately on the law abiding, or those without the means to exploit legal loopholes;
6. How the tax revenue collecting authority is performing, whether it is adequately resourced and whether funds are being used to best effect;
7. International tax relations and vulnerabilities, especially to specific forms of tax competition pursued by other countries.

Whatever the motivation or concern, tax spillover appraisals based on a comprehensive and systematic qualitative reporting methodology can assist the achievement of these objectives, with many of these objectives existing simultaneously in different branches of government.

In summary, one of the main things a tax spillover assessment can do, as evident in points 1-7 above, is to explain why tax gaps exist and identify their sources. Flowing from this diagnostic

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<sup>35</sup> Baker, A and Murphy, R (2019) The Political Economy of Tax Spillover: A New Multilateral Framework, *Global Policy*, Vol. 10, No. 2, pp 178-192.

tool are remedial prescriptions, that could rectify those gaps and weaknesses, as an evidence informed tax reform agenda. Spillover assessments are, as a result, dynamic and interactive rather than static. They offer a moving lens on a tax system’s aggregate effectiveness, providing a gold standard level of aspirational transparency for adaptable and effective modern tax systems.

### A methodology for tax spillover assessment

The aim of a tax spillover assessment system is to appraise spillovers in two ways.

The first is the way in which spillovers exist within the domestic economy i.e. how one tax or administrative issue within a country impacts on another tax or administrative issue within the same country. This is a relatively self-contained process.

The second way to undertake a tax spillover assessment is to appraise international tax spillovers. This process requires two elements. The first appraises the threat that the tax system of the country being assessed poses to other countries (risks generated), while the second assesses the vulnerability of the country’s tax system to a loss of revenue as a consequence of the tax policies of other countries (vulnerability to risks elsewhere).

The tax spillover appraisal methodology rests on an assumption that a good tax, or a good tax policy measure, is one that should cause no harm to another tax or tax policy measure either in the same jurisdiction, or in other jurisdictions. In this respect, the appraisal system focuses on identifying and alleviating negative, costly spillovers. Since it generally appears that negative tax spillovers are much more commonplace than tax measures that have a reinforcing effect, buttressing other parts of tax systems, this should be viewed as a strength of the appraisal system.

In the framework that has been developed, risks facing, or generated by, particular parts of tax systems are scored on a ranking system from one to five. The scores are awarded based on the collation and documentation of actual practices garnered from the impressions of a range of stakeholders arising from the interactions and experiences with the tax system. A score of 5 is indicative of bad spillover performance and the generation of high spillover risks, or significant spillover vulnerabilities. A score of 1 is the best score possible. The higher the score overall, the higher the spillover risks and vulnerabilities.

When considering domestic spillovers, an entire appraisal can be recorded in one table. The object is to:

- Draw out issues that harm tax transparency;
- Highlight the issues that give rise to tax gaps;
- Make clear how the tax system can be abused in ways that are not readily apparent, including to the tax authorities themselves (the commentary in spillover reports is more ambitious than a basic minimal transparency agenda might imply is required);
- Encourage the creation of solutions to these problems, meaning that greater transparency is used to produce reform results.

The scoring system for both the domestic spillover and international systems is as follows:

Score	Meaning
5	The tax base or policy area being considered is heavily undermined by and vulnerable to the area it is being compared with.
4	The tax base or policy area being considered is to some extent undermined by and vulnerable to the area it is being compared with.
3	The tax base or policy area being considered is neither undermined nor reinforced by the area it is being compared with and has limited vulnerability.
2	The tax base or policy area being considered is to some extent reinforced by the area it is being compared, and has little vulnerability.
1	The tax base or policy area being considered is significantly reinforced by the area it is being compared with and is secure.

The international system also appraises tax bases and policy measures on a scale from 1 to 5. However, with regard to measuring the spillover risks the jurisdiction generates for other countries, an adjusted scale is used as follows:

Score	Meaning
5	The issue being considered undermines this element of the tax system in other countries to a considerable extent.
4	Some features of the issue being considered undermine elements of this aspect of the tax system of other countries to some extent.
3	Some features of the issue being considered can have detrimental effects on this area of the tax system in other countries, but this is limited.
2	The issue being considered has limited impact on this element of the tax system in other countries, with few signs of harm.
1	The issue being considered poses no threats or risks to this element of the tax system in other countries.

The international vulnerability making scale is the same as that used for domestic spillovers, noted above.

### Undertaking a tax spillover assessment

To undertake a tax spillover assessment assessors complete three appraisal grids (one domestic; two international) that look like the following table, and for each square on the grid the assessor awards a grade on a 1–5 scale.

**Table 1 – example tax spillover assessment making grid**

Domestic tax spillover	Issue having impact										Sub totals		
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax politics	Tax administration	Company and trust administration	International agreements	Total			
Issue being assessed	Income tax									0	0	Taxes	
	Corporation tax									0			
	Capital gain tax									0			
	Social security									0			
	Tax politics									0			
	Tax administration									0	0	Tax policy	
	Company and trust administration									0			
	International agreements									0			
	Total	0	0	0	0	0	0	0	0	0	0	0	

For example, for the domestic grid, an assessor begins in the top left corner, and works across horizontally, considering how the tax or policy area listed in the rows, starting with income tax (top of y axis), is impacted upon by the areas listed in the columns (x axis). So, for the second box on the first row, the assessor asks ‘is this country's income tax base undermined by its corporation tax system?’ If they think it does then the score is either 5 or 4, depending upon the severity of that threat. Alternatively, if they think that corporation tax reinforces the income tax base, then the appropriate score is 1 or 2. Where there is no impact either way the score is 3. A domestic spillover assessment provides a reading of the degree to which a tax system is balanced, asking whether different elements support and reinforce, or undermine one other.

This process is repeated for the international risk vulnerabilities grid i.e. for the appraisal as to how the domestic tax system is threatened by other countries. For example is this country’s income tax vulnerable to threats posed by corporation tax practices in other states.

However, for the international risk grid the process is reversed. Now the country being appraised is assessed for its aggression, and the risks its tax policies project outwards for the tax bases and policies of other countries. The assessor asks how the issue being considered –the rows on the y axis, –create potential risks for the various taxes and policy areas of other countries listed in the columns on the x axis. So for example as the grid below indicates, the assessor starts off in the first grid (row 1, column 1) in the far left hand corner asking what risks the income tax policies and practices in the country being assessed pose for the income tax base and policies of other countries, before moving onto the impact of income tax on corporation tax in other countries and so on, working through the grid from left to right and top to bottom. To aid this process a full assessors guide provides details of the questions to be asked and the areas and issues to be considered in reaching a full evaluation for each grid<sup>36</sup>.

<sup>36</sup> Baker, A & Murphy, R (2019c) Tax Spillovers: The Assessment Procedure, accessible via supporting information at: <https://onlinelibrary.wiley.com/doi/full/10.1111/1758-5899.12655>

**Table 2 – International spillover risks generated for other countries**

International spillovers	Issue it has impact on in other countries										Sub totals	
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax politics	Tax administration	Company and trust administration	International agreements	Total		
Issue being assessed	Income tax									0	0	Taxes
	Corporation tax									0		
	Capital gain tax									0		
	Social security									0		
	Tax politics									0		
	Tax administration									0	0	Tax policy
	Company and trust administration									0		
	International agreements									0		
	Total	0	0	0	0	0	0	0	0	0		

These different forms of assessment are necessary because states can be both aggressors and generators of risk, but they can simultaneously also be vulnerable to both domestically generated spillover risks, and spillover risks generated by other countries. As the IMF analysis of 2014 showed developing countries tend to be disproportionately vulnerable to cuts in corporation tax in other countries, having harmful effects on their own corporate tax revenues and base.

The spillover framework based on the grids above aims to provide a comprehensive and systematic reading of the diverse elements of spillover risks from multiple directions: those generated internally as domestic spillovers; those going out to the rest of the world (international risks generated); and those coming in from the rest of the world (vulnerability to international risks).

In the example table (Table 1) the assessment process reviews four major direct tax systems and four areas of tax administration and policy. Each has to be appraised in turn. By definition, because spillover effects are being considered, they are appraised for their impact on each other. It is only by breaking down this process in this way, permitting many issues to be considered and independently marked, that a full comprehensive and systematic tax spillover assessment can be undertaken.

It is stressed that in this example only direct taxes have been taken into consideration. This is because indirect taxes, such as domestic sales taxation or value added taxes, are not usually the subject of significant tax competition: those indirect taxes that are exploited for internationally competitive purposes are usually associated with trade competition rather than tax competition e.g. tariffs and customs duties. However, there is no reason why indirect taxes could not be included in a tax spillover analysis. If that was to be the case then additional rows and columns could be added. It is, of course, possible that some rows and columns might also be deleted. Possible additions include:

- Excise duties and tariffs
- Value added taxes
- Carbon based taxes

- Environmental taxes
- Tourist taxes
- Wealth taxes

The choices will depend upon a country’s own situation and priorities. It is also possible that other areas of administration might wish to be included, and again some might be omitted (although that is likely to undermine the value of the process). Additional areas of administrative consideration might include:

- Climate change regulation
- Tourism administration
- Health administration

These parts of a jurisdiction’s administration are suggested because they might have significant interaction with tax policy.

The direct taxes noted in the sample grid were chosen because of their significance in the overall taxation revenues of many countries (income tax, social security contributions and, potentially, corporation tax) or because the taxes in question were originally intended to be defensive in purpose (e.g. corporation tax and capital gains tax), protecting other parts of a tax base.

The concept of a defensive tax is that they exist, at least in part, to prevent leakage from another tax base. In the case of both corporation tax and capital gains tax the original intention of introducing these taxes was to defend the income tax base from leakage by the re-categorization of income sources into these alternative tax bases. Spillover appraisal then enables assessment of whether these original reinforcing objectives are still being fulfilled.

**Tax spillover appraisal – administrative systems**

One of the features of the Baker and Murphy method of spillover tax appraisal is its focus on aspects of tax (and related) administration issues. These are considered important because the effectiveness of tax systems, and relatedly, tax transparency within a jurisdiction are heavily dependent upon the support provided by a jurisdiction (including the general political climate around taxation) for taxation in general, and the tax administration. Also important here is the related issues of company and trust administration, without which many potential taxpayers could not be identified. Similarly, the approach the jurisdiction takes to international tax cooperation and participation in arrangements such as automatic exchange of information (AEOI), matters because it increases the chances of identifying all the sources of income that it might wish to tax. Questions to be addressed in assessing these administrative issues are set out below:

System appraised	Brief description of the issue being considered and the reason for appraising it
Tax administration	<ul style="list-style-type: none"> <li>• Does the design of the tax system make it relatively straightforward for the tax administration to undertake its work?</li> <li>• Alternatively, is the tax regime such that there are so many allowances, reliefs and complications that it is hard for the tax administration to appraise whether a taxpayer is tax</li> </ul>

	<p>compliant<sup>37</sup>, or not?</p> <ul style="list-style-type: none"> <li>• Is the tax administration adequately resourced?</li> <li>• Are those within the tax administration paid adequately to ensure that those of sufficient calibre to enforce the tax system are recruited?</li> <li>• Is the tax administration led by those who believe that tax compliance is a matter of importance, or is it, instead, dominated by those from the tax professions, other parts of the civil service, or political appointments, who show bias against the positive role that tax can play in society?</li> <li>• Are all taxpayers required to submit tax returns?</li> <li>• Does the tax administration go out of its way to assist the payment of tax e.g. by providing for deduction of tax at source, the pre-population of tax returns, ease of online tax return submission, the quality of tax communication, etc.?</li> <li>• Does the tax administration have a positive or negative view of taxpayers, and how does this impact upon the tax morale of the jurisdiction?</li> <li>• Does the tax administration appropriately pursue those who do not comply with its requirements?</li> <li>• Is there an appropriate penalty regime?</li> <li>• Are the systems of appeal available against the decisions of the tax administration readily accessible and free to use?</li> <li>• Does the tax administration publish regular reports upon its working that are freely available for those with an interest in the issue to use?</li> </ul>
<p>Company and trust administration</p>	<ul style="list-style-type: none"> <li>• Is incorporation easy, making the opt out from the income tax system a readily available thing to do?</li> <li>• Is the corporation tax and trust regime of the jurisdiction actively enforced meaning that the directors of an entity that fails to settle tax liabilities owing within either such structure faces the same degree of personal risk as they would face if failing to settle their personal income tax liabilities?</li> <li>• Are the identities of those making use of the company and trust structures provided by the jurisdiction identifiable so that the consequences of their use of such structures can be appraised within the income tax system?</li> <li>• Is that information on identities also readily available to those who wish to know with whom they are trading, meaning that the chance of error reporting from the public is increased?</li> <li>• Are the accounts of the entities making use of the arrangements offered freely available to the public so that the chance of error reporting from the public is increased?</li> <li>• Is the company and trust administration regime of the jurisdiction adequately resourced to undertake its work and</li> </ul>

<sup>37</sup> Tax compliance is for these purposes defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

	<p>enforce the standards laid down in law?</p> <ul style="list-style-type: none"> <li>• Are those who fail to comply with the regime prosecuted and are the penalties imposed of appropriate scale?</li> <li>• Is data on the operation of these administrations published and freely accessible?</li> </ul>
International agreements	<ul style="list-style-type: none"> <li>• Does the income tax system of the jurisdiction fairly and consistently treat those who are both long-term resident and short-term migrant within the jurisdiction?</li> <li>• Does the income tax system of the jurisdiction provide 'ring fences' that can be exploited by those not ordinarily resident in the jurisdiction, so undermining the credibility of its tax system in the eyes of its local population?</li> <li>• Does the jurisdiction engage in effective information exchange with other jurisdictions, encompassing income tax, corporation tax, capital gains tax and other sources of income to ensure that the local tax base is adequately protected from those seeking to evade their liabilities by attempting to record their income or assets offshore?</li> <li>• Is corporate and trust information readily and usually automatically shared with other tax administrations?</li> <li>• Does the jurisdiction proactively engage with other jurisdictions to cooperate in the collection of tax owing to whichever jurisdiction it may be due?</li> <li>• Does the jurisdiction proactively engage in measures to beat international tax abuse or is it a reluctant participant once a standard is being forced?</li> </ul>

The above issues have to be taken into account when considering how these areas impact on and may create risk for other areas of tax, or administration.

**Tax spillover – how the approach works**

Undertaking a tax spillover assessment in practice requires two stages. The first looks at each tax, policy or administrative issue and considers issues regarding its own design and the strengths or weaknesses. The second then considers these issues in comparison to the other areas listed on the respective grids. These issues are considered for each tax in turn.

To get most benefit from the process it is suggested that if these appraisals are documented the resulting appraisal might well be a useful review of the tax system of the jurisdiction in its own right. If a range of views are sought and collated when undertaking the review then the resulting assessment should reflect a cross-section of stakeholder experiences with and perceptions of the tax system, and add greater value as a result. Those from whom views might be sought should reflect all the various stakeholders of the tax system such as taxpayers, businesses, professional advisers, pensioners and employee representatives such as trade unions. Each score allocated requires a written justification in note form that provides some description of how widespread certain practices and behaviours are in the practical functioning of the tax system are and what their resulting implications are.

As example of how a tax spillover assessment might be undertaken, an income tax appraisal might be considered. An income tax system usually charges individuals tax on their earnings in a year from employment; self-employment; royalties; investments including interest, dividends and rents; as well as income from pensions, and (for those fortunate enough to enjoy them) trusts, foundations and other such sources. The income of partnerships is usually taxed as if it is the individual income of the partners and income tax is paid by each of them. Some companies and other structures are also taxed as if they are partnerships even though in legal terms they are not. In that case their members pay income tax on their share of the company’s income. The potential scope of such a tax is, then, very broad and getting the structure of the tax right is in that case very important to the overall credibility of the tax system, while transparency with regard to its operations is fundamental.

The assessment process will begin by asking some background questions. The following might be appropriate:

Generic question	Answer
What is the overall perception of income tax rates?	Low rates induce might inward flows from other taxes. High rates might induce outward flows to other tax bases. Objective data can assist understanding and support perceptions e.g. effective tax rates can be reported at varying income levels within a tax and comparison can be made between taxes.
What is the rate of progressivity within the income tax by percentage bands?	Highly progressive rates may encourage flows out of the income tax base towards other taxes. Low rates of progressivity, or no progressivity at all, may encourage inward flows to income tax from other tax bases.
What is the progressivity by income band?	If higher rates are not due until income is well above national average then progressive tax rates will be more readily accepted as being fair. As a result rates at certain key data points (relative poverty, average pay, median pay, 90 <sup>th</sup> decile, etc) should be compared both in principle and with effective tax rates to appraise this issue.
Is the tax base comprehensive?	No significant income should fall out of the tax base. If it does then opacity results, undermining tax transparency.
Are there a significant number of incentives, allowances and reliefs that encourage tax planning?	The more incentives, allowances and reliefs, the greater the opportunities and incentives for tax planning, and for tax avoidance and the greater is the likelihood of loss to such activities.
Is the tax base consistent when comparing the situations of those resident in the jurisdiction in both the short and long term?	A good tax actually treats people equally before the law. It does not offer incentives to relocate between jurisdictions to secure a tax advantage.

It is then appropriate to address some specific spillover questions with regards to the various taxes and aspects of tax administration with which the income tax system is being compared. These questions might be as follows, but note that some of the potential answers refer to the general background questions already noted:

Issue being compared with	Questions that might be asked when undertaking the comparison
Corporation tax	<ul style="list-style-type: none"> <li>• Are there significant differences between income tax and corporation tax rates that encourage flows between these tax bases, in either direction?</li> <li>• Does the corporation tax system allow roll-up of income at lower tax rates than the income tax system? This will encourage a shift of income from the income tax system to the corporation tax system.</li> <li>• Does the corporation tax system have additional incentives, allowances and reliefs for trades when compared to the income tax system? For example, are expenses easier to offset against gross income in a company than they are against an employment?</li> <li>• Is the corporation tax regime of the jurisdiction as well enforced as the income tax regime?</li> <li>• Do the penalties for non-compliance with either tax encourage a person to relocate their income to the other tax base?</li> </ul>
Capital gains tax	<ul style="list-style-type: none"> <li>• Does the capital gains tax system provide significant opportunities to save tax if a source of income can be shifted into it when compared to the income tax system?</li> <li>• Is there an additional annual allowance or exemption for capital gains that encourages income to be shifted into the capital gains tax regime?</li> <li>• Does either regime favour one form of family structure over another?</li> <li>• Do the taxes tax superficially similar transactions differently so encouraging bias against or for one or other?</li> <li>• Are there significant differences between income tax and capital gains tax rates?</li> </ul>
Social security	<ul style="list-style-type: none"> <li>• Are there aspects of either the income tax or social security systems that encourage income to be recategorised in ways that undermine the overall effectiveness of either tax system. For example, does social security encourage income</li> </ul>

	<p>to be declared as arising from a self-employment or does it encourage earned income to be recategorised as unearned income arising from, for example, dividends from a family owned company, to avoid a social security charge arising?</p> <ul style="list-style-type: none"> <li>• Does the complexity of having two tax systems on similar sorts of income from work discourage overall tax compliance?</li> <li>• Are there serious disparities in rates between the two taxes that discourage compliance at certain income brackets e.g. with regard to low or high pay?</li> <li>• Do the taxes, in combination, create uneven progressiveness within the tax system creating perverse tax incentives to avoid or evade at certain points within it?</li> <li>• Do the systems determine net income in the same way for all categories of income? For example, can the same expenses be offset in each case? If not, does this have perverse effects on compliance?</li> </ul>
Tax politics	<ul style="list-style-type: none"> <li>• As noted in the general questions.</li> </ul>
Tax administration	<ul style="list-style-type: none"> <li>• As noted in the general questions.</li> </ul>
Company and trust administration	<ul style="list-style-type: none"> <li>• As noted in the general questions.</li> </ul>
International agreements	<ul style="list-style-type: none"> <li>• As noted in the general questions.</li> </ul>

Once answers to these questions have been noted then an overall score can be considered, and will then be inserted into the grid.

Once the whole grid has been prepared then an overall appraisal can take place. Table 2 shows a sample grid prepared on a trial basis for the domestic tax spillovers within the United Kingdom based on this approach:

**Table 2: UK domestic tax spillovers example**

United Kingdom domestic tax spillovers	Issue having Impact										Sub totals
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax politics	Tax administration	Company and trust administration	International agreements	Total	
Issue being assessed	Income tax	4	5	5	3	5	5	5	4	36	134
	Corporation tax	3	5	3	3	5	5	5	4	33	
	Capital gain tax	3	4	5	3	5	5	4	4	33	
	Social security	3	5	3	4	4	5	5	3	32	
	Tax politics	3	3	3	3	5	5	5	4	31	135
	Tax administration	4	4	4	3	5	5	5	4	34	
	Company and trust administration	4	4	4	4	5	4	5	4	34	
	International agreements	5	5	5	3	4	5	5	4	36	
	Total	29	35	32	26	38	39	39	31	269	

Scores have been colour coded. A score of 2 would have been pale green and 1 would be pale blue. In this case those colours are absent as no area scored less than 3. Notably large numbers of risks were rated as 5, and most arose in aspects of tax administration. Overall, the social security system created least risk whilst the tax administration’s own weaknesses, as well as those in the company and trust administration, created the most spillover risk. Red indicates the highest rate of risk in the tax system.

The purpose of the spillover assessment should be apparent from this grid. It identifies risk and then ranks it for significance. If the objective of the government or tax authority is to reduce risk then the spillover table makes clear where the ‘low hanging fruit’ that will yield greatest return for the least effort are likely to be located within the system. As such a tax spillover assessment indicates where greatest attention should be focused. The supporting notes prepared to justify the scores awarded in the appraisal and document practices, provide a crucial narrative that answers the noted questions, and sets out in detail some of the issues that need to be addressed. The act of undertaking a spillover assessment therefore involves generating in report form qualitative commentary that explains the grids and the scores and risk ratings they contain. In the process the report generates extensive information about how a tax system is functioning in practice, constituting a significant degree of tax transparency in its own right that can be of benefit to a range of stakeholders including the government itself and can inform societal wide debate about future tax reform priorities.

**The most common risks likely to be identified by tax spillover assessments**

The risks that might be identified by a tax spillover and analysis could be many, and varied. However, there are some which are more predictable than others including:

**a. Tax bases that compete with each other**

Examples of competing tax bases are very commonplace and are found in many jurisdictions. The obvious example is the apparent conflict between income tax and corporation tax. Both can tax income arising from trading profits, rents, interest and other such activities.

It is important to recall that corporate income taxes were created as a defensive measure, to stop the leakage of income, profits, rents, investment income and gains out of the income tax base because of their transfer to corporations, where they were very often untaxed. The same was also true of capital gains taxes, where the same problem of competing tax bases also arises. These too were usually created to prevent tax bases being lost altogether. The fact that both taxes, corporate income taxes in particular, do now play a significant role in the tax revenues of some countries does not change this.

This issue can be best addressed by appreciating that these taxes were always meant to be complimentary. This should be apparent, and emphasized, in a transparent tax system. This means that, for example, tax spillover risk can be addressed by:

- Ensuring rate alignment to the greatest degree possible;
- Eliminating excessive or duplicative tax allowances;
- Ensuring that income received in private corporations is subject to income tax either by making these entities tax transparent, which results in their income being attributed to their members for taxation purposes, or by the use of close company regulation, which ensure that the income of these entities is distributed to their members and so is taxed on receipt by them;
- The use of comprehensive general anti-avoidance provisions.

If these risks are reduced the chance of tax avoidance, which deliberately creates opacity on taxpayer activity, will be considerably reduced.

**b. Permitting the choice of differing taxable entities for one particular tax base**

This problem does, of course, arise with regard to corporations in particular, where the issue can be addressed in the ways noted in the previous section. It does, however, also arise where income can be assigned to trusts, charities and foundations without appropriate restrictions being put in place to ensure that these are genuine. There are now many jurisdictions which, for example, permit the settlor of a trust to retain considerable control over it, including the right to revoke the whole arrangement and have the trust property revert to them. Such arrangements can give rise to substantial opportunities for tax abuse. These issues can be best addressed by:

- The maintenance of proper registers of trusts and related entities, on public record;
- The full public disclosure of the beneficial interests in trusts and related entities;
- The rigorous enforcement of charity law;
- Alignment of trust tax rates with those that might be due by their settlors in absence of distribution to beneficiaries;
- The use of comprehensive general anti-avoidance provisions.

**c. Differing tax rates within and between taxes**

This problem can be of the type noted in sections (a) and (b). It does, however, also arise in other taxes. For example:

- It is commonplace for investment income to be subject to tax at the lower rate than income earned from employment and trading profits within income tax systems. This provides significant opportunities for tax avoidance;

- In those jurisdictions that have social security as well as income tax systems it is commonplace for that social security charge to only apply to income arising from work, meaning that there can be a substantial differential in tax rates between earned and unearned income. This does, again, provide a substantial incentive for the re-categorization of income as unearned wherever that might be possible, and this generates tax avoidance activity.
- Land taxes can be subject to different rates depending upon the status of the occupant, which arrangements can be open to abuse;
- Exemptions, allowances and release within sales and value added taxes can frequently create problems in determining the appropriate rates to apply, which can be abused.

Other examples are, of course, found in many jurisdictions. These problems can be addressed by:

- Reducing the number of rate differentials within taxes, without necessarily undermining the objective of progressive taxation;
- The use of investment income surcharges on unearned income that are equivalent to social security charges;
- Better design of tax reliefs, exemptions and allowances;
- Better specification of the purpose of taxation;
- The use of comprehensive general anti-avoidance provisions.

#### **d. Different tax rates outside the jurisdiction**

It is not uncommon for different tax rates to be applied to similar sorts of income dependent upon whether they are earned within, or outside, the jurisdiction of residence of the person who receives them. This can happen because, for example:

- Income from outside the jurisdiction is exempted from tax as is, for example, commonplace within corporate tax systems;
- Income from outside the jurisdiction is presumed to have been already taxed, whether that is the case or not;
- Assets located outside the jurisdiction are exempted from wealth or capital gains taxes;
- Sales and value added taxes provide incentives for export by offering low or no tax rates, without matching controls on imports, creating the risk of tax abuse;
- People temporarily resident in the jurisdiction, even for quite extended periods, are exempted from all taxation on the income arising outside it, giving rise to opportunity for abuse;
- Overseas entities trading within the jurisdiction are exempted from tax within it, even if they trade or manage assets (e.g. rental properties) within the jurisdiction;
- No, or only limited, attempt is made to control transfer prices into and out of the jurisdiction, meaning that it is easy to relocate income that really arises within it to another jurisdiction, with the result that tax is avoided;
- There is no effective controlled foreign company legislation that requires that the income of a tax haven company owned by a person resident within the jurisdiction is brought within the scope of tax in the jurisdiction of that person's residence, which is now internationally recommended best practice;

- There is no attempt made to collect data on the income arising outside the jurisdiction attributable to people resident within it meaning that, in effect, that type of income falls outside tax whether that is the official intention, or not.

Many of the practices noted arise as a consequence of neglect or poor administration rather than deliberate design. In all cases the issues need to be addressed by a commitment to:

- Tax transparency, which makes it clear what is happening;
- An economic level playing field;
- The provision of adequate resources to ensure that taxes are collected;
- The collection of international data to ensure that it is known:
  - Who is resident in the jurisdiction;
  - Which companies are trading in the jurisdiction;
  - What income sources are received in the jurisdiction from outside it;
  - Who within the jurisdiction owns assets outside it;
  - Who owns assets within the jurisdiction but who are resident outside it so that tax arising within the location can be appropriately assessed;
  - Who is trading into and out of the jurisdiction so that transfer prices can be controlled;
- The use of comprehensive general anti-avoidance provisions.

#### **e. Failing to collect the data to support a tax base or bases**

As the section in Making Tax Work that deals with the design of a tax notes, without the necessary data to identify the ownership of a tax base it is nigh on impossible to collect it. A tax is, in essence, just a law. A tax system is something else altogether: it is a whole system intended to make sure that a tax can be recovered by a government that is seeking to impose it within a jurisdiction. That tax system requires information to make it work, and amongst the common failings in tax systems are failures to collect the information to ensure that the tax authority knows who might be liable to what taxes. The failures in question are numerous, but include:

- Not having census data to establish how many potential taxpayers there are within a country;
- Not having any form of national personal registration system to identify potential taxpayers;
- Not having an adequate company registration system, or having one that does not identify the beneficial owners of the companies in question, or their managers, so that those who might be liable to make payment of the tax on behalf of these companies cannot be identified and those that might benefit from the companies activities are, similarly, not known;
- Not having an adequate trust, foundation and charity register giving rise to the same problems as noted for inadequate company registers;
- Not having an adequate national income accounting system, meaning that that potential tax base for the country cannot be estimated so that likely tax yields cannot be compared with actual taxes collected;
- Not having adequate land registry is so that the ownership of property cannot be identified;
- Failing to put in place adequate information exchange systems e.g.:

- From employers to the tax authority with regards to the identity of those that they do employ;
- From banks to tax authorities on those that they provide banking services to and any interest that they pay, which is particularly important with regard to corporate entities to indicate that they trading;
- From landlords or their agents to the tax authority with regard to rental income;
- From lawyers and other advisers to tax authorities with regard to land and other capital transactions;
- From companies to tax authorities with regard to dividend payments;
- From traders to tax authorities with regard to sales, where an electronic and other automated payment systems would now allow the transfer of this data;
- From online payment platforms to identify traders, including those operating from overseas;
- From ports and airports with regard to customs declarations so that these can be reviewed for transfer pricing data.

Other examples clearly exist.

There are also problems in this area with regard to the failure of the tax authority to supply sufficient information to enable the appraisal of data. These include:

- Not publishing sufficient information to appraise the value of tax reliefs and allowances;
- The failure to supply information on the beneficiaries of tax reliefs and allowances so that the success, or otherwise, the policy objectives can be considered;
- The failure to publish information detailed in the section of Making Tax Work on government accounting, which means that the effectiveness of the tax authority cannot be appraised within the context of tax spillover analysis.

In each of these situations the solution to the problem is similar: effort must be made to put in place the appropriate systems to secure the necessary information.

#### **f. Having a weak or under-resourced tax administration**

As noted in the previous section, tax law cannot be implemented unless there is an appropriate tax system to support the tax collection process, and that requires that there be an adequately funded, trained and motivated tax authority. There are numerous reasons why this may not exist, but by far the most commonplace is that adequate funding is not provided to ensure that the tax authority can pay sufficient staff of appropriate caliber to undertake the necessary work to collect tax without fear of them either being lured away from their work by offers of alternative employment within the private sector or being open to bribes because of their own poor economic situation. It is, therefore, a necessity that any tax authority publish accounting data on the number of staff that it employs and their average pay so that the adequacy of this can be appraised.

#### **g. The absence of international tax agreements**

Most of the issues arising with regard to the failure to secure international data that supports a tax system have already been noted in the previous parts of this section.

There have been substantial efforts in recent years to increase international co-operation with regard to tax because it has been appreciated that so much tax has been avoided and evaded as a consequence of the structures adopted by multinational corporations. Transfer pricing abuse from high to low tax jurisdictions and the evasion of tax liabilities by individuals through the use of tax havens have been prominent. Information sharing by companies and between tax authorities has increased in an effort to deal with this.

However, problems remain in some international tax information sharing agreements. For example, those with the United States of America (USA) tend to be unilateral i.e. information has to be provided to the USA, but is not provided in return. In addition, country-by-country reporting data sharing agreements are far from comprehensive as yet, denying many countries the information that they need to appraise whether they face transfer mispricing risk, or not. It is also true that to participate in some OECD driven tax information sharing arrangements, some countries have to agree to participate in tax agreements that are not necessarily beneficial, most especially for developing countries. This is because such arrangements frequently include bias towards a residence basis of taxation, which favours developed over developing countries.

These are real issues of concern, but it remains the case that without data many tax systems are exceptionally vulnerable to international tax evasion and avoidance and, therefore, careful scrutiny of the international agreements into which the country has entered is necessary when determining whether appropriate tax transparency is in place.

#### **h. The failure of politicians to support the tax system**

The role of tax politics, which can also be described as a tax morale, within the jurisdiction is important to the overall success, or otherwise, of its tax authority. It also has a significant bearing upon attitudes towards tax transparency.

If a jurisdiction has high tax morale it is likely that that the tax system will be transparent with regards to its aims, and the chance of its success or otherwise in achieving them, is high. This however is dependent in investment in that high tax morale. This might require:

- A government that is willing to invest in its tax authority;
- The existence of comprehensive measures to ensure that there is a level playing field in tax paid;
- Effective measures to ensure that tax avoidance and tax evasion are both discouraged and beaten.

In turn each of these measures requires that the tax system be transparent with regards to its aims, High tax morale is both, in that case, the consequence of high tax transparency and in turn encourages it. There is a 'virtuous circle' within this process.

On the other hand, in tax jurisdictions with low tax morale, where a government contributes to this through its attitude towards tax, funding for its authority, poor commitment to tax level playing fields, high commitment to tax competition, and a general lack of willing to put in place arrangements to prevent tax abuse, there is also likely to be a low commitment to tax transparency.

There is no easy way to address this issue, which may take decades to change, but recognition that there is an issue, if it exists, is an important part of any tax spillover appraisal.

Overall tax systems are complex and made up of a series of interactions between different parts of the same tax system, and with tax practices and policies pursued in other countries. Having a fully transparent tax system that can be the subject of informed public debate and understanding, requires some transparent assessment and recording of the nature of these interactions and their consequences. Spillover appraisal provides a means of offering that kind of assessment in publicly accessible reports that deliver an extra layer of transparent analysis of how tax systems cohere in practice and with what consequences.

## Making Tax Work

### Chapter 13

#### Using tax transparency data

Making Tax Work is about the transparent data required to appraise the quality of tax systems. The aim is to check whether particular tax systems achieve their objectives as stated by the government of a jurisdiction and as a result whether they are fit for purpose.

Many suggestions and recommendations have been made in this Guide. This section offers examples of good practice that are in use. It also looks at some poor examples and explains why they can be problematic.

Examples cover:

- Budgets
- Financial reporting
- Additional, non-tax reporting
- Tax gaps
- Tax spillover assessments.

Some examples of how data might be used by those trying to understand tax systems both within a country, and between countries, are offered. It is stressed that this review is a long way from comprehensive and that practice changes quite often. For ease and to provide language consistency, all the examples are in English, and come from the territory best known to the authors. They are however chosen for their technical content, and not just because of their jurisdiction. They are intended to be illustrative of the issues encountered when considering how tax transparency works in practice, and how it could be made to work.

#### Budgets

Budgets should be provided in detail, and include sufficient explanation as to the basis on which they are prepared. To ensure that they can be fully understood it is important that any budget be compared with at least two prior periods, one of which at least should have had its accounts concluded, with the other being the current period of progress.

The UK provides an example of reasonable practice in his regard. This data comes from its March 2020 budget statement, as published by its Office for Budget Responsibility<sup>38</sup>:

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<sup>38</sup> <https://obr.uk/download/economic-and-fiscal-outlook-march-2020/> accessed 13-7-20

Table 3.3: Current receipts

	£ billion						
	Outturn	Forecast					
		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income tax <sup>1</sup>	192.6	195.2	207.5	217.4	227.3	236.6	246.6
of which: Pay as you earn	163.5	165.3	175.5	184.3	193.3	201.0	209.7
Self assessment	31.5	32.3	34.3	35.9	37.2	38.9	40.5
Other income tax	-2.4	-2.4	-2.2	-2.8	-3.2	-3.4	-3.6
National insurance contributions	137.3	145.4	150.2	157.0	164.0	170.3	177.1
Value added tax	133.1	136.6	140.6	145.9	151.0	155.8	160.7
Corporation tax <sup>2</sup>	56.3	55.1	58.1	60.0	62.6	64.9	67.2
of which: Onshore	54.4	54.0	57.2	58.9	61.4	63.6	66.0
Offshore	1.9	1.1	0.9	1.1	1.1	1.2	1.2
Petroleum revenue tax	-0.7	-0.4	-0.3	-0.3	-0.2	-0.2	-0.2
Fuel duties	28.0	27.7	27.5	28.1	30.5	31.2	31.7
Business rates	30.6	31.2	31.5	33.4	34.3	34.9	36.2
Council tax	34.8	36.2	37.9	39.1	40.3	41.6	42.9
VAT refunds	18.3	19.2	20.2	21.0	21.8	22.5	23.7
Capital gains tax	9.2	10.0	11.4	12.7	14.3	15.7	17.0
Inheritance tax	5.4	5.1	5.5	5.9	6.3	6.7	7.1
Property transaction taxes <sup>3</sup>	12.9	12.8	13.8	14.7	16.2	17.4	18.7
Stamp taxes on shares	3.6	3.4	3.6	3.7	3.9	4.0	4.1
Tobacco duties	9.2	8.7	9.0	8.8	8.8	8.7	8.7
Alcohol duties	12.1	12.1	11.9	12.4	12.8	13.3	13.9
Air passenger duty	3.6	3.8	4.0	4.2	4.4	4.6	4.8
Insurance premium tax	6.3	6.5	6.6	6.7	6.9	7.0	7.1
Climate change levy	1.9	2.1	2.2	2.1	2.3	2.4	2.6
Bank levy	2.5	2.4	1.9	1.1	1.1	1.1	1.0
Bank surcharge	1.8	1.5	1.6	1.6	1.6	1.7	1.7
Apprenticeship levy	2.6	2.8	3.0	3.1	3.2	3.3	3.5
Soft drinks industry levy	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Digital services tax	0.0	0.1	0.3	0.4	0.4	0.5	0.5
Other HMRC taxes <sup>4</sup>	7.4	7.4	7.4	7.6	7.7	7.7	7.8
Vehicle excise duties	6.5	6.7	7.1	7.0	7.2	7.4	7.6
Licence fee receipts	3.2	3.3	3.6	3.8	3.8	3.9	3.9
Environmental levies	7.5	10.2	9.6	9.9	9.8	10.4	10.8
EU ETS auction receipts	0.3	1.5	1.2	1.2	1.3	1.3	1.3
Other taxes	8.8	8.8	9.0	9.3	9.7	9.8	9.9
<b>National Accounts taxes</b>	<b>735.3</b>	<b>755.8</b>	<b>786.2</b>	<b>818.2</b>	<b>853.6</b>	<b>885.0</b>	<b>918.6</b>
Less own resources contribution to EU	-3.4	-3.4	-2.4	-	-	-	-
Interest and dividends	24.0	27.6	27.6	28.9	30.6	32.4	33.9
Gross operating surplus	52.9	54.3	57.0	58.7	61.3	63.5	66.2
Other receipts	4.0	5.0	4.5	4.9	3.7	3.8	3.6
<b>Current receipts</b>	<b>812.9</b>	<b>839.3</b>	<b>872.9</b>	<b>910.8</b>	<b>949.2</b>	<b>984.7</b>	<b>1,022.3</b>
Memo: UK oil and gas revenues <sup>5</sup>	1.1	0.7	0.7	0.9	0.9	1.0	1.0

<sup>1</sup> Includes PAYE, self assessment, tax on savings income and other minor components, such as income tax repayments.

<sup>2</sup> National Accounts measure, gross of reduced liability tax credits.

<sup>3</sup> Includes SDLT, ATED and devolved property transaction taxes.

<sup>4</sup> Consists of landfill tax (excluding Scotland and Wales), aggregates levy, betting and gaming duties, customs duties and diverted profits tax.

<sup>5</sup> Consists of offshore corporation tax and petroleum revenue tax.

The 2018/19 data is for a year where the accounts had been finalized (the UK has a 31 March financial year end). The data for 2019/20 provided a best current year estimate. A forecast is provided for five years. These are indications of good practice.

There are, however, weaknesses. In particular, there is no comparison of the 2018/19 budget with outturn and likewise no reporting on the same basis for 2019/20. This means that those being asked to consider the current budget have no idea when doing so how good past budgeting performance was, and therefore whether the current process is likely to be reliable.

This difficulty is increased because the forecast is only explained in relation to policy decisions made in the current year<sup>39</sup>:

**Table 2.1: Budget 2020 policy decisions (£ million)<sup>1</sup>**

		Head <sup>2</sup>	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
<b>Investing in excellent public services</b>								
<i><b>Spending review</b></i>								
1	Spending Round 2019 and set resource envelope for the Comprehensive Spending Review 2020	Spend	-2,530	-12,600	-27,225	-32,095	-36,085	-42,320
2	Delivering public service commitments including on health, schools, criminal justice system (resource spending) <sup>3</sup>	Spend	0	-1,430	-2,685	-2,795	-2,825	-
3	EU contributions: benefit from contributions no longer paid and customs duties retained	Spend	0	+4,340	+4,990	+7,130	+11,250	+14,605
4	Farm Support: domestic direct payments <sup>4</sup>	Spend	0	-2,710	-	-	-	-
<i><b>Delivering excellent services</b></i>								
5	National Health Service: 40 hospitals, diagnostics, operational capital <sup>5</sup>	Spend	0	-1,065	-	-	-	-
6	Immigration Health Surcharge: increase to £624 with £470 rate for children and extend to EEA nationals	Tax	0	+150	+355	+355	+360	+355
7	Pensions: increase annual allowance taper threshold and adjusted income limit, reduce minimum annual allowance	Tax	0	-180	-315	-450	-560	-670
8	Prisons: maintenance <sup>4,5</sup>	Spend	0	-175	-	-	-	-
9	Policing: counter terrorism <sup>4</sup>	Spend	0	-80	-	-	-	-
10	Safer Streets Fund: CCTV and street lighting <sup>4,6</sup>	Spend	0	-15	-	-	-	-

No overall justification is provided for the sum budgeted: it is simply assumed that budgets for prior years were correct and that all that needs to be explained is why they are being changed. This is rarely an appropriate assumption when it comes to budgeting in any organization, and is not when it comes to any government.

In addition, this data is not specified by tax. It represents the views of the agencies responsible, but takes little account of stakeholder need. It takes considerable effort as a result to find suitable data to appraise the budget.

<sup>39</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/871799/Budget\\_2020\\_Web\\_Accessible\\_Complete.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871799/Budget_2020_Web_Accessible_Complete.pdf)

That said, the UK Treasury has for more than twenty years published easy to understand summaries of its budget in the form of pie charts:

## Government spending and revenue

Chart 1 shows public spending by main function. Total Managed Expenditure (TME) is expected to be around £928 billion in 2020-2021.

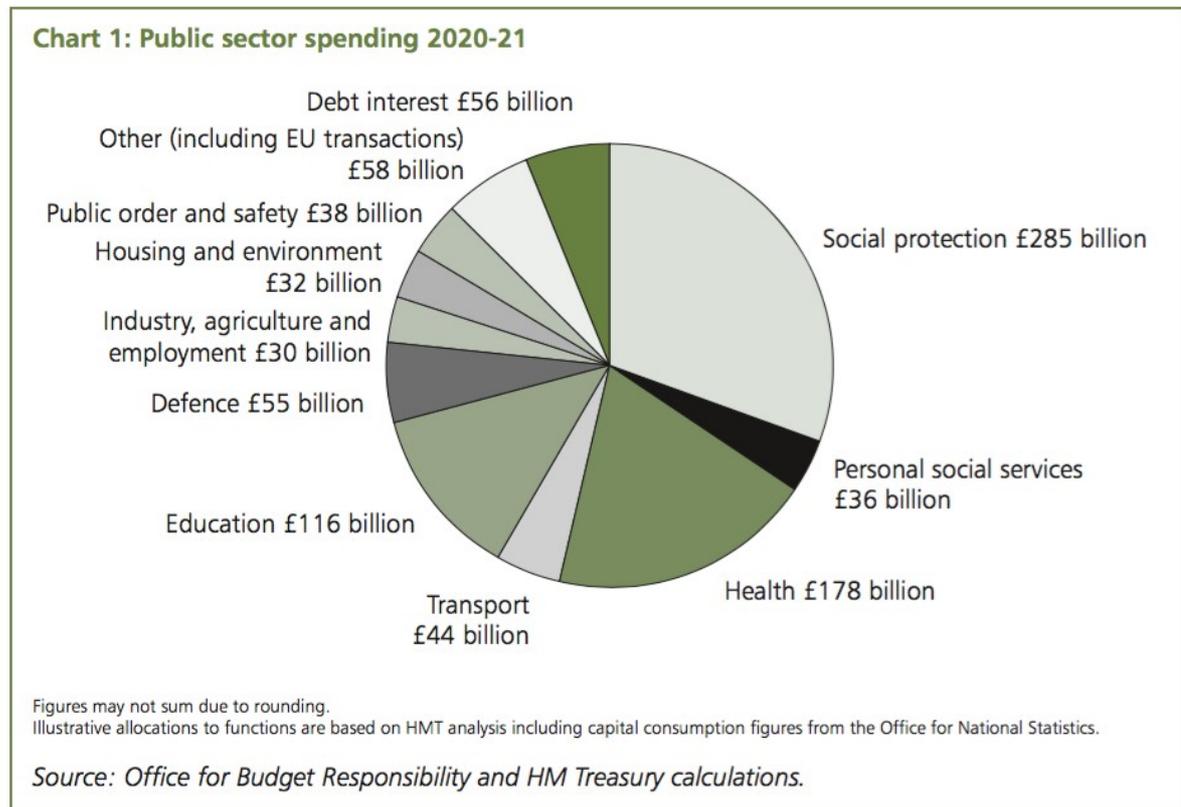
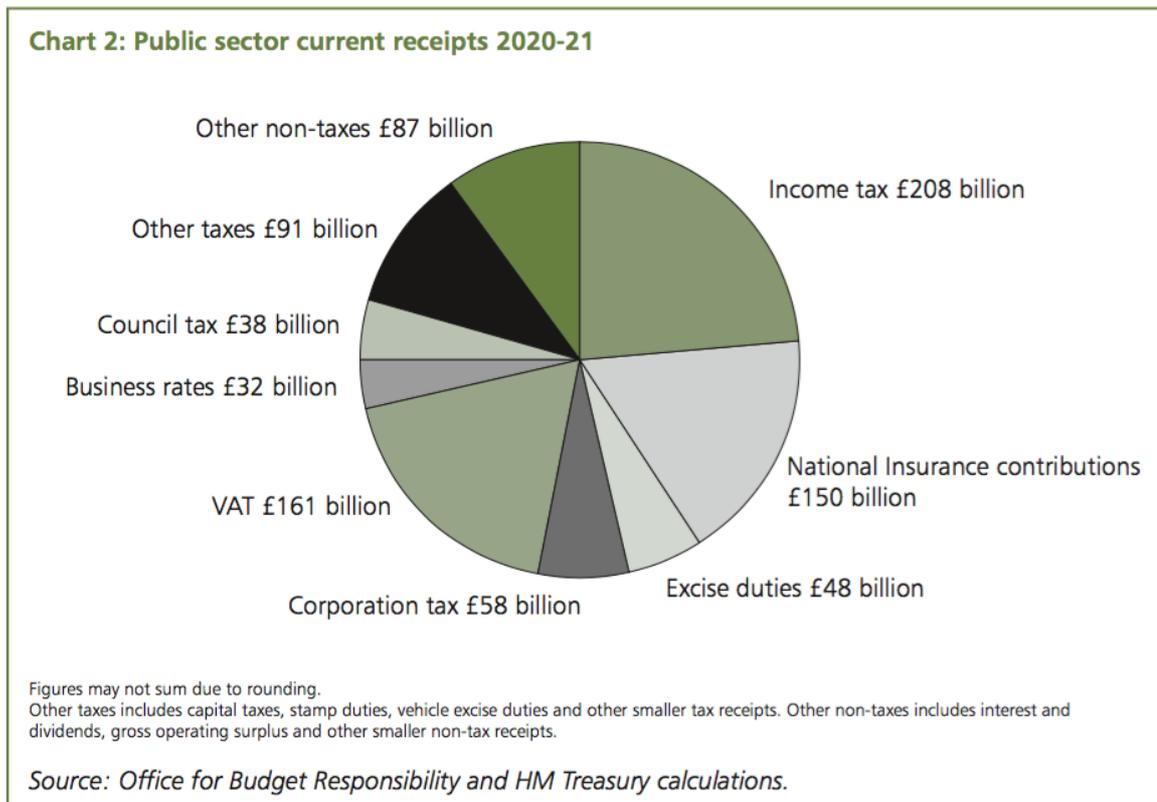


Chart 2 shows the different sources of government revenue. Public sector current receipts are expected to be about £873 billion in 2020-2021.



There are, however, problems with this presentation, including, in particular that:

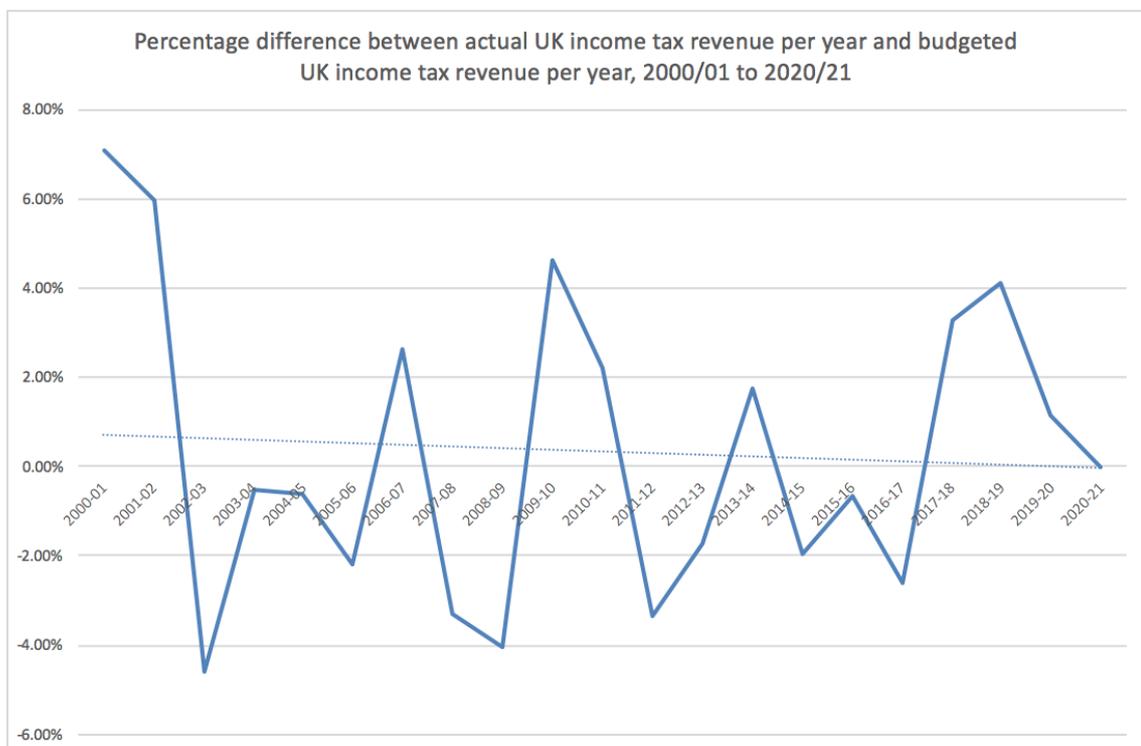
- No report on outturns has ever been provided in the same format;
- Outturn data for spending is never published under the headings as used in these charts, which reduces their usefulness;
- Comparisons over time are not provided for this data.

This last point is significant. Time series data can, relatively easily, be prepared by the diligent willing to do the number crunching on this data (including the authors of this report). The following chart shows the difference between budgeted income tax receipts and actual income tax receipts (shown as being the same for 2020/21, which is the first year of the forecast) since 2000/01. Income tax was chosen as an example because of its significance in overall tax revenues in the UK:



Source: Author’s calculations based on annual reporting over the period from the UK’s HM Treasury and Office for Budget Responsibility

The variances revealed here do not appear to be that large. However, as percentages the variances are quite significant, and are as follows:



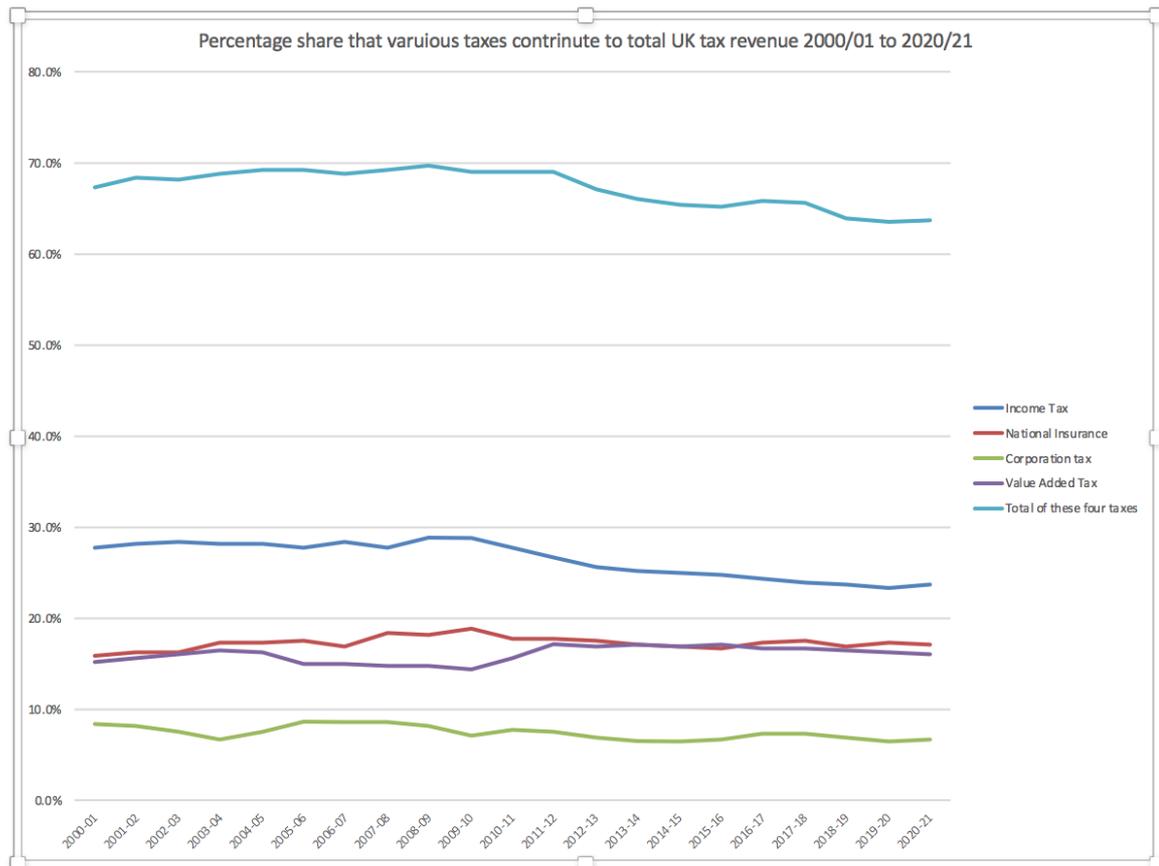
Source: Author's calculations based on annual reporting over the period from the UK's HM Treasury and Office for Budget Responsibility

Note that a linear trend line has been added to the data to give an indication as to whether the data may be getting better over time. It looks like it is, but do not over-rely on such auto-generated data. It is a discussion point, but not proof of anything. The important point is that there is a persistent difference between budgets and outcomes when it comes to income tax in the UK, and that this is unpredictable as to which will be greater than the other, and that those appraising the budget need to know this.

#### **Learning issues**

- Be willing to collect data over time and analyse it;
- If a government does not compare budgets with outcomes check if this can be done based on published data;
- Be prepared to interpret the data to make it comprehensible – drawing graphs frequently helps;
- If percentages are meaningful over time (and in this example they are) they can show whether there are trends in the data, and it is always useful to spot these.

Spotting trends in data is often useful. This chart shows the percentage shares of total tax revenue that the UK's four biggest taxes (personal income tax, value added tax, national insurance (a social security charge) and corporate income tax) have contributed to total UK tax revenue over 20 years:



Source: Author’s calculations based on annual reporting over the period from the UK’s HM Treasury and Office for Budget Responsibility

As is apparent there are trends that become clear when data is plotted over long time periods. The relative significance of income tax in the UK has fallen. Value added tax has a growing role to apparently compensate for this. Both national insurance and corporation tax have made relatively stable contributions over time.

But, there has as a result been a shift from direct tax (income tax) to indirect tax (VAT). The UK income tax system is broadly progressive (tax paid increases as a proportion of income as that income rises). The UK VAT system is broadly regressive (tax paid increases as a proportion of income as that income falls). The UK tax system is, then likely to have become more regressive overall as a result of this change and inequality is likely to have risen as a result, which is a consequence many have observed. Knowing these trends explains why it is important that tax reporting, both when budgeting and reporting outturns requires the reporting of long term trends.

### Learning issues

- Long term data frequently discloses trends within tax systems that short term analysis hides;
- The best way to test whether a tax system is really changing to achieve dated goals is to appraise long term data;
- Long term trends can reveal the social implications of long term tax trends;
- This analysis makes it easier to hold governments to account.

Some locations deliver better budget reporting than the UK does. While commonly described as tax havens, the UK Crown Dependencies of the Isle of Man and Jersey happen to provide good examples of budgeting practice. That may, of course, be because so many involved in government in these places are engaged in the financial services industry. The budget data for Jersey does, for example, provide better indication of how the data has been prepared than that for the UK, and unlike the UK is all available from one source, when the UK spreads this between a number of separate reports from more than one organisation, making it hard to access information.

This is the Jersey budget for taxes for 2019:

**Figure 1: Revised forecast (September 2018) for States income from taxation and duty**

Total States Income	Outturn	September 2018 Forecast					
	2017	2018	2019	2020	2021	2022	2023
	£'000	£'000	£'000	£'000	£'000	£'001	£'002
Income Tax	514,930	529,000	566,000	597,000	625,000	655,000	688,000
GST	87,946	90,517	92,358	93,482	94,538	95,728	96,833
Impots	59,999	62,109	62,785	62,679	62,692	62,816	62,960
Stamp Duty	33,283	34,736	35,366	35,008	35,771	36,557	37,366
<b>Total States Income from Taxation and Duties</b>	<b>696,158</b>	<b>716,362</b>	<b>756,509</b>	<b>788,169</b>	<b>818,001</b>	<b>850,101</b>	<b>885,159</b>
<i>Annual Growth</i>		2.9%	5.6%	4.2%	3.8%	3.9%	4.1%
<b>Budget 2018 forecast (September 2017)</b>	<b>657,903</b>	<b>686,246</b>	<b>707,335</b>	<b>732,052</b>	<b>757,830</b>	n/a	n/a
<b>Variation</b>	<b>38,255</b>	<b>30,116</b>	<b>49,174</b>	<b>56,117</b>	<b>60,171</b>		
<i>2018 Budget Measures</i>	-	(2,900)	(10,200)	(10,200)	(10,200)		
<i>2018 Budget 2nd Amendment - VED</i>	-	(2,200)	(2,100)	(2,100)	(2,100)		
<b>Variation (including 2018 Budget Measures)</b>	<b>38,255</b>	<b>25,016</b>	<b>36,874</b>	<b>43,817</b>	<b>47,871</b>		

Importantly, each tax is then subject to its own separate budget note with explanations for the budget and background assumptions supplied. It is that supporting data that is also important: budgets must say why they are the way they are stated: it is not enough to give figures alone.

## Accounts

Accounting for tax can come in a number of ways. The account can be included in 'Whole of Government Accounts' for the jurisdiction. Jersey, whose tax budget has just been noted, does this. The following data comes from the States of Jersey accounts<sup>40</sup> for 2019:

### 3.1 Consolidated statement of comprehensive net expenditure (SoCNE) for the year ended 31 December 2019

	Note <sup>a</sup>	States of Jersey Core Entities <sup>iii</sup> 2019 £'000	States of Jersey Group 2019 £'000	States of Jersey Core Entities <sup>iii</sup> Restated <sup>d</sup> 2018 £'000	States of Jersey Group Restated <sup>d</sup> 2018 £'000
<b>Revenue</b>					
Levied by the States of Jersey	6	(1,039,290)	(1,039,466)	(996,417)	(995,353)
Earned through Operations	6	(199,477)	(265,243)	(192,661)	(259,601)
<b>Total Revenue</b>		<b>(1,238,767)</b>	<b>(1,304,709)</b>	<b>(1,189,078)</b>	<b>(1,254,954)</b>
<b>Expenditure</b>					
Social Benefit Payments	7	413,855	413,855	393,659	393,659
Staff Costs	8	389,890	417,579	374,363	397,190
Other Operating Expenses		278,863	305,863	257,258	285,030
Grants and Subsidies Payments	9	44,629	44,740	44,655	44,668
Depreciation and Amortisation		47,932	72,608	49,695	76,138
Impairments & Abortive Costs	12b	12,135	26,756	17,012	24,134
Finance Costs	12b	25,759	26,833	26,752	26,156
Net Foreign-Exchange (Gains)/Losses		2,596	1,869	(212)	(195)
<b>Total Expenditure</b>		<b>1,215,659</b>	<b>1,310,103</b>	<b>1,163,182</b>	<b>1,246,780</b>
<b>Operating Net Revenue Expenditure/(Income)</b>		<b>(23,108)</b>	<b>5,394</b>	<b>(25,896)</b>	<b>(8,174)</b>
(Gains)/Losses on Disposal of Non-Current Assets <sup>iv</sup>		(99)	(109)	22	21
(Gains)/Losses on Financial Assets	12b	(391,949)	(402,305)	112,889	94,504
Movement in Past Service Liability		29,024	29,024	(21,716)	(21,716)
<b>Net Revenue Expenditure/(Income)</b>		<b>(386,132)</b>	<b>(367,996)</b>	<b>65,299</b>	<b>64,635</b>
<b>Other Comprehensive Income</b>					
Items that will not be reclassified to Net Revenue Expenditure					
Revaluation of Property, Plant and Equipment	10	(52,452)	(85,472)	(82,522)	(99,196)
Actuarial (Gain)/Loss in Respect of Defined Benefit Pension Schemes	24	(235)	(235)	211	211
Items that may be reclassified subsequently to Net Revenue Expenditure					
Loss on Revaluation of Available for Sale Financial Assets	12b	20,978	20,978	10,978	10,977
Reclassification Adjustments for Losses Included in Net Revenue Expenditure		-	-	-	50
Other Adjustments		-	-	-	(13)
<b>Total Other Comprehensive Income</b>		<b>(31,709)</b>	<b>(64,729)</b>	<b>(71,333)</b>	<b>(87,971)</b>
<b>Total Comprehensive Income</b>		<b>(417,841)</b>	<b>(432,725)</b>	<b>(6,034)</b>	<b>(23,336)</b>

The data is prepared according to International Financial Reporting Standards (IFRS) in place as of 1 January 2017, as adapted and interpreted for the Public Sector in Jersey. Since IFRS are not designed for government use this is an acceptable accounting policy, and the framework is published.

<sup>40</sup> <https://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=5234>

Note 6 to those accounts explains tax income:

## 4.6 Revenue

	Notes	2019 £'000	2018 - Restated £'000
Levied by the States of Jersey			
<b>Taxation Revenue</b>			
Personal Income Tax		475,000	453,000
Companies		116,342	100,173
GST		90,202	92,321
<b>Taxation Revenue</b>		<b>681,544</b>	<b>645,494</b>
Social Security Contributions		233,217	226,048
<b>Island rates, duties, fees, fines and penalties</b>			
Impôts Duty - Other		62,877	62,463
Stamp Duty and Land Transfer Tax		34,898	34,501
Island Rates		13,895	12,825
Other Fees and Fines		13,035	14,022
<b>Island rates, duties, fees, fines and penalties</b>		<b>124,705</b>	<b>123,811</b>
<b>Total Levied by the States of Jersey</b>		<b>1,039,466</b>	<b>995,353</b>
Earned through operations			
Sale of Goods and Services		118,589	104,519
Hire & Rentals		77,790	79,803
<b>Sales of goods and services</b>		<b>196,379</b>	<b>184,322</b>
<b>Investment Income</b>			
Interest Income	12	4,188	990
Dividend Income	12	47,586	53,896
<b>Investment Income</b>		<b>51,774</b>	<b>54,886</b>
<b>Other Revenue</b>			
Other Income	i	17,090	20,393
<b>Other Revenue</b>		<b>17,090</b>	<b>20,393</b>
<b>Total Earned through operations</b>		<b>265,243</b>	<b>259,601</b>
<b>Total Revenue</b>		<b>1,304,709</b>	<b>1,254,954</b>

This data can now be compared to the budget, but the IFRS framework for reporting does not allow this in itself, and so there is a restriction in place that means that a most important part of the revenue cycle is hard to appraise within these accounts. Jersey does not adapt its system for this. Given that it is clear that there are significant variances from budget to budget this is unfortunate.

Other governments overcome this. For example, the Isle of Man also publishes audited accounts<sup>41</sup> but they do so using United Kingdom Accounting Standards as applicable to an Isle of Man Entity, including Financial Reporting Standard 102 (FRS102). This provides them with what appears to be greater flexibility in reporting:

<sup>41</sup> <https://www.gov.im/media/1368468/audited-accounts-government-accounts-2018-19.pdf>



**6.3 Income and Expenditure Account – Central Government**

<b>Income and Expenditure Account</b>					
	Note	Central Government			
		2018-19			2017-18
		Gross Spend £000	Gross Income £000	Net (Spend)/ Income £000	Net (Spend)/ Income £000
<b>Treasury Department</b>					
Customs and Excise	7.3.1	-	383,583	383,583	358,814
Income Tax	7.3.2	-	236,196	236,196	229,928
Social Security	7.3.3	-	212,041	212,041	208,703
Other Treasury Income	7.3.4	-	10,224	10,224	10,603
Treasury Reserves Income	7.3.5	-	50,777	50,777	69,596
<b>Total Treasury</b>		-	<b>892,821</b>	<b>892,821</b>	<b>877,644</b>
<b>Other Departments</b>					
Cabinet Office	8.2	(40,068)	1,591	(38,477)	(34,952)
Enterprise	8.2	(31,678)	27,588	(4,090)	(5,141)
Education, Sport & Culture	8.2	(154,800)	9,438	(145,362)	(130,156)
Environment, Food & Agriculture	8.2	(23,010)	3,840	(19,170)	(18,253)
Health & Social Care	8.2	(320,306)	56,742	(263,564)	(259,209)
Home Affairs	8.2	(46,410)	1,286	(45,124)	(41,272)
Infrastructure	8.2	(217,224)	56,711	(160,513)	(115,788)
Treasury Gross Expenditure	8.2	(317,475)	-	(317,475)	(340,775)
<b>Sub-total Government Departments</b>		<b>(1,150,971)</b>	<b>157,196</b>	<b>(993,775)</b>	<b>(945,546)</b>
<b>Other bodies</b>					
Executive Government	8.2	(5,463)	69,316	63,853	62,317
Manx National Heritage	8.2	(6,337)	1,095	(5,242)	(4,773)
Statutory Boards (Revenue Funded)	8.2	(11,729)	9,191	(2,538)	(629)
		<b>(23,529)</b>	<b>79,602</b>	<b>56,073</b>	<b>56,915</b>
Legislature	8.2	(4,641)	57	(4,584)	(5,036)
<b>Total Expenditure</b>	8.2	<b>(1,179,141)</b>	<b>236,855</b>	<b>(942,286)</b>	<b>(893,667)</b>
<b>Net Voted Income</b>	7.4.2	<b>(1,179,141)</b>	<b>1,129,676</b>	<b>(49,465)</b>	<b>(16,023)</b>
<b>Surplus before Interest</b>		<b>(1,179,141)</b>	<b>1,129,676</b>	<b>(49,465)</b>	<b>(16,023)</b>
Interest payable and similar charges	7.7	(101,586)	-	(101,586)	(103,690)
Interest and investment income		-	1,127	1,127	-
Unrealised gain/(loss) on investments		-	32,581	32,581	(60,903)
<b>(Deficit) for the year</b>		<b>(1,280,727)</b>	<b>1,163,384</b>	<b>(117,343)</b>	<b>(180,616)</b>

This is a more stakeholder orientated approach to government reporting than that dictated by International Financial Reporting Standard. Even so, the Isle of Man still thinks that the data that the audited accounts supply is insufficient. As a result they also publish additional unaudited accounting data<sup>42</sup> to meet stakeholder need. In this the following information is supplied:

<sup>42</sup> <https://www.gov.im/media/1366577/detailed-government-accounts-year-ended-31-mar-2019.pdf>

#### 4.5 Government spending by department

Table 4.5

GOVERNMENT SPEND BY DEPARTMENT											
£000	Actual 2018-19			Revised Budget 2018-19			Variance to Budget			Actual 2017-18 Net Spend	Variance to Net Spend
	Gross Spend	Gross Income	Net Spend	Gross Spend	Gross Income	Net Spend	Gross Spend	Gross Income	Net Spend		
<b>Treasury Income</b>											
Customs and Excise	-	(369,703)	(369,703)	-	(369,436)	(369,436)	-	267	267	(358,746)	10,958
Income and Other Taxes	-	(237,742)	(237,742)	-	(223,200)	(223,200)	-	14,542	14,542	(232,897)	4,845
Other Treasury Income	-	(10,503)	(10,503)	-	(9,333)	(9,333)	-	1,169	1,170	(10,905)	(402)
Social Security	-	(212,041)	(212,041)	-	(211,283)	(211,283)	-	758	758	(208,703)	3,338
<b>Sub-total -Treasury Income</b>	-	<b>(829,989)</b>	<b>(829,989)</b>	-	<b>(813,252)</b>	<b>(813,252)</b>	-	<b>16,737</b>	<b>16,737</b>	<b>(811,251)</b>	<b>18,738</b>
<b>Government Departments</b>											
Cabinet Office	32,305	(1,591)	30,714	32,247	(1,516)	30,730	(59)	75	16	30,012	(702)
Enterprise	27,606	(27,588)	17	26,352	(26,328)	24	(1,254)	1,260	7	3,363	3,346
Education & Children	111,740	(9,438)	102,302	111,557	(9,120)	102,438	(183)	319	136	96,614	(5,688)
Environment, Food & Agriculture	19,882	(3,840)	16,042	19,550	(3,496)	16,054	(332)	344	12	15,712	(330)
Health & Social Care	276,889	(56,742)	220,147	275,844	(55,388)	220,456	(1,045)	1,354	309	219,178	(969)
Home Affairs	36,395	(1,286)	35,109	36,271	(1,160)	35,111	(124)	127	3	33,365	(1,744)
Infrastructure	120,289	(56,711)	63,578	119,667	(56,087)	63,580	(622)	624	2	58,738	(4,840)
Treasury (Gross Expenditure)	312,864	-	312,864	320,195	-	320,195	7,331	-	7,331	314,363	1,500
	<b>937,969</b>	<b>(157,196)</b>	<b>780,773</b>	<b>941,683</b>	<b>(153,094)</b>	<b>788,588</b>	<b>3,713</b>	<b>4,103</b>	<b>7,816</b>	<b>771,346</b>	<b>(9,427)</b>
<b>Other Bodies</b>											
Executive Government	80,211	(69,316)	10,895	81,262	(70,788)	11,196	1,051	(1,473)	300	9,175	(1,721)
Manx Museum and National Trust	5,540	(1,095)	4,445	5,312	(861)	4,451	(228)	234	6	4,403	(42)
Statutory Boards (Revenue Funded)	7,809	(9,191)	(1,382)	8,601	(8,295)	(416)	792	896	966	(1,325)	56
Legislature (Parliament)	4,626	(57)	4,569	4,799	(9)	4,790	173	48	221	4,506	(63)
<b>Sub-total - Voted Services</b>	<b>1,036,154</b>	<b>(236,854)</b>	<b>799,300</b>	<b>1,041,656</b>	<b>(233,047)</b>	<b>808,609</b>	<b>5,502</b>	<b>3,807</b>	<b>9,308</b>	<b>788,104</b>	<b>(11,196)</b>
<b>(Surplus)/Deficit</b>	<b>1,036,154</b>	<b>(1,066,843)</b>	<b>(30,689)</b>	<b>1,041,656</b>	<b>(1,046,299)</b>	<b>(4,643)</b>	<b>5,502</b>	<b>20,544</b>	<b>26,046</b>	<b>(23,147)</b>	<b>7,542</b>

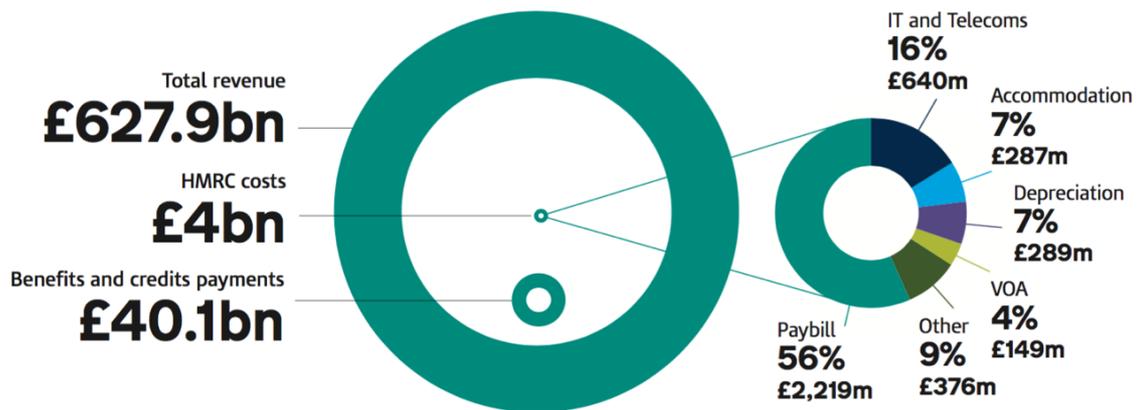
That the figures do not readily reconcile between the audited and additional statements does, unfortunately, undermine what otherwise appears to be a notable effort to reconcile actual results with budgets. The conflict between accounting policies used for budgeting and accounts reporting is a commonplace problem in tax transparency and is noted again, below, with regard to the UK.

The UK delivers a significantly worse performance than these two tax haven Crown Dependencies when it comes to accounting. The accounts of its tax authority, HM Revenue & Customs, are published annually. Those for 2018/19, for the year to 31 March 2019, were published<sup>43</sup> in July 2019, which is timely. There is, however, a problem with them. They do not account for the tax that the authority collects, except in non-audited notes where, for example, the following is recorded:

43

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/824652/HMRC\\_Annual\\_Report\\_and\\_Accounts\\_2018-19\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/824652/HMRC_Annual_Report_and_Accounts_2018-19_web.pdf)

Figure 1: Expenditure and benefits and credits relative to total revenue 2018-19\*



\* The above figures are based on budgeting treatment as opposed to accounting treatment as represented in the Resource Accounts. Numbers may appear not to sum due to rounding.

This is interesting, and a useful graphic, but it is unaudited data. The audited data on tax revenues for that same year was not produced until a year later when the UK government's Whole of Government Accounts<sup>44</sup> were published in July 2020, some sixteen months after the end of the period to which they related and therefore far too late to have an impact on decision making. These accounts were again prepared on the basis of a modified form of International Financial Reporting Standard, in similar fashion to HM Revenue & Customs. In those accounts there was this note as to tax revenues:

<sup>44</sup> <https://www.gov.uk/government/collections/whole-of-government-accounts>

## Note 4. Taxation revenue

	2018-19 £bn	% of total	2017-18 £bn	% of total
Income Tax	194.0	28%	186.0	28%
National Insurance Contributions (NIC)	120.4	18%	118.4	18%
Value Added Tax (VAT)	135.6	20%	128.6	19%
Corporation Tax	53.1	8%	53.2	8%
Hydrocarbon oils duty	28.0	4%	27.9	4%
Excise duty	28.5	4%	26.7	4%
Stamp taxes	16.4	2%	17.2	3%
Capital gains tax	9.3	1%	7.8	1%
Other taxes and duties	33.6	5%	33.6	5%
<b>Central government taxation revenue</b>	<b>618.9</b>	<b>90%</b>	<b>599.4</b>	<b>90%</b>
Council Tax	34.5	5%	32.1	5%
National Non-Domestic Rates (NNDR)	32.3	5%	30.1	5%
<b>Local government taxation revenue</b>	<b>66.8</b>	<b>10%</b>	<b>62.2</b>	<b>10%</b>
<b>Total taxation revenue</b>	<b>685.7</b>	<b>100%</b>	<b>661.6</b>	<b>100%</b>

Total tax revenue increased by £24.1 billion (3.6%) in 2018-19.

Income tax increased by £8.0 billion (4.3%) and National Insurance Contributions rose by £2.0 billion (1.7%). Both were supported by increases in the number of people in employment and wage levels.

**Value Added Tax (VAT)** increased by £7.0 billion (5.4%), resulting from economic growth, inflation and higher consumer spending.

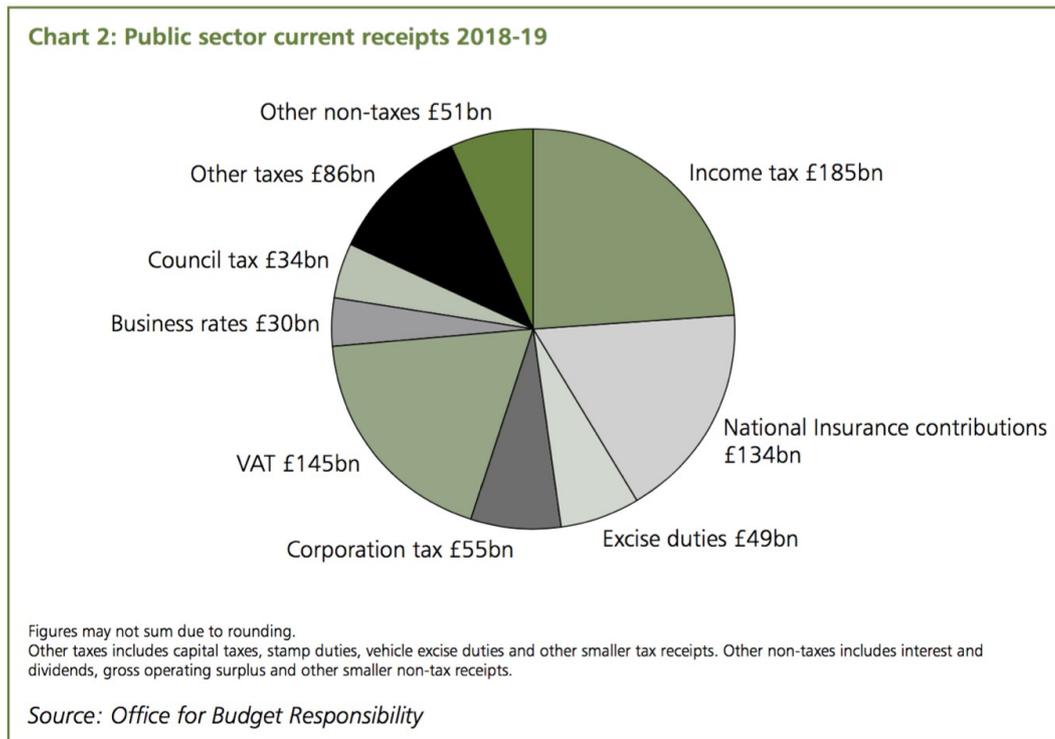
**Excise duty** increased by £1.8 billion (6.7%), reflecting increases in the rates of duty on alcohol and tobacco and increased alcohol consumption which may be due to hot weather, the FIFA world cup and royal wedding in 2018-19.

**Capital gains tax** increased by £1.5 billion (19.2%) and business rates collected by local authorities increased by £2.2 billion (7.3%).

The increases are partially offset by a decrease in stamp taxes which decreased by £0.8 billion (4.7%) as a result of 2018-19 being the first full year of First Time Buyers Relief claims.

2017-18 figures have been re-presented by moving £1.9 billion from corporation tax to other taxes and duties. This is due to certain tax streams previously included in corporation tax now being included in other taxes for 2018-19.

That is the entirety of the data supplied. It will be noted that this data is not compared to budgets. The summary of the budget for the year in question was<sup>45</sup>:



Oddly, the data also differed from the declared outturn for 2018/19 noted on page 3 above. When comparing these various sources the following table has been prepared:

UK government declared tax revenues according to varying sources

	Per audited accounts £'bn	Per budget for the year £'bn	Per 2020 budget statement £'bn
Income tax	194.0	185.0	192.6
National Insurance	120.4	134.0	137.3
Value added tax	135.6	145.0	133.1
Corporation tax	53.1	55.0	56.3
Hydrocarbons oil duty	28.0	-	28.0
Excise duty	28.5	49.0	22.2
Stamp taxes	16.4	-	16.5
Capital gains tax	9.3	-	9.2
Other taxes	33.6	86.0	74.7
Council taxes	34.5	34.0	34.8
National non domestic rates	32.3	30.0	30.6
	<b>685.7</b>	<b>718.0</b>	<b>735.3</b>

<sup>45</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/661480/autumn\\_budget\\_2017\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf)

The point is that none of these sources are consistent in the categorisations that they use, or the accounting treatment that they seem to apply, or even in the definitions of what is, and is not, a tax. Accounting data is critical, but consistency is key. This data fails to provide that consistency.

#### **Learning issues – accounts**

- Always check whether the accounts are audited, or not. Audited should be the final statement on what is considered the result for a year;
- Make sure that there are not differing versions of data, as is clearly the case in the UK;
- Check whether the accounts are prepared in accordance with a recognised accounting framework;
- Check whether the basis of accounting for budgets and accounts differ, as they clearly do in the UK;
- Compare accounts with budgets and seek explanations for variances;
- Where accounting data is not presented over time seek to summarise it so that trends can be identified.

#### **Learning issues – accounting analysis**

Much of what can be done with accounting data is similar to the analysis that can be undertaken with budgeting data, especially when combined with non-financial or other data (see the next section). However accounting data does also provide an opportunity, if data of the form published in the style offered by HM Revenue & Customs in the UK is made available to check:

- The cost of tax collected, and changes in it
- Tax collected per employee in the tax authority
- Average pay per person in the tax authority
- Tax paid per person and changes in it
- Tax paid by company and changes in it
- Taxes paid per household, if this data is known

Imagination and the limits to available data are the usual constraints when preparing this data.

#### **Other financial data**

The critical point to understand about all financial data is that none of it makes sense unless it can be compared with other information that provides a benchmark for comparing its credibility. This is as true of government data as it is for any other form of financial analysis.

The reasons for comparing budgets over time, and budgets with outcomes as well as outcomes over time, have already been noted.

The advantage of comparing tax systems has also been noted.

There is, however another type of data with which tax information should be compared, and that is the underlying economic data of the jurisdiction itself. The range of comparisons that might be made here, and the supporting data that might be required to make them, is very largely only limited by the imagination of the person undertaking the analysis, but that said there are some common items worth considering. What, however, always constrains this type of analysis is the availability of data to permit the analysis being undertaken.

As previously noted, the UK Crown Dependencies provide some surprisingly good examples of best practice when it comes to tax reporting. The Isle of Man does, for example, provide an annual publication entitled 'The Isle of Man in Numbers'<sup>46</sup>. The 2020 edition has this table of contents, which is itself indicative of the effort the government of the Island is making to provide information on at least some of the activities that go in there:

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<sup>46</sup> <https://www.gov.im/news/2020/jun/23/isle-of-man-in-numbers-2020/>

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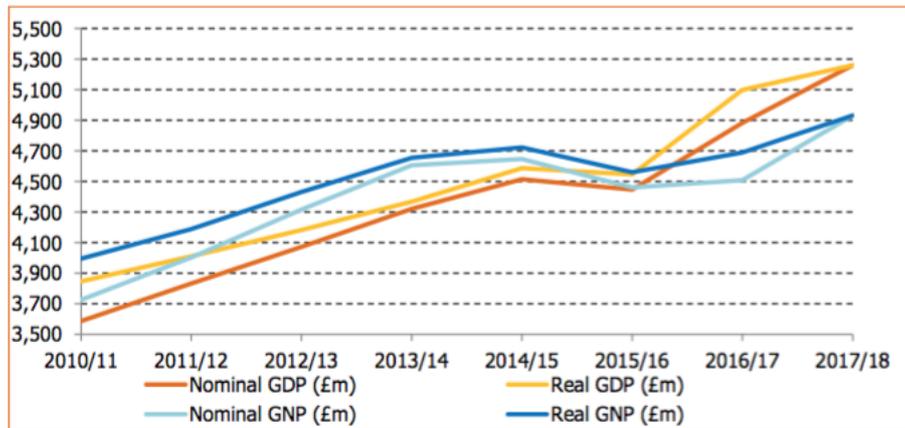
There are many governments throughout the world who might usefully copy this example.

A number of examples show good practice. For example, national income data is shown clearly, the method of calculation is stated and different bases are offered in this one page of information:

## Our Economy

### National Income

Figure 1 Gross Domestic Product and Gross National Product



Source: Cabinet Office

Table 3 Gross Domestic Product and Gross National Income (ESA 10 Methodology)

Year	Nominal GDP (£m)	Real GDP (£m)	Real GDP Change (%)	Nominal GNP (£m)	Real GNP (£m)	GNP Change (%)
2010/11	3,587	3,846		3,726	3,995	
2011/12	3,833	4,010	4.3%	4,003	4,188	4.8%
2012/13	4,072	4,182	4.3%	4,315	4,431	5.8%
2013/14	4,321	4,367	4.4%	4,605	4,654	5.0%
2014/15	4,514	4,586	5.0%	4,647	4,721	1.4%
2015/16	4,446	4,545	-0.9%	4,460	4,560	-3.4%
2016/17	4,883	5,098	12.2%	4,508	4,689	2.8%
2017/18	5,260	5,260	3.18%	4,931	4,931	5.16%

Source: Cabinet Office

Other data is also clearly presented. For example, this data on employment is made easier because of the small numbers involved, but most countries should be able to approximate this data based on survey information:

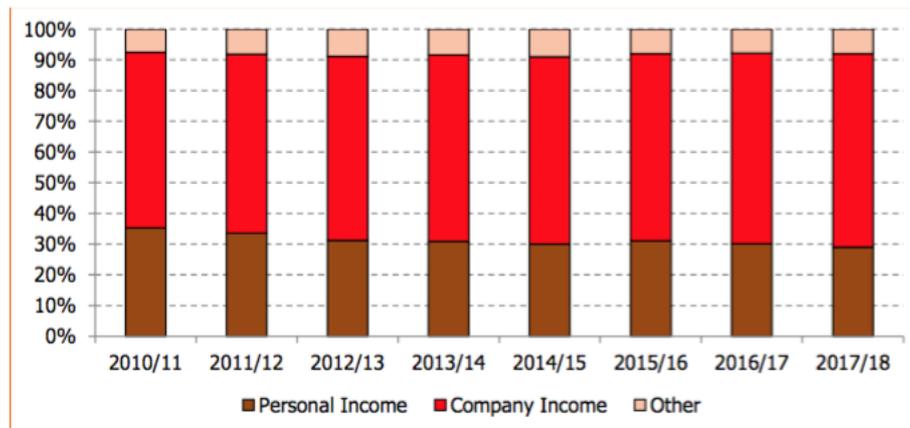
**Table 6 Employment by Sector 1951 to 2016**

Industrial Sector	1951	1961	1971	1981	1991	1996	2001	2006	2011	2016
Agriculture, forestry, fishing	2,542	1,911	1,433	1,412	1,240	938	543	642	850	866
Manufacturing	694	435	3,111	3,467	3,348	3,562	3,185	2,248	2,295	1,915
Construction	3,073	1,664	2,755	2,921	3,404	3,372	2,512	3,374	3,352	3,482
Gas, electricity and water	616	465	504	496	513	462	515	603	878	473
Transport and communication	2,180	1,875	2,122	2,624	2,437	2,693	3,331	3,809	3,037	3,162
Wholesale distribution		672	845	867	851	781	728	905	821	429
Retail distribution	3,315	2,411	2,696	2,687	2,993	2,911	3,644	3,645	3,683	3,253
Insurance, banking, finance and business services	357	370	760	1,515	4,353	5,941	8,959	9,395	9,444	8,703
Professional, educational, medical and scientific services	1,576	1,702	2,690	3,737	5,438	6,081	7,296	8,060	8,917	9,430
Tourist accommodation	0	0	1,451	987	856	765	743	362	679	629
Other catering and entertainment	4,605	4,344	678	996	1,403	1,156	2,116	1,897	2,129	2,393
Miscellaneous services	0	0	1,954	2,530	2,849	2,768	2,373	3,075	3,382	3,884
Public administration	1,870	1,250	1,134	1,625	2,144	2,147	3,105	2,898	3,058	3,027
Not stated or inadequately described		146							609	
<b>Total</b>	<b>20,828</b>	<b>17,245</b>	<b>22,133</b>	<b>25,864</b>	<b>31,829</b>	<b>33,577</b>	<b>39,050</b>	<b>40,913</b>	<b>43,134</b>	<b>41,656</b>

Source: Cabinet Office

And this data on the breakdown of gross domestic product is invaluable and hard to secure in such readily accessible form in many jurisdictions:

**Figure 2 Contributions to GDP**



Source: Cabinet Office

**Table 4 Nominal Contribution to GDP (£ million)**

Year	Personal Income	Company Income	Other	GDP
2010/11	1,264	2,053	269	3,587
2011/12	1,286	2,233	314	3,833
2012/13	1,269	2,441	363	4,072
2013/14	1,334	2,622	364	4,321
2014/15	1,360	2,770	384	4,514
2015/16	1,377	2,711	357	4,446
2016/17	1,470	3,028	384	4,883
2017/18	1,518	3,315	428	5,261

Source: Cabinet Office

This data shows the oddity of the Isle of Man, and the distortion caused by the fact that it chooses not to tax that company income (which is what makes it a tax haven), making it surprising that it makes this information available.

The critical issue is that underlying data allows comparison.

**Learning issues**

- Secure underlying data on the nature of the economy being taxed from the most reliable sources available;
- Use this data to consider:
  - Trends in total tax collected, and by individual tax, when compared to GDP;
  - Compare taxes in income to the share of labour in GDP over time;
  - Compare taxes on corporate profits to the share of profits in GDP over time;
  - Compare taxes on sales with GDP over time;
  - Undertake the same data per head of population;
  - Prepare the same analyses having allowed for inflation;
  - Check the resulting data against stated tax objectives over time.

**Other sources of data**

If a government is not good at publishing data it is important to note that not all is hopeless for the person seeking to prepare tax analysis so that they can appraise a tax system, although they will have to conclude that its transparency is not as good as it might wish for. There are many alternative sources of data to turn to.

First, and most obviously, there is Wikipedia. It is widely recognised that there are weaknesses in Wikipedia because of the way in which it is edited. It is, therefore, unwise to use it as a source in its own right, but the reality is that much of the information on Wikipedia is referenced to the location from which it is sourced on the web. If that is the case, and (most importantly) the primary data source can be verified, Wikipedia can be an invaluable starting point for research even if to actually reference it in a publication is unwise.

Another source is the CIA World Factbook<sup>47</sup>. Most people are a little suspicious of data from such a source, but this dataset is well researched and covers many required data points, albeit that the information in question is sometimes out of date or estimated, usually meaning that the CIA researchers also had problems in finding accurate information.

The World Bank’s Open Data is also an invaluable resource<sup>48</sup> and is especially valuable because information in comparable formats can be downloaded for each country, which makes comparisons easier to make, but there is little narrative explanation of the data and data is scarce for some countries.

<sup>47</sup> <https://www.cia.gov/library/publications/the-world-factbook/>

<sup>48</sup> <https://data.worldbank.org/>

The IMF also publishes general country level data<sup>49</sup>, as well as a great deal of country specific information, of which the most important for the purposes of the tax analysis is the Global Financial Statistics database, which is capable of being searched by country and for multiple countries at a time for the sake of comparison<sup>50</sup>. The dataset is broken down into seven sub-data sets, as follows:

1. Government Finance Statistics (GFS), Main Aggregates and Balances
2. Government Finance Statistics (GFS), Revenue
3. Government Finance Statistics (GFS), Expense
4. Government Finance Statistics (GFS), Expenditure by Function of Government (COFOG)
5. Government Finance Statistics (GFS), Integrated Balance Sheet (Stock Positions and Flows in Assets and Liabilities)
6. Government Finance Statistics (GFS), Financial Assets and Liabilities by Counterpart Sector
7. Government Finance Statistics (GFS), Statement of Sources and Uses of Cash

These are valuable resources when a government does not publish its own data, but care must be taken with currency translation issues and it must be remembered that the data is only as good, as the sources within the country that the IMF can use.

The Organization for Economic Cooperation and Development is also a source of data, and not just with regard to its own members. Its tax dataset is especially comprehensive<sup>51</sup>. They say of it:

*The [Global Revenue Statistics Database](#) provides detailed comparable tax revenue data for African, Asian and Pacific, Latin American and the Caribbean and OECD countries from 1990 onwards. The database provides the largest source of comparable tax revenue data, which are produced in partnership with participating countries and regional partners.*

The authors' experience supports this view, although this does not mean that the data is always comparable because of problems with the underlying source information. Also of use are the country summaries<sup>52</sup>.

The OECD also provides valuable information on the degree to which each country decentralizes its tax procedures and collection process in its fiscal decentralization database<sup>53</sup>.

<sup>49</sup> <https://www.imf.org/en/countries#A>

<sup>50</sup> <https://data.imf.org/?sk=a0867067-d23c-4ebc-ad23-d3b015045405>

<sup>51</sup> <https://www.oecd.org/tax/tax-policy/tax-database/>

<sup>52</sup> <https://www.oecd.org/tax/tax-policy/tax-database/>

<sup>53</sup> <https://www.oecd.org/tax/federalism/fiscal-decentralisation-database.htm>

The OECD is also unique in supplying data on tax authority efficiency, although the coverage is by no means comprehensive<sup>54</sup>.

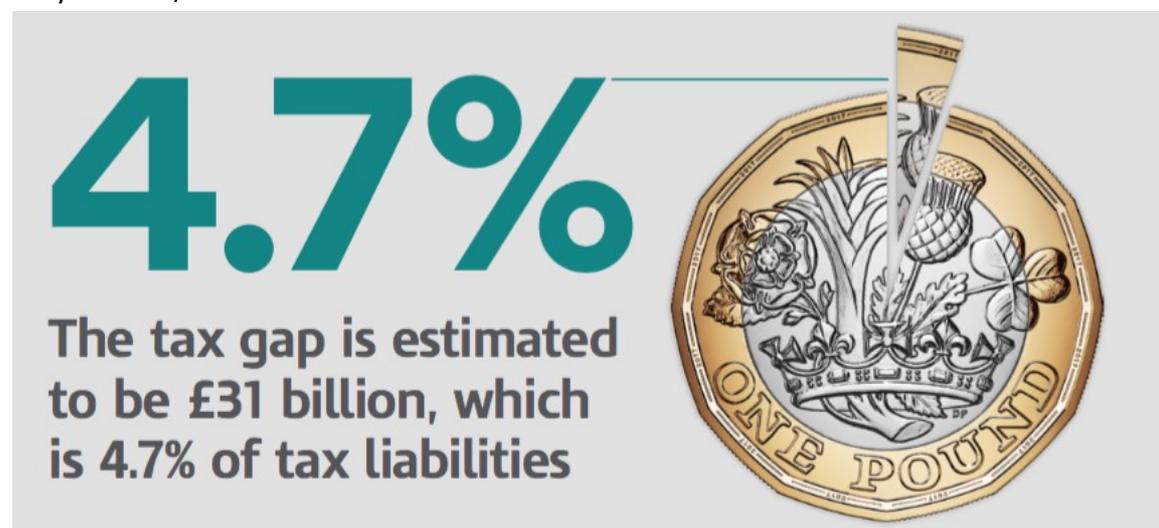
Learning issues – other data sources

- It is very easy to presume that the absence of local data means that analysis of a tax system is not possible;
- It may be concluded that a local tax system is not very transparent because of the absence of local data, but that does not prevent analysis;
- Alternative analysis of the available data on a tax system is an excellent way of generating questions that can be used to support a drive for tax transparency.

**Tax gaps**

Few tax authorities produce comprehensive tax gap data. The UK is the only tax authority to do so annually across its whole tax system. It provides the examples for this chapter, although there are serious issues with its tax gap methodology. It relies very heavily on bottom up rather than top down tax gap analysis, meaning the tax gap is likely to be understated.

The UK tax gap report is summarised as follows in the 2020 edition<sup>55</sup>, which relates to the UK tax year 2018/19:

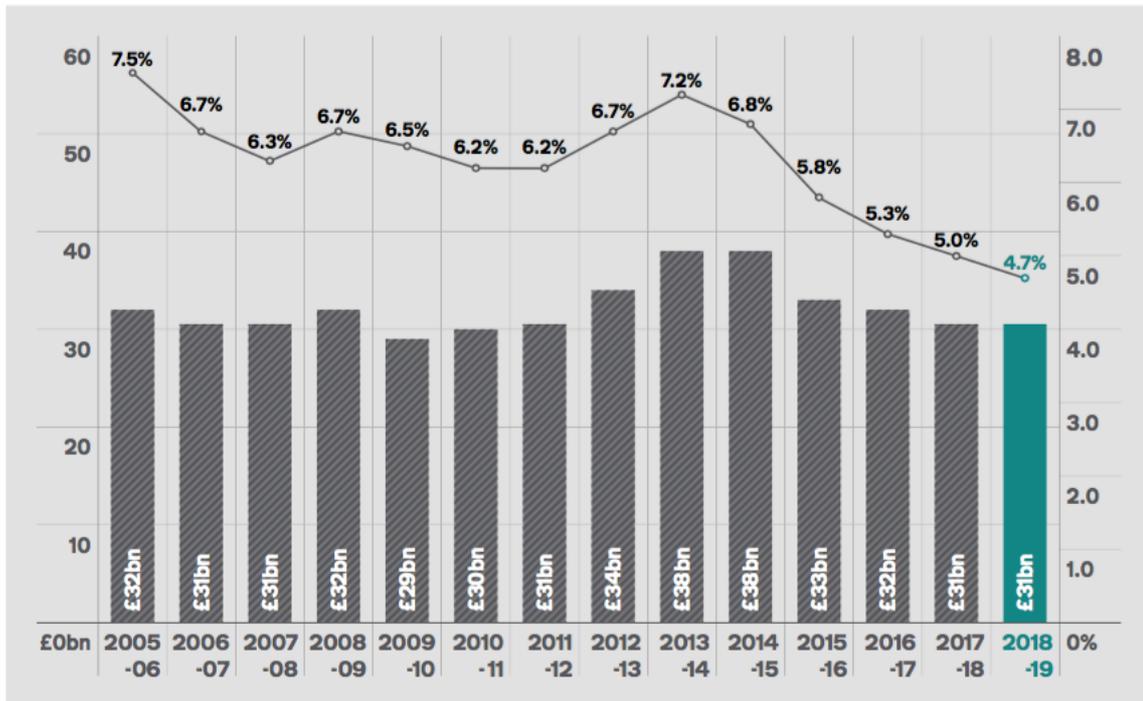


As apparent from the graphics, HM Revenue & Customs is intent on publicizing this issue. It is intended as a report for consumption as part of its own tax transparency programme. They follow up with these charts:

<sup>54</sup> <http://www.oecd.org/ctp/administration/tax-administration-23077727.htm>

<sup>55</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/899009/Measuring\\_tax\\_gaps\\_2020\\_edition.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/899009/Measuring_tax_gaps_2020_edition.pdf)

Tax gap and percentage of liabilities: tax years 2005 to 2006 up to 2018 to 2019



Value of the tax gap: tax year 2018 to 2019



And they offer this explanation:

**What is the tax gap?**  
The tax gap is the difference between the amount of tax that should, in theory, be paid to HMRC, and what is actually paid.

**Why measure it?**  
Tax gap analysis helps us to understand the reasons for losses in the system.

**How is it calculated?**  
It's an official statistic produced by government analysts in HMRC using a range of internal and external data and different analytical techniques.

The tax gap is difficult to measure and there are many sources of error. However, it gives an indication of our long-term performance – we have seen that the tax gap has decreased since the tax year 2005 to 2006.

It is welcome that they offer time series data as well:

		Summary						
Table 1.2: Percentage tax gap by type of tax <sup>1</sup>								
Tax	Type	Percentage tax gap <sup>2,3</sup>						
		2005-06	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Value Added Tax	<b>Total VAT</b>	<b>14.0%</b>	<b>11.9%</b>	<b>10.4%</b>	<b>8.6%</b>	<b>8.9%</b>	<b>8.6%</b>	<b>7.0%</b>
	Tobacco duties	21.7%	16.5%	12.8%	16.4%	17.8%	14.1%	13.8%
Excise duties	Alcohol duties <sup>4</sup>	9.8%	11.1%	14.7%	10.1%	9.4%	8.1%	7.5%
	Hydrocarbon oils duties	2.8%	0.1%	0.1%	0.1%	0.5%	0.5%	0.5%
	Other excise duties <sup>5</sup>	6.3%	10.0%	12.1%	8.8%	8.4%	6.7%	6.3%
	<b>Total excise duties</b>	<b>8.4%</b>	<b>6.5%</b>	<b>6.4%</b>	<b>6.1%</b>	<b>6.3%</b>	<b>5.1%</b>	<b>5.0%</b>
Income Tax, National Insurance contributions and Capital Gains Tax	Self Assessment	16.7%	24.7%	22.9%	16.2%	12.6%	13.0%	12.9%
	PAYE	1.5%	1.7%	1.3%	1.3%	1.1%	0.9%	1.0%
	Avoidance <sup>6</sup>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	Hidden economy <sup>6</sup>	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	<b>Total personal income taxes</b>	<b>4.5%</b>	<b>5.6%</b>	<b>5.3%</b>	<b>4.1%</b>	<b>3.5%</b>	<b>3.3%</b>	<b>3.4%</b>
Corporation Tax	Small businesses	19.1%	13.0%	14.9%	14.7%	13.6%	13.6%	14.4%
	Mid-sized businesses	13.5%	9.7%	12.1%	9.2%	6.6%	6.4%	6.8%
	Large businesses	8.8%	4.0%	4.3%	4.6%	3.2%	3.2%	2.9%
	<b>Total Corporation Tax</b>	<b>11.3%</b>	<b>7.8%</b>	<b>9.1%</b>	<b>8.8%</b>	<b>7.0%</b>	<b>6.8%</b>	<b>7.0%</b>
Other taxes <sup>7</sup>	Stamp duties	2.5%	1.3%	1.4%	1.2%	1.1%	1.0%	1.3%
	Other direct taxes <sup>8</sup>	3.1%	8.6%	8.4%	7.8%	7.7%	8.6%	8.6%
	Other indirect taxes	7.5%	6.1%	6.1%	6.3%	6.6%	4.8%	5.6%
	<b>Total other taxes</b>	<b>4.3%</b>	<b>4.5%</b>	<b>4.3%</b>	<b>4.3%</b>	<b>4.4%</b>	<b>3.7%</b>	<b>4.3%</b>
<b>Total tax gap</b>	<b>7.5%</b>	<b>7.2%</b>	<b>6.8%</b>	<b>5.8%</b>	<b>5.3%</b>	<b>5.0%</b>	<b>4.7%</b>	

1 Figures for previous years have been revised.  
 2 Estimates are rounded to nearest 0.1%.  
 3 The percentage tax gap for tax types may differ between Chapter 1 and subsequent chapters. We use published receipts figures in Chapter 1 as liability figures are not available at the level required across all tax heads. Read the published receipts figures used in Chapter 1 on GOV.UK: [www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk](http://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk)  
 4 The total alcohol duties figure excludes wine, as wine is now included in 'Other excise duties' in this edition. We explain this further in Chapter 3.  
 5 'Other excise duties' includes betting and gaming duties, cider and perry duties, spirit-based ready-to-drink duties and wine duties.  
 6 Percentage tax gap estimates for avoidance and the hidden economy are not shown as tax receipts cannot be calculated.  
 7 The petroleum tax gap is not calculated from tax year 2015 to 2016 as Petroleum Revenue Tax was permanently zero-rated from 1 January 2016.  
 8 'Other taxes' includes indirect taxes (Aggregates Levy, Air Passenger Duty, Customs Duty, Climate Change Levy, Insurance Premium Tax, Landfill Tax, Soft Drinks Industry Levy) and direct taxes (Stamp duties, Inheritance Tax and Petroleum Revenue Tax for years prior to 2015 to 2016).

It is more unfortunate that this has been heavily restated over time, leading to doubts as to the methodology used, as this chart shows with regard to Value Added Tax, where the restatements are quite significant:



Although HM Revenue & Customs publish a methodological note<sup>56</sup> to accompany the tax gap it is notable that the UK National Audit Office<sup>57</sup> also published a note: indicating that they felt clarification was required. That National Audit Office report does, for example, provide this useful explanation of what the tax gap is:

<sup>56</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/899010/Measuring\\_tax\\_gaps\\_2020\\_edition\\_-\\_methodological\\_annex.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/899010/Measuring_tax_gaps_2020_edition_-_methodological_annex.pdf)

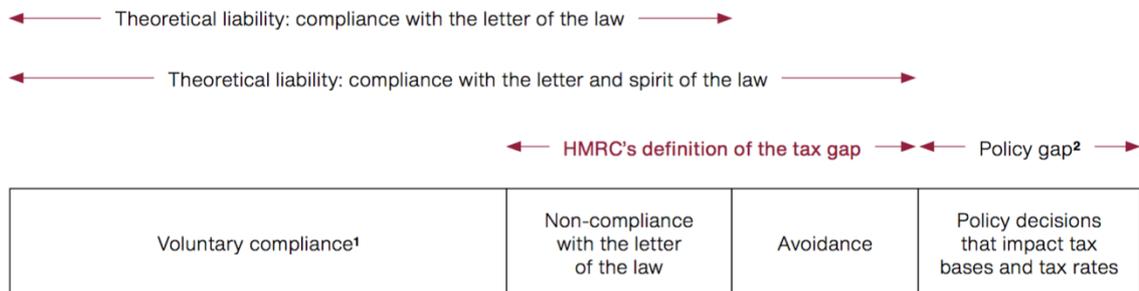
<sup>57</sup> <https://www.nao.org.uk/report/tackling-the-tax-gap/>

[https://www.nao.org.uk/report/tackling-the-tax-gap/?utm\\_content=&utm\\_medium=email&utm\\_name=&utm\\_source=govdelivery&utm\\_term=](https://www.nao.org.uk/report/tackling-the-tax-gap/?utm_content=&utm_medium=email&utm_name=&utm_source=govdelivery&utm_term=)

**Figure 1**

HM Revenue & Customs' definition of the tax gap

HM Revenue & Customs' (HMRC's) measurement of the tax gap includes both non-compliance with the letter of the law (such as tax evasion) and non-compliance with the spirit of the law (such as tax avoidance)



**Notes**

- 1 Voluntary compliance is also influenced by HMRC's actions to promote compliance and deter non-compliance.
- 2 The European Commission defines the policy gap as the difference between the total amounts of tax theoretically collectable under the general rules of tax law (that is, if no exemptions, etcetera, would apply) and the total amounts of tax theoretically collectable based on the applicable tax law.

Source: National Audit Office presentation of HM Revenue & Customs' definition of tax gap

Importantly, they note that policy tax gaps (comprising the tax base gap and tax spend gap as defined in Making Tax Work) exist but that they are not included in HM Revenue & Customs' tax gap estimates, by choice. This is significant as in the same month as this tax gap report and National Audit Office report were issued the UK House of Commons Public Accounts Committee<sup>58</sup> noted that there was no effective monitoring of the effectiveness or use of UK tax allowances and spends and that there was no effective accounting for at least £117 billion of tax spends as a result.

The National Audit Office is also concerned at the effectiveness of the HM Revenue & Customs methodology, largely because much of it is bottom up and even experimental as HM Revenue & Customs' own methodological note makes clear:

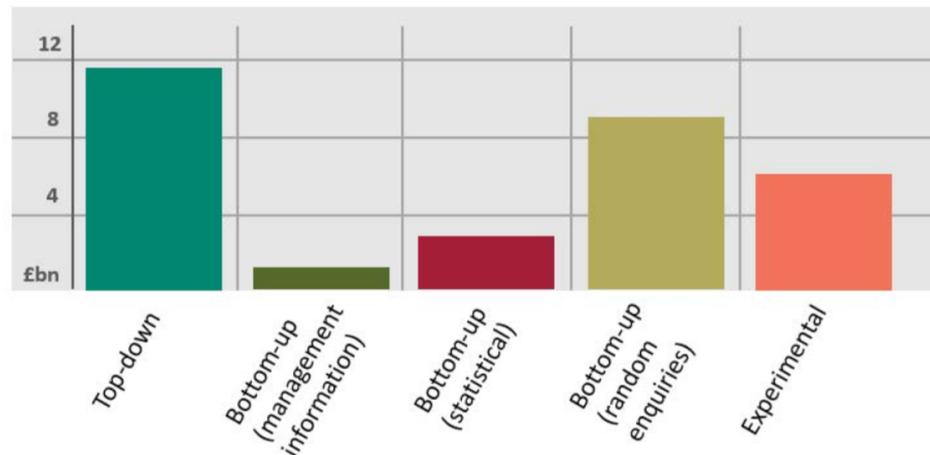
**Figure A.1 Tax gap methodologies**

Top-down	Bottom-up (management information)	Bottom-up (statistical)	Bottom-up (random enquiries)	Experimental
VAT all businesses	Stamp duties	PAYE mid-sized business	PAYE small business	Other excise
Tobacco duties		CT mid-sized business	CT small business	SA large partnerships
	Alcohol duties	CT large business	SA business & non-business	Hidden economy
		Inheritance tax	Diesel duties	PAYE large business
				Other remaining taxes

<sup>58</sup> [https://www.nao.org.uk/report/tackling-the-tax-gap/?utm\\_content=&utm\\_medium=email&utm\\_name=&utm\\_source=govdelivery&utm\\_term=](https://www.nao.org.uk/report/tackling-the-tax-gap/?utm_content=&utm_medium=email&utm_name=&utm_source=govdelivery&utm_term=)

The result is that only a limited part of the data reported is based on GDP based statistics and a much larger part is based on random statistical data from which many tax evaders may be excluded because they simply do not disclose their existence to the tax authority:

**Figure A.2 Tax gap by methodology**



One of the authors of Making Tax Work has been a long term critic of the HM Revenue & Customs methodology for this reason<sup>59</sup>. An alternative approach to tax gap measurement, based on shadow economy data, suggests a much larger UK tax gap than that arrived at by HM Revenue & Customs<sup>60</sup>. This alternative, for the tax year 2015/16, suggested that tax evasion alone might give rise to a tax gap of about €87bn in the UK, or £70bn, with tax avoidance and tax debt taking the total to in excess of £80 billion.

Despite the deficiencies being known for some time there has been little apparent attempt to address them and as a result the UK National Audit Office has suggested the following improvements:

*seek opportunities to base more of the overall tax gap estimate on established methodologies to reduce the level of uncertainty”. They add that “while recognising that it is appropriate for HMRC to primarily organise its approach to compliance by risk and customer group, consider extending, where relevant to other tax gap behaviours, good practice shown in its tax avoidance strategy and approach. For example, by setting out, in a single place for other behaviours, clear strategic objectives for tackling the underlying behaviour and a summary of the different actions HMRC is taking to achieve those objectives.*

The behavioural usefulness of the data is implicitly criticized.

If HM Revenue & Customs provides the most consistent tax gap estimates at present there appears to be some way to go in getting these measures right, or making them more useful.

<sup>59</sup> <https://www.taxresearch.org.uk/Documents/PCSTaxGap2014.pdf>

<sup>60</sup> <https://www.socialistsanddemocrats.eu/publications/european-tax-gap>

### Tax spillovers

Tax spillovers are even more experimental in the development of tax transparency methodology than tax gap reports at present.

No country currently publishes a tax spillover analysis and the aspects of the issue that we suggest should be explored are already covered by the chapter on this issue in this report.

An example of what a tax spillover analysis could look like as a country report is available [here](#).

## Making Tax Work

### Chapter 14

#### Sub-national government

While much of the attention in relation to tax transparency is focused at the level of national government, and many of the issues presented and elaborated in Making Tax Work are intended to assist scrutiny of national level policies, subnational government has a major role to play in the governance and delivery of services in many jurisdictions. As such their transparency on taxation matters and other revenues is a matter of importance that should be a constituent part of an overall tax transparency framework.

Much of the data that it should be expected that sub-national government should supply is of a basic and intermediate level. The advanced and aspirational levels of transparency noted in this report are only of real relevance at subnational levels of government when the degree of tax autonomy devolved is very significant.

This section of Making Tax Work considers the issues that arise when considering this issue at the subnational level and focuses in particular upon:

- The more restricted sources of revenue that many subnational governments have;
- The constraints that these sources of revenue can impose upon subnational governments, and the issues arising, most particularly when alternatives to taxation are used as a way to fund local programs of work;
- How concepts such as the tax gap and tax spillover can be adapted for local purposes;
- What subnational governments should be reporting and how the qualities of that data can be appraised.

#### 1. Introduction

The tax management of sub-national governments and agencies is an issue little considered in most tax discussion, and yet it can be significant. Many of the issues to be considered are similar to those of national tax authorities, but over a smaller range of taxes.

That said, tax transparency with regard to subnational government does depend on the level of subnational government being considered. This can vary across a range of possibilities:

- Village, community, parish and rural councils;
- Town councils;
- City and regional councils;
- Sub-federal state councils;
- Devolved national governments in countries like the United Kingdom and Spain.

The complexity of the issues clearly increases as progression through this list advances. Despite their differences, however, each of these types of subnational government will share many characteristics in common. In particular it is likely that:

- The range of taxes that they might impose may be constrained by the national government;
- The rates of tax that they may charge might also be constrained by the national government;
- The uses to which funds may be applied by a subnational government will usually be constrained by the national government;
- Whether a subnational government may borrow, or not, and in what amount, will usually be constrained by the national government, often meaning that it must balance its income with its revenues;
- The scope of the activities that a subnational government may partake in to raise alternative revenues e.g. from trading, the supply of facilities, the rent of land, or suchlike, is usually limited in scope by the national government.

One of the critical issues common to all these constraints when considering the issue of tax transparency with regard to subnational governments is, therefore, one that is absent when considering national governments, and that is whether or not the subnational government has acted within the law. These issues frame much of the discussion that follows.

## 2. Choice of tax

As with national governments, any subnational government has to be clear about the tax bases that are available to it. What differs between the two is that the range of options available to a subnational government will usually be constrained by a national government. However, subnational governments are frequently given the right to tax these bases:

- Land;
- Sales;
- Some or all forms of income;
- Specific taxes akin to charges that are often, but not necessarily exclusively, related to tourism and environmental issues.

It is unusual for subnational governments to be given any right to tax wealth. It is, however, commonplace for them to tax individuals, companies, partnerships, trusts, charities and other entities that are within the scope of the tax bases over which they have control. As a result identifying the existence and ownership of such entities can be as big an issue for subnational governments as it is for national governments.

In this case the notes in the section already included in Making Tax Work on the choice of tax bases applies just as much to subnational government, subject to the scope of its remit, as it does to national government. A number of other considerations therefore follow:

- a. In its reporting a subnational government that is tax transparent must make clear what tax bases it has available to it;
- b. As with national governments, a subnational government must seek to determine the value of the tax base that it has available to it, whether from local data, national data sources, surveys or other data sources. Only when it knows what it might tax can it determine at what rate it might wish to tax, and with what allowances, reliefs and exemptions to apply, if choice on those are within its power;
- c. The very existence of these choices mean that the first two tiers of the tax gap i.e. the tax base gap and the tax spend gap, also apply to subnational government, and that

- these could, at an advanced stage of tax transparency, therefore be calculated to inform any decision-making at this level;
- d. Many subnational governments' limited borrowing power meaning they need to balance their income and expenditure more frequently than national governments. In addition, because subnational governments do not have control of a central bank the range of borrowing options available to them are substantially reduced. As a result, the required level of revenue generation for a subnational government will likely equate with the costs of and demand for services. In that case it is not possible, in most situations, to consider the tax revenue budget and subnational government spending budgets independently of each other: they will always be intimately related in a way which is not automatically true in the case of central government;
  - e. Consequently, scrutiny of the difference between sums collected by the subnational government and the sum that might have been collected based upon the estimated tax base, requires as much scrutiny in the case of subnational governments, as in the case of national governments. This difference represents the third, fourth and fifth tiers of the tax gap as already explained in *Making Tax Work*. The fifth tier is bad debt with regard to tax liabilities, which will be a sum that any subnational government will be able to calculate from its own records. Given that in most cases the taxes operated by subnational governments are simpler than those operated by national governments it is likely that there will be less tax avoidance involved in non-payment to subnational government: in some cases this might make consideration of the tier four tax gap, on tax avoidance, largely irrelevant. That then means that tax evasion, which is the third tier of the tax gap, may well dominate revenue loss in subnational government;
  - f. Determining the scale of this loss will always be important and contribute to tax transparency at the subnational level. This is because the relationship between services supplied and revenue generated is so intimately connected in the case of many subnational governments. The consequences of failure to collect tax can have a significant social impact, because either necessary services cannot be supplied, tax-induced inequality results from uneven compliance, or because these losses result in choices on tax bases, rates, allowances, reliefs and exemptions that in turn have unintended social impacts. The impact on tax morale of services not being supplied also has to be taken into account. This is a particularly strong reason to promote tax transparency at the subnational level. Local authorities have as much duty as national government to consider the non-revenue raising aspects and wider social impacts of their taxes, including the implications for the delivery of overall policy objectives.

### 3. Other income

There is another dimension to the activities of many subnational governments that can often be overlooked but which is critical to its revenue in very many cases. This is that many subnational governments generate significant parts of their income by activities that look like trading. Depending upon the scale of the government in question this can vary but the following are all commonplace:

- the provision of car parking,
- land rental,
- the operation of shopping malls,
- the management of leisure facilities,
- local power generation schemes,
- the operation or management of public transport;

- the management of health and care facilities;
- recycling and waste management schemes;
- local housing supply;
- training and related facilities;
- land management operations e.g. with regard to flood defence;
- and many more such activities.

Such arrangements are considerably more commonplace amongst subnational governments than amongst national governments largely because many such schemes require local decision-making and are therefore naturally orientated towards subnational government supply.

There is, however, a significant risk within these activities when it comes to tax transparency, and this is that while the services in question may well be the responsibility of a subnational government the actual delivery will be undertaken through trading entities incorporated as limited liability corporations, whether wholly or partly in subnational government ownership, or in joint-venture arrangements.

The supply of local government services through such structures can create considerable opacity unless great care is taken to ensure that:

- The ownership of these trading entities is fully disclosed;
- Details of the officers of these entities is disclosed, including their remuneration, most especially when this is paid to persons elected to subnational government;
- The full trading accounts of these entities is made available, free of charge, on public record;
- The tax paid by these entities is fully explained;
- Other local accounting requirements are fully complied with.

Reporting on such entities owned, or part owned by sub national government should include the above requirements, as an important component part of tax transparency.

#### 4. Reporting

Given the issues noted in this section it is clear that just because a subnational government might have a simpler range of taxes to consider it cannot ignore the reporting of the social consequences of its decisions on what, and what not to tax, and on what allowances, reliefs and exemptions to give, all of which can have major social and economic impacts. All should be part of the information made available in a system of tax transparency. As a result, a reporting system similar to that of national governments may be required by subnational governments, albeit adjusted to suit their scale.

## Making Tax Work

### Chapter 15

#### Conclusions

Making Tax Work suggests why a tax transparency framework should be an essential part of the tax management system of any tax authority.

What Making Tax Work also makes clear is that a commitment to tax transparency is about more than the publication of data, however significant that issue is in its own right.

Tax transparency is about a commitment to the fair treatment of all taxpayers so that the tax system of a jurisdiction represents as far as possible a level playing field for as many participants as possible. But tax transparency as a process outlined in this document, is also about increasing access to, understanding of and confidence in the integrity of tax system and its functioning, for multiple parties and stakeholders. That in turn reflects the mutuality of obligations that exist within a society between the tax authority, taxpayers, their agents, civil society and their political representatives. Such obligations rest on and require more than data to fulfil.

However, in the absence of satisfactory data there can at best be only very limited tax transparency. This means, for example, that a tax authority has to make it as easy as possible for taxpayers to fulfil their obligation to settle their tax liabilities by delivering full disclosure of all data required to ensure those obligations can be fairly determined.

That completeness of information supply that a tax authority expects from a taxpayer must also be reciprocated. Tax authorities should provide sufficient data on the taxes that they manage, their legislation and procedures, the tax that is actually collected as well as estimates of that tax that is not recovered, as well as engaging in some independent assessment of their overall efficiency in managing the tax system.

This might be described as a mutual commitment by all parties to full disclosure. Much of Making Tax Work has been about describing what that full disclosure might mean, most particularly in the case of tax authorities, where the issue has not been as well developed as it has been in the case of most taxpayer obligations.

Tax transparency should consequently be regarded as an ongoing commitment amongst multiple stakeholders. This is implicit in our definition of tax transparency, which we have described as a process that supplies the quantitative and qualitative data (as a public good) that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of the tax system.

Having discussed the issues that arise from this definition over the previous fourteen chapters we now conclude by offering some high-level broad principles of tax transparency that can be distilled from that prior discussion. These ten principles of tax transparency are intended to be act as a high level guide, for an international standard, that can inform governments, international organisations, civil society and business in working towards enhanced tax transparency and the more informed, inclusive tax policy dialogues that would entail. The purpose of these principles is to act as a framework that will enable judgements to be formed on how much tax transparency exists within a particular jurisdiction, but also to provide a general concise route map that sets out the kinds of steps that if taken will improve tax transparency for the benefit of all parties. These principles are to act as a baseline starting and reference point for further discussion on the appropriate substance and content of future international principles of tax transparency.

## The Ten Principles of Tax Transparency

The ten principles emerging from Making Tax Work are as follows:

1. Everyone in a country has the right to seek, receive and access information on the tax system.
2. Governments should publish clear, measurable objectives and aspirations for the tax system.
3. Those objectives should be supported by detailed budget projections for future tax revenues, along with explanations of those projections and their implications.
4. Governments should operate a consultation process on significant proposed changes in tax policy and seek responses from a wide range of stakeholders.
5. All subsequent tax changes should be implemented with statutory approval.
6. Governments should publish accounts on tax revenues generated at least once a year, reporting on success and failures in achieving stated objectives with reference to numerical data and previously published budgets.
7. All taxes, and their administration, should be backed by law.
8. Taxpayers should have access to clear information and advice to enable them to comply with the tax law of a jurisdiction, as well as a right of appeal against liabilities with which they disagree.
9. Governments should periodically evaluate the performance of their tax system in its entirety using tools such as tax gap analyses and tax spillover assessments.
10. The data underpinning tax transparency should be subject to a verification process, undertaken by an independent agency that would audit, evaluate and report on the accuracy and fairness of that data.

Making Tax Work sets out the case for these principles.

Tax transparency however, is not of benefit in isolation. Making Tax Work has defined tax transparency as a public good. That means it is a service that is provided without profit to benefit all members of a society. But so too is the tax system itself a public good. While few pay tax with enthusiasm, most appreciate just how important it is, for the many reasons noted in Making Tax Work. If the value of this overall public good is enhanced by tax transparency and the benefit to society increases as a result then there has been an overall welfare gain to society as a whole. Ultimately, this is why tax transparency, and the delivery of an appropriate tax transparency framework matters.

**Making Tax Work**

**Glossary**

**Note:** This glossary seeks to cover the issues covered in Making Tax Work but cannot cover all the issues that might arise.

Other recommended glossaries are that in the International Monetary Fund's [Government Finance Statistics Manual 2014 \(GFSM 2014\)](#) and that available from the [Organisation for Economic Cooperation and Development](#)

Some of the definitions noted here were previously included in a glossary for which one of the authors of Making Tax Work was largely responsible that was published by the Tax Justice Network and are reproduced with its permission.

Accountant	A person, usually but not always qualified by examination, who prepares accounts, offers taxation and commercial advice and who may audit the accounts of companies and other limited liability entities when that is required by law.
Accounts	<p>The annual published statements issued by a company in accordance with the legislation and regulation of the country in which it is incorporated for the benefit of share-holders and others (if they are permitted access under local law) who wish to appraise the financial performance of a limited liability company or other limited liability entities such as a limited liability partnership.</p> <p>If the company is registered on a stock exchange which requires compliance with the rules of the International Accounting Standards Board, then the accounts will also have to comply with their rules. Otherwise they will comply with locally issued accounting standards.</p> <p>Accounts will normally include a statement from the directors of the company providing an overview of the trading of the entity for the year, a profit and loss account showing its income and expenditure during the period and its net profit plus an estimate of taxation liabilities that will arise from them, a cash flow statement showing how it used the net cash surplus or deficit that it generated during the course of the year, a balance sheet showing its total assets and liabilities at the year-end as represented by the total net investment by the shareholders and notes to the accounts which explain each of the statements.</p>
Accounting data	The books and records, both internally generated and supplied by third parties with whom the entity contracts, which are required to prepare a set of accounts.

Accounting policy	<p>Within the context of taxation this refers to the way in which tax is accounted for within national (and subnational) accounts as well as within the accounts of a tax authority itself. Of particular significance are questions as to:</p> <ul style="list-style-type: none"> <li>• Whether tax will be accounted for on a cash basis (i.e. when it is paid) or on an accruals basis (i.e. when it is due);</li> <li>• How tax bad debt, and other aspects if the tax gap will be reflected in the accounts;</li> <li>• What level of disclosure with regard to individual taxes will be included in those accounts;</li> <li>• How the costs of tax collection will be disclosed;</li> <li>• How tax disputes as to income to be collected will be recognised and on what basis disputed income will be recognised.</li> </ul>
Accounting standards	<p>Regulations governing the way in which certain transactions are reported within the accounts of companies and other entities.</p> <p>Originally issued on a national basis, and usually by the professional bodies of accountants within each country, they are now being supplanted by International Financial Reporting Standards issued by the International Accounting Standards Board.</p>
Affiliated company	<p>A company likely to be more than 20% owned by another company that does not however own more than 50% of it. The owning company often has significant influence over an affiliate but not absolute control which 50% usually brings.</p>
Aggressive tax avoidance	<p>A term used by those who try to argue that some tax avoidance is acceptable by seeking to rank schemes so that some are worse than others.</p> <p>Aggressive tax avoidance is a term applied to the use of complex schemes of uncertain legality to exploit taxation loopholes. The term tax avoidance is more appropriate in describing all schemes that seek to get around the law.</p>
Arising basis	<p>A method for taxing income earned somewhere other than the country where the taxpayer is resident for tax purposes. Under the arising basis income earned outside the country of residence is liable to tax in the year in which that income is earned even if it is not remitted to the country where the taxpayer is resident and liable to pay tax. Compare with the remittance basis.</p>

Arm's length method	This is an OECD guideline that has become the central organising method for determining the internal prices of trades between affiliates of multinational corporations (or between an affiliate and the parent company), for tax purposes. Under this method, the internal price is supposed to be the same as if the two related parties are in fact unrelated and trading at arm's length with each other in a free market. This fiction – treating a multinational as a loose collection of separate unrelated entities trading bilaterally with each other at arm's length – has created huge gaps in the international tax system, allowing for abusive transfer pricing and large-scale tax avoidance. It is frequently impossible to find a anything like a realistic 'arm's length' price – for example, because the relevant internal trade is unique in the market (meaning relevant 'comparables' are simply not available), or because some transactions, such as royalty payments for the use of a brand – are intrinsically hard to value.
Associated company	See affiliated company.
Articles of Association	See Constitution.
Asset protection trust	An asset protection trust includes a clause preventing a trust beneficiary from passing his or her expected interest in the trust to a creditor. The Cook Islands created the world's first asset protection trust law in 1989. This was controversial because under its provisions the settler of the trust could also be a beneficiary, a feature generally making a trust void in the USA and UK. The law in question has now been copied by a large number of tax haven jurisdictions as part of the general "race to the bottom" in regulation. Controversially it has also been copied by some US states, including Delaware.
Auditor	A person or organisation employed to examine whether a report on quantitative data e.g a set of accounts, accords with the underlying data used to support its preparation and is a fair reflection of it that assists those likely to read that report achieve the stated goals implicit or explicit in its preparation. Most commonly refers to the expressing of an opinion on the truth and fairness of financial statements or accounts, including those of a government and tax authority.
Audit report	The report of an auditor, usually made in writing, and which will commonly set out the terms of reference for their engagement and which will specify the quantitative information on which they are expressing opinion. The audit report will include an audit opinion, which will specify whether the auditor thinks that the qualitative data on which they are reporting does accord with and fairly represent the information underpinning the report on which they are forming an opinion. Most commonly attached to accounts or financial statements.

Automatic Exchange of Information (AEOI)	The sharing of tax information between countries, where a jurisdiction receives relevant information from a foreign jurisdiction about its own taxpayers with assets or income in that foreign jurisdiction. This exchange of information should be automatic and not require a specific request from tax or law enforcement officials from one jurisdiction to the other. The Organisation for Economic Co-operation and Development (OECD) has introduced and monitors a global standard on this.
Banking secrecy	Banking secrecy laws strengthen the normal contractual obligation of confidentiality between a bank and its customer by creating criminal penalties that prohibit banks from revealing the existence of an account or disclosing account information without the owner's consent. These laws can be used to block requests for information from foreign tax authorities. Banking secrecy is not just created by law: it can also be created by fact. For example some of the UK linked tax havens do not have banking secrecy laws but by the time a bank account is hidden behind a trust and a company, often with each being in different jurisdictions, the same effect is achieved. Until 2005, most of the concluded double tax agreements did not specifically include provisions to override banking secrecy laws when responding to information requests by foreign treaty partners. Bank secrecy was, and remains in these cases, a massive obstacle to progress in obtaining information required to secure tax enforcement.
Bare trust	A bare trust is a trust in which the beneficiary has an absolute right to both the income and capital of the trust and may as such ask for them to be paid to them at any time. The result is that the trustees are simply nominees for the beneficiary. This means that the trust income and gains are also the property of the beneficiary and should therefore be taxed as their own in whatever jurisdiction they are resident.
Bearer shares	A bearer share differs from a normal share because no record is kept of who owns it. Whoever physically has the bearer share is for legal purposes its owner. Bearer shares are used to preserve anonymity on the part of owners. Because of their potential use for money laundering and in tax evasion they are severely frowned upon but some states, including the UK, still allow their use regardless.
Beneficial owner	The warm-blooded human being (or 'natural person') who ultimately owns or controls the asset in question. The beneficial owner is not necessarily the same as the beneficiary. The term is used in contrast to the legal owner of a property, which may be a trustee or a nominee who has legal title but does not have power to control or enjoy the benefits of it. In many cases, assets are hidden behind structures such as discretionary trusts, where the original owner has given the assets away, but nobody has yet received them (thus the asset is, legally speaking, in an 'ownerless' limbo). In many cases, the beneficial owner of an asset is the natural person that the relevant legislation deems it to be.
Beneficiary	The natural person who is ultimately entitled to the benefits that flow from an arrangement such as a trust or life insurance policy. This may or may not be the beneficial owner.

Big 4	The “Big 4” are the four firms of accountants who dominate the world’s audit, accountancy and taxation advice markets. They are, in order of significance, PricewaterhouseCoopers, Deloitte, KPMG and Ernst & Young. No other firms compare in terms of influence, size and market share. All 4 are present in almost every major, and many minor, secrecy jurisdictions. They dominate accounting standard-setting worldwide and can therefore be said not only to comply with the rules of accounting, but to at the very least heavily influence the composition of the rules themselves. See <a href="http://www.pwc.com">http://www.pwc.com</a> , <a href="http://www.deloitte.com/">http://www.deloitte.com/</a> , <a href="http://www.kpmg.com/">http://www.kpmg.com/</a> and <a href="http://www.ey.com/">http://www.ey.com/</a>
Bilateral information exchange	Exchange of information between the tax authorities of states can be done bilaterally or multilaterally. When done bilaterally, two main types of agreements are used. The first are Double Taxation Agreements (DTAs). The second are Tax Information Exchange Agreements (TIEAs). Bilateral Double Taxation Agreements and Tax Information Exchange Agreements are agreed between the two participating states: no other state is party to the agreement. In multilateral agreements more than two states are parties to the agreement. Bilateral agreements are relatively common; multilateral agreements are very rare.
Brass plate company	See Shell Corporation.
Budget	A statement of the planned income and expenditure of a government (whether national or subnational) for a coming financial period (usual of a year’s duration) broken down in sufficient detail so that a reasonably informed person can determine the likelihood of each goal being achieved by comparison with data from past periods (which should be included in the budget statement) and stated policy changes, which should be specified.
Capital expenditure	That expenditure by a government that would be considered to be on fixed assets that would be recorded upon a balance sheet if the government in question was to prepare accounts in accordance with most generally accepted accounting principles, with depreciation then being provided over time to record the wearing out of the asset in question in use.
Capital gains tax	A tax on the profits from the sale of capital assets such as stocks and shares, land and buildings, businesses and valuable assets such as works of art.
Capital flight	The process where wealth holders deposit their funds and other assets offshore rather than in their country of residence. Usually the result is that assets and income are not declared in the country in which a person resides. Capital flight and tax evasion are intimately linked phenomena.

<p>Cell company</p>	<p>A protected cell company, or PCC, is like a standard limited company that has been separated into legally distinct portions or cells.</p> <p>The revenue streams, assets and liabilities of each cell are kept separate from all other cells. Each cell has its own separate portion of the PCC's overall share capital, allowing shareholders to maintain sole ownership of an entire cell while owning only a small proportion of the PCC as a whole. The undertakings of one cell have no bearing on the other cells. Each cell is identified by a unique name, and the assets, liabilities and activities of each cell are ring-fenced from the others. If one cell becomes insolvent, creditors only have recourse to the assets of that particular cell and not to any other.</p> <p>It is claimed that PCCs can provide a means of entry into captive insurance market to entities for which it was previously uneconomic. The overheads of a protected cell captive can be shared between the owners of each of the cells, making the captive cheaper to run from the point of view of the insured. Without strong regulation they do, however, create considerable financial opacity.</p>
<p>Charitable trust</p>	<p>A trust established for purposes accepted by law as having a charitable purpose. These are often abused, because of their tax-free status. They can be used to pass assets between generations, free of inheritance tax, while keeping them firmly under family control. Money can be extracted by family members via fees or salaries, for example, meaning that despite the charitable structure there may be little or no benefit to charity.</p>
<p>Citizenship basis of taxation</p>	<p>This is one way of deciding who within a state is liable to pay tax in that place. The citizenship basis of tax ensures tax is paid on the worldwide income of all citizens of the state irrespective of whether they are physically resident or not in the territory. The best-known example of a country using the citizenship basis is the USA.</p>
<p>Civil tax matters</p>	<p>A civil tax matter is one where the person committing a tax offence is not facing a prison sentence. What precisely constitutes a civil tax matter is largely defined in diverging national tax laws. Often, a civil tax matter defines a wrongful payment or nonpayment of taxes that (in contrast to a criminal tax matter) remains below a certain threshold. This can be the case because the amount of tax evaded is considered rather low and/or the act was based on negligent rather than intentional behaviour.</p> <p>The distinction is important for international cooperation. Today, most cooperation between authorities takes place only if criminal tax matters are involved. The cooperation in civil tax matters takes place mostly through specific, bilateral treaties. (see: Information exchange). Compare with criminal tax matters.</p>
<p>Company or corporation</p>	<p>A legal entity created by law treated as a separate legal person from those who set it up. Almost all countries allow for the creation of companies but the rules by which they do so vary considerably. Most offer limited liability, which means the members of the company are not liable for its debts if it were to go bankrupt. When companies were first made available it was thought that this was a privilege, and certain duties were demanded in return, not least that accounts and information concerning the ownership and management of the company should be put on public record. That principle has been undermined by offshore secrecy.</p>

<p>Consolidated accounts</p>	<p>A group of companies is made up of two or more member companies with one company owning, directly or indirectly, more than 50% of each of the other members. When this happens the shareholders of the ultimate parent company can only appraise the return on their investment if they can see the combined result of the parent company in which they have invested and that of all the subsidiary companies that it controls. This outcome is achieved by preparing consolidated accounts. In consolidated accounts all the trading between members of the group of companies is eliminated because this cannot generate profit for the ultimate parent company shareholders, which can only be earned by trading with independent third parties. It is only a third-party trading that is reflected in consolidated accounts. The balance sheet in a set of consolidated accounts only reflects liabilities owing to or from third parties, those between group companies being eliminated.</p>
<p>Constitution</p>	<p>The constitution of a company is often called its articles and memorandum of association, or in the USA its articles and memorandum of incorporation. For a trust the constitution is the trust deed, for a partnership it is either the partnership deed or agreement.</p> <p>It is important that third parties have access to such constitutions, not least because they often include limitations on the activities of the entities in question and if they trade beyond those agreed limitations their actions can be deemed to be ultra vires i.e. beyond their powers, and in that case the person trading with the entity that has acted in this way may find themselves without legal recourse for recovery of their funds.</p>
<p>Consumption tax</p>	<p>See indirect tax or sales tax.</p>
<p>Contingent liability</p>	<p>A liability which will only arise if a conditional event occurs: for example, a tax liability that will only be due if a tax return is challenged as inaccurate by a tax authority. The liability can be calculated as the total possible sum due, multiplied by the probability of the conditional event occurring. If the resulting figure is small it is customary for little or no liability to be included in the accounts of a company. If the probability is small but the potential liability is big, the risk of the liability arising may be separately disclosed in the accounts of a company, but this has not been the precedent to date. In the USA this was changed by the introduction of Financial Accounting Standards Board (FASB) Financial Interpretation Note 48 (FIN 48) 'Accounting for uncertain tax positions'. This requires that all tax positions where there is uncertainty as to the outcome be disclosed and quantified. This for the first time gave indication of how much tax companies were trying to hold back through tax planning schemes. The effect can be material. For example in its December 2008 accounts Google Inc said: "In addition, as a result of having adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48) in January 2007, we increased long-term taxes payable by \$400.4 million in the year ended December 31, 2007 as FIN 48 specifies that tax positions for which the timing of the ultimate resolution is uncertain should be recognized as long- term liabilities. We also recognized additional long-term taxes payable of \$362.8 million in the year ended December 31, 2008".</p>

Controlled foreign company or corporation (CFC)	A CFC is a subsidiary company or corporation of another (parent) company. The CFC is registered in a tax haven or other territory where little or no tax is charged on the profit the subsidiary makes. This clearly opens up opportunities for profits to be shifted from the parent company to the offshore subsidiary, to avoid tax. To prevent this, CFC rules provide that profits declared by the subsidiary can in some cases be subjected to tax in the country of residence of the parent company even though it is not actually resident there. Since the turn of the millennium, EU court rulings have dramatically undermined their effectiveness, leading to a boom in offshore activity.
Coordination centres	A special form of company with taxation advantages, often used to attract corporate headquarters to a country. Most notably found in Belgium, the Netherlands and Ireland and are often used by IT and other intellectual property based companies that can sell their services at a distance over the web or by companies that rely heavily on patent income e.g. pharmaceutical companies.
Corporation tax	A tax on the profits made by limited liability companies and other similar entities in some countries. This is usually a form of income tax, but it can also embrace a capital gains tax. Corporation taxes are typically lower than those used for ordinary income tax purposes, especially for high net-worth individuals, giving them considerable incentive to transform their personal income into corporate income.
Country-by-country reporting	A proposed form of accounting in which a multinational corporation will be required to report in its accounts in which countries it operates, what the names of its subsidiaries are in each and every jurisdiction in which it operates, and to publish a profit and loss account of each such jurisdiction, without exception, showing its sales and purchases, both from third parties and intra-group, the number of employees it has and the cost of employing them, its financing costs both third party and intra-group, its profit before tax, its tax charge split between current and deferred tax, and a summary of its assets and liabilities in the location.
Criminal tax matters	A criminal tax matter refers to a person committing a tax offence that carries criminal penalty e.g a prison sentence. What constitutes a criminal tax matter is largely defined in diverging national tax laws. Often, a criminal tax matter defines a wrongful payment or non-payment of taxes that (in contrast to a civil tax matter) falls above a certain threshold. This can be the case because the amount of tax evaded is considered high and/or the act was based on intentional behaviour. The distinction is important for international cooperation. Today, most cooperation between authorities takes place only if criminal tax matters are involved. However, this does not imply that cooperation takes place necessarily if a criminal tax matter is suspected. Neither does it imply that this cooperation is effective. The most reliable form of cooperation in criminal tax matters takes place through specific, bilateral treaties only (see: Information exchange). Compare with civil tax matters.
Currency transaction tax	A form of financial transaction tax: it is a tax levied by a country that issues a currency on all the trades in that currency worldwide at very low rates e.g. 0.005 per cent. See financial transaction tax for more details.
Customs duty	Taxes charged when goods move across international borders. Usually used for revenue raising, but also having other goals, including the protection of domestic industries from what is seen as unfair competition from overseas competitors.

Deficit or fiscal deficit	The amount by which government spending exceeds government income from taxation during a period, which is usually a year.
Director	Shareholders own limited companies but they do not run them. That job is given to its directors. All limited companies must have at least one director. The directors of limited companies may be other limited companies in many jurisdictions. Directors are responsible for the management of the affairs of a company and its compliance with all laws that apply to it. Directors are usually appointed by the members of the company at General Meetings of the membership. In many offshore arrangements directors are 'nominees' who sell their names to the company so that they can be considered directors. Despite holding that office these 'nominees' actually have little or no knowledge of what the company actually does, its real affairs being managed by other people who are technically called 'shadow' directors, but whose identity is often hard to discover.
Direct taxation	Taxes on profits, income and gains i.e. the residual benefits that accrue to the tax-payer from a transaction. Examples are income taxes, corporation taxes, taxes on capital gains and taxes on gifts.
Discretionary trusts	Most offshore trusts permit payments to be made to almost anyone at the discretion of the trustees, which means that the identity of the beneficiaries of those trusts can remain a secret. In practice, trustees normally follow a 'letter of wishes', provided by the settlor, instructing them who they are to pay money to, when and how. There is, therefore, much less discretion about who actually benefits from those trusts than their trust deeds would suggest is the case.
Domicile	The country identified as a person's natural country of origin even if that person has not been resident there for extensive periods of time. The concept is important in determining who pays tax in some countries, and most especially in the UK where a "non-domiciled" person need not necessarily pay tax on their worldwide income when domiciled people must. This explains why the UK is a tax haven for wealthy people.
Double tax relief	Tax relief given by the country in which the taxpayer resides for tax paid in another country on a source of income arising in that other country to ensure that no more tax is paid on that income than is demanded to be paid by the country with the higher of the two rates that might be applied to it.
Double tax agreement or treaty (DTA)	An agreement between two sovereign states or territories to ensure, as far as possible, that income arising in one and received in the other is taxed only once. Includes rules to define Residence and Source, and limits on Withholding Taxes. Also usually includes provisions for cooperation to prevent avoidance, especially information exchange. Many are now being rewritten as attitudes on information exchange develop.

Economic policy	<p>An economic policy is a statement of goals established by a government that specifies the expectations that a government has for its interventions in the economy. Those expectations might relate to:</p> <ul style="list-style-type: none"> <li>• Growth</li> <li>• Employment</li> <li>• Inflation</li> <li>• Trade balances</li> <li>• Exchange rates</li> <li>• Etc.</li> </ul> <p>The policy tools for influencing outcomes include:</p> <ul style="list-style-type: none"> <li>• Tax policy</li> <li>• Interest rates</li> <li>• Planned surpluses / deficits</li> <li>• Specific spending programmes</li> </ul> <p>Tax features in, but does not dominate, economic policy.</p>
Economically active population	<p>The economically active population of a place comprises "all persons of either sex above a specified age who furnish the supply of labour for the production of economic goods and services (employed and unemployed, including those seeking work for the first time) [...] during a specified time reference period." (OECD).</p>
Economist	<p>A person qualified to offer comment on economic issues. Economists tend to specialize. Macroeconomists specialize in the economics of economies as a whole and the role of governments within them, but microeconomists, who specialize in the economic behaviour of individuals, households and corporations also have a role to play on tax policy issues.</p>
Effective tax rate	<p>The percentage of tax actually paid in relation to the total income of the person paying the tax. This can either be calculated for one tax, or for all taxes payable. It is used as a basis for comparison within a state, to see if a system is progressive or regressive, and for international comparison.</p>
Elsewhere	<p>An unknown place in which it is assumed, but not proven, that a transaction undertaken by an entity registered in a secrecy jurisdiction is regulated.</p>
Excise duties	<p>Specific sales taxes usually added to the price of goods that are considered harmful or which create a specific externality (see separate entry). Commonly applied to tobacco, alcohol and carbon based products but can be used for other purposes. They are very effective revenue raising taxes, albeit subject to the ability to control smuggling and illicit products. They have a social as well as revenue function.</p>
Export processing zones – see also Freeports	<p>Artificial enclaves within states where the usual rules relating to taxation and regulation are suspended to create what are, in effect, tax havens within larger countries.</p> <p>The rules that are relaxed may be for import and export taxes or corporation taxes or all three and may also extend to relaxing other regulations e.g. on health and safety or the environment.</p>

Externalities	<p>The costs that a product gives rise to which are not usually reflected in its sale price because they are born by society at large and not by their specific consumer e.g. the pollution from driving a car. Excise duties are often used to correct for the cost of externalities.</p> <p>Tax externalities can arise from the impact one tax, or practice associated with one tax base, can have on other taxes or tax bases, both within and between countries. These externalities are also known as tax spillovers.</p>
Facilitation payments	<p>A bribe designed to quicken the pace at which an official performs a routine, non-discretionary action, sometimes referred to as a “grease payment.” Facilitation payments are legal under the Foreign Corrupt Practices Act but not under the OECD Anti-Bribery Convention or the vast majority of anti-bribery statutes around the world.</p>
Financial Action Task Force (FATF)	<p>The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. The FATF has published 40 Recommendations in order to meet this objective.</p>
Financial flows	<p>In the context of taxation usually refers to the transfer of funds across international borders. The term is usually used within the context of the term ‘illicit financial flows’. These are international payments of money across international borders where the source of the payment was illegal or the result of the abuse of the law (e.g. by tax avoidance activity) of one or both jurisdictions involved, or those of another state associated with the payment or where the payment itself creates such consequence.</p>
Financial reporting standards	<p>The term now commonly used for accounting standards.</p>
Financial Sector Assessment Programme (FSAP)	<p>The FSAP is a joint IMF and World Bank effort introduced in May 1999 and aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. Its work programmes seek to identify the strengths and vulnerabilities of a country’s financial system; to determine how key sources of risk are being managed; to ascertain the financial sector’s developmental and technical assistance needs; and to help prioritize policy responses. The results are published in Reports on Observance of Standards and Codes (ROSCs).</p> <p>The FSAP also forms the basis of Financial System Stability Assessments (FSSAs), in which IMF staff address issues of relevance to IMF surveillance, including risks to macroeconomic stability stemming from the financial sector and the capacity of the sector to absorb macroeconomic shocks.</p>
Financial services industry	<p>A collective term to cover a wide range of activities that relate to the management of money and other investments. The companies represented might include banks, loan and mortgage companies, mutual savings and deposit companies, credit card companies, insurance companies, pension companies, stock exchanges and all the brokerage related to them, plus support services such as accountants, lawyers, actuaries and more.</p>
Financial statements	<p>See Accounts.</p>

Fiscal policy	<p>One of the two generally recognised policy options available to a government to influence the behaviour of the economy for which they are responsible, the other being monetary policy (see separate entry).</p> <p>Fiscal policy describes the process by which a government determines its spending and overall level of taxation income with the intention of delivering a surplus or deficit when comparing government income with spending. The impact of the policy comes from a) the scale of the spending the government undertakes and b) the impact of the tax it withdraws from the economy (which has the consequence of reducing demand for private sector goods and services) and c) the relationship between the two.</p> <p>If government income exceeds spending it is generally presumed that this will have a deflationary effect within an economy by reducing the overall scale of economic activity, and vice versa.</p> <p>Deficits are more commonplace than surpluses, usually because economies are not running at full employment and fiscal policy is seen as a way of delivering that goal.</p>
Fiscal space	The capacity a government has to increase spending without risking its own fiscal sustainability.
Flags of convenience	The flag of a country with easy or lax maritime regulations and low fees and taxes, flown by ships registered in such countries, even though they have no substantial connection with the country. Liberia was once the best known but many tax havens now offer such services. They are also commonly associated with regulatory abuse e.g. with regard to seafarers pay and work conditions.
Flat tax	A tax system in which as income increases above an agreed tax free sum the amount of tax paid remains constant in proportion to total income. Compare with progressive taxes. The term is usually only applied to income taxes.
Flee clause	A flee clause is a provision included in a tax haven / secrecy jurisdiction trust deeds requiring that the management and administration of a trust be changed to a different jurisdiction if a disadvantageous event occurs such as the breakdown of law and order in the place in which the trust is administered or the imposition of taxation on the trust.
Foreign Corrupt Practices Act (FCPA)	A U.S. law passed in 1977 that makes it illegal for U.S. citizens, U.S. corporations and certain non-U.S. corporations to bribe foreign officials.

Foundation	<p>Foundations are distinct legal entities, and therefore to some degree equivalent to companies or corporations, except that they are almost invariably set up for charitable purposes or for the administration of the assets of a family or other social grouping. In many states they fulfil a role that charitable trusts play in jurisdictions with Anglo Saxon law.</p> <p>Foundations are subject to considerable variation in legal structure, but are usually characterised by owning property in their own right despite having no persons who claim ownership rights over the assets of the foundations. Foundations are usually managed by a board.</p> <p>In some jurisdictions, such as Austria, foundations are reasonably transparent and must file data on public record. In others, such as Panama and Liechtenstein they are extremely secretive.</p> <p>The appeal of foundations is growing as trustees seek to limit their liability to settlors, beneficiaries and others and as such foundation laws are becoming more commonplace in Anglo Saxon legal systems.</p>
Freeport	<p>A designated geographic location within a jurisdiction where some of the normal tax rules of the location do not apply e.g. customs or excise duties are suspended or taxes on profit are applied at differing rates and lower land taxes are charged. Sometimes called special enterprise zones. They are usually intended to induce the relocation of economic activity from other countries. They provide light touch regulation in most cases, but that has also attracted criminality and criticism from money laundering agencies.</p>
Freezing of assets	<p>The process by which a person suspected of money laundering may have their assets seized temporarily by the state(s) investigating their affairs to ensure that if the case against them is proven those funds can be either claimed by that state or be returned to those to whom the rightfully belong.</p> <p>See also tracing of assets and seizing of assets.</p>
Front corporation	<p>A corporation that has conducted or is currently conducting some legitimate business in order to hide illicit activity. For example, a gas station where the owner also acts as a launderer for a drug cartel, moving drug money through the gas station's legitimate accounts.</p>
Generally Accepted Accounting Principles (GAAP)	<p>A corporate accounting standard used for financial reporting in the United States and some other countries, established and overseen by the Financial Accounting Standards Board. GAAP is in the process of being merged with the International Financial Reporting Standard. Changes could be made to GAAP/IFRS that require the adoption of country-by-country reporting.</p>
General anti-avoidance principle (GAntiP)	<p>A legal principle that seeks to prevent a taxpayer from obtaining the taxation benefit arising from any transaction if they undertook it solely or mainly to obtain a tax benefit. It does so by looking at the motivation of the taxpayer at the time of entering into the transaction, which is usually determined by the likelihood of any tax advantageous step in a transaction having a commercial explanation. If a commercial motive for each step in a transaction can be offered then it is likely that the person undertaking it will secure the tax benefit inherent in the transaction. If no such motive can be found, then tax benefits would not be obtained. Compare with a general anti-avoidance rule.</p>

General anti-avoidance rule	A general anti-avoidance rule seeks to tackle those who try to break the rules of taxation through the use of further rules. Rather than considering intention, it lays down ways of interpreting a series of events to determine whether the benefit of tax legislation can be given to the taxpayer. Rules are invariably open to interpretation, hence a general anti-avoidance rule runs the risk of increasing the opportunity for abuse.
Gift tax	Taxes charged on gifts either during life or on death. The charges may be on the donor or on the cumulative value of gifts received by the recipient.
Gini coefficient	The Gini coefficient is a measure of income inequality within a country. It is usually expressed as a percentage or index where either 1 or 100% indicates "perfect" inequality and 0 or 0% indicates "perfect" equality of income distribution. The compiling of the Index requires that costly surveys be undertaken. Neither the IMF nor the World Bank computes Gini coefficients as part of their country missions and programmes. Thus, the Gini coefficient has a rather sparse coverage in terms of countries and years available. Scandinavian countries have Gini coefficients of around 25%, continental European countries of around 30%, Anglo-Saxon countries of around 40%, many Latin American Countries of around 50-60%, and some African countries reach Gini coefficients of 60-70%.
Goods and services tax (GST)	Goods and services tax or sometimes a general sales tax. See sales tax.
Gross domestic product	Gross Domestic Product (GDP) is a measure of the economic output of a country. It is the total value of all goods and services produced in a country in a period, irrespective of who produced them. The method for computing the GDP involves statistical inference: it is not an accounting process. The GDP is usually expressed in the national currency. GDP is usually calculated as $GDP = \text{consumption} + \text{gross investment} + \text{government spending} + (\text{exports} - \text{imports})$ .
Hague Convention of the Law Applicable to Trusts and on their Recognition	The Hague Convention of the Law Applicable to Trusts and on their Recognition was signed on 1 July 1985 but came into force on 1 January 1992. The Convention aims to harmonise trust law by creating mutual legal recognition of trusts, defining the characteristics of trusts and setting out rules for determining the governing law of trusts with a cross border element.
Hawala	An informal system of money transfer between entities in different countries. Brokers use handshake deals and/or agreements with counterparts in other countries to move money without physically transferring funds (especially across borders) or using bank transfers. Often extremely difficult to monitor, hawala is used primarily in the Middle East, East Africa and South Asia.
Hedging	In theory hedging is a form of insurance involving a variety of financial instruments including call options, put options, short selling or futures contracts. Genuine hedging can reduce market risk, for example on the price of a crop to be sold at a future date. In reality much hedging involves speculation, often of a very short-term nature. Its complexity hides the risks latent within it while the fact that a lot of hedging is recorded offshore (even though managed from onshore) suggests that a significant proportion of hedging activity is conducted to shift real profits made onshore into offshore locations.

Here	A transaction taking place and regulated within the geographical limit of a jurisdiction. Compare with somewhere, elsewhere and nowhere.
High net- worth individuals	Otherwise known as HNWI's (pronounced hen-wees). Generally categorised as individuals with more than US\$1 million of financial assets (i.e. worth excluding the value of their main home) available for investment.
Holding companies	A company that either wholly owns or owns more than 50 percent of another company, the latter being called a subsidiary. An intermediate holding company is a holding company which has one or more subsidiaries but is itself owned by another company.  The term 'ultimate holding company' refers to the one that is finally not controlled by another company. Some holding companies have thousands of subsidiary companies.
Horizontal ring-fencing	The tax and regulation regime in a jurisdiction may discriminate between local companies (or trusts, etc.) and those that are owned by non-resident people. Horizontal ring-fencing occurs if non-resident people or foreign (business) activity is generally privileged in matters of tax and regulation. For example, secrecy jurisdictions often exempt non-residents from paying income tax on corporate and/or personal income. Such jurisdictions might also exempt non-residents from paying tax on income that stems from foreign sources and at the same time encourage or allow these non-residents to conduct business primarily or exclusively abroad.
Indirect tax	Taxes on bases other than income. For example, sales taxes, excise duties, customs duties, tourist taxes and land taxes.
Illicit financial flow	Illicit money is money that is illegally earned, transferred or utilized. Breaking laws anywhere along the way earns such funds the label. Frequently described as "dirty money". These cross-border transfers come in three forms: (1) the proceeds of bribery and theft by government officials; (2) criminal activities including drug trading, human trafficking, illegal arms, contraband and more; and (3) commercial trade mis-pricing and tax evasion. The latter is by far the largest, and is believed to comprise two thirds of the total.
Income tax	A tax charged upon the income of individuals. It can also be extended to companies. The tax is usually charged upon both earned income from employment and self employment and unearned income e.g. from investments and property.
Incorporated cell	A form of cell company. See cell company.
Indirect taxes	A form of tax charged upon transactions, usually upon their gross value. Examples include sales taxes, value added taxes, goods and services taxes, stamp duties, land taxes and excise and customs duties and levies of all sorts.
Information exchange	See bilateral and multilateral information exchange.
Inheritance tax	A tax charged upon the gifts people make out of their wealth, most commonly (but not always) at the time of their death.

International Accounting Standards Board (IASB)	A privately owned company registered in Delaware in the USA but based in London in the United Kingdom, which issues International Financial Reporting Standards. It is largely financed by the largest firms of accountants in the world and other major actors in the financial services industry. It is self-regulating and resists government interference. Its status as an issuer of accounting standards was transformed when its standards were adopted by the European Union for use by all companies quoted on stock exchanges in that territory from 2005 onwards.
International Asset Recovery	Efforts to return the proceeds of corruption to their country of origin.
International Bureau of Fiscal Documentation	IBFD is an international provider of cross-border tax expertise and independent tax research. See <a href="http://www.ibfd.org/?bookmarkablePage=home">http://www.ibfd.org/?bookmarkablePage=home</a>
International Business Corporations (IBC)	A type of company offered by many offshore finance centres and tax havens, usually one which receives all or most of its income from abroad. IBCs usually pay an annual registration fee but are subject to minimal or zero tax rates. Now less common than a decade ago as a result of pressure brought to bear on the jurisdictions offering them as a result of the EU Code of Conduct on Business Taxation.
International financial centre	See offshore financial centre.
International financial reporting standards (IFRS)	Accounting standards issued by the International Accounting Standards Board for use by quoted companies in the whole of the European Union and more than 70 other jurisdictions. The accounting standards of the USA, Japan and other nations are converging with International Financial Reporting Standards. Changes could be made to IFRS to require the adoption of country-by-country reporting.
International Monetary Fund (IMF)	The International Monetary Fund (IMF) is an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.  The IMF promotes international monetary cooperation and exchange rate stability, facilitates the balanced growth of international trade, and provides resources to help members in balance of payments difficulties or to assist with poverty reduction.  Through its economic surveillance, the IMF keeps track of the economic health of its member countries, alerting them to risks on the horizon and providing policy advice. It also lends to countries in difficulty, and provides technical assistance and training to help countries improve economic management. This work is backed by IMF research and statistics.
International provider	A financial services supplier making supply within the regulated market from an international financial centre to clients in more than one country, including that in which it is itself located.
Internationally regulated	A transaction regulated in more than one jurisdiction, with all jurisdictions being aware of the others involvement.

Inversion	The act of a parent company whose headquarters are located within one jurisdiction switching registration with an offshore subsidiary they own to secure location within that offshore jurisdiction in order to secure a tax advantage. At one time mainly occurring in the USA, it became a UK phenomenon as well from 2009 onwards and has also been used by corporations such as Glencore, which is technically registered in Jersey as a result.
Investment fund	Investment funds are marketed opportunities to buy units in a collective investment entity which in turn invests in a broad range of other assets with the objective of creating diversified risk and consistent investment returns.
Irrevocable trust	A trust where the settlor cannot reclaim the trust property or derive benefit from it once it has been transferred to the legal ownership of the trustees.
Jurisdiction	Usually refers to a nation state but can also refer to a self-governing region that is not fully independent e.g. the UK's Crown Dependencies and Overseas Territories and some French and Dutch protectorates. A jurisdiction has a national government i.e. it is the highest tax setting authority within its domain. Compare with sub-national governments.
Knowingly unregulated	A transaction which is not regulated by any jurisdiction, or where the degree of regulation is so minimal that this is effectively the case, with this being known to all parties with any responsibility for the entity. This has the effect that the transaction takes place 'nowhere'.
Land taxes	As distinct from land value taxation.  Taxes charged for the occupancy of land that may or might not relate to the value of the land itself. Often used by subnational governments as a mechanism for charging for services supplied to properties.
Land value taxation	A tax on the rental value of a site, assessed as if it were undeveloped and unimproved - in other words, as if it were bare land. It therefore charges tax on an immovable and therefore unavoidable tax base which is always firmly located within a jurisdiction – the land itself.
Lawyer	A person providing advice on the law, who prepares legal agreements or who pursues disputes through the legal system of a jurisdiction. The use of the term and the entitlement to practice as a lawyer is regulated in many jurisdictions.
Local provider	A financial services provider supplying services to entities resident in the jurisdiction in which they themselves operate.
Locally regulated	A transaction or entity that is solely regulated within the jurisdiction in which it is registered or takes place.

Legal person	<p>A legal person is a person that is not necessarily a human being but still has rights and obligations. Companies and many types of partnerships are legal persons, as are most foundations. The rights and obligations of a legal person are not equivalent to those of a natural person and are usually limited e.g. to the holding of ownership, entering into contractual relations etc.. Most, but not all legal persons will be owned by natural persons. Exceptions are legal persons owned by legal persons: these then create groups of companies, and foundations, which have no ownership but which are established for the benefit of designated groups, usually comprising natural persons. As such some argue that legal persons act as mere agents for their members or those on whose behalf they act, but this does not reflect their rights in law and the impact they consequently have on the arrangement of property rights within and between jurisdictions and as such they have to be considered as persons in their own right separate from those natural persons who own them or benefit from their existence.</p>
Legal system	<p>There are basically two different types of legal system of significance in international tax law. The first is civil or roman law, the second is common law. Civil law is the most widespread type of legal system. Common law is employed in the USA and the UK (and most of the latter's former colonies). The main difference between the two systems is the relative importance of case law i.e. law made by judges when offering opinions on cases heard before them in common law systems. These play a crucial role in common law but civil law, in contrast, relies almost solely on statutes and the constitution for rule making. Sometimes, legal systems display a blend of both or apply one system in one particular legal domain and the other in the remaining legal system. When such a blend exists, that of significance here is the one used for taxation and commercial law.</p>
Licence (Licensing)	<p>A contract for the use of property, often intellectual property such as a patent, copy-right or trademark. If ownership of the intellectual property is placed in a company located in a tax haven the licence fee income paid to that tax haven company may be exempt from tax whilst the fee paid to it may be subject to tax relief in the country from which it is paid, giving a significant tax benefit. This type of tax exploitation is now commonplace in the IT, pharmaceutical and similar sectors where patents are commonplace.</p>
Limited company or corporation	<p>A limited company is a legal person with an existence separate from those natural persons that own it. Those natural persons interest in the limited company is delineated by the number of shares that they own within it. The management of a limited company is governed by its constitution. This is usually split into two parts, described as the articles and memorandum of association (or incorporation). The day-to-day management of the affairs of a company are delegated to a board of directors who are elected by the members. Those directors do not necessarily have an ownership interest in it. The directors are often served by a company secretary who manages the administration of the company. There are variants on this theme such as protected cell companies, incorporated cell companies, and various types of corporation. Some jurisdictions, such as the UK, designate companies differently if their shares may be traded but their structure is fundamentally similar. The limited company or corporation is by far the most common type of legal person in the world.</p>
Limited liability partnerships (LLP)	<p>A partnership that provides its non-corporate members with limited liability. LLPs are frequently based offshore for tax avoidance purposes.</p>

Limited liability	The right granted in law to the members of a company to be protected from claims made by that company's third party creditors in the event of its insolvency. First found in 16th century England, its more general availability revolutionized the raising of capital in the 19th century and permitted the industrial revolution. Now available at very low cost in almost every jurisdiction in the world (California being one of the last to grant it, in the 1940s). Whilst of benefit when used properly it is also an opportunity for fraudulent abuse, requiring its proper regulation which can rarely happen in secrecy jurisdictions where too little information is available to regulators for this purpose.
Look through	<p>"Look through" when used as tax terminology refers to a legal person (and some other entities, such as unlimited partnerships) that undertake transactions but whose existence is then ignored when the resulting taxation liabilities are computed because the profits arising are attributed by the tax authority of the jurisdiction in which the liability arises to those persons, whether legal or natural, that have an ownership interest in the entity that is "looked through" and the tax liability is computed upon them in its place.</p> <p>Those members are then liable for the tax due. Partnerships, whether limited or unlimited are the most commonly "looked through" structures but such arrangements have been adopted for limited companies in some of the UK's Crown Dependencies to avoid the ring fencing provisions of the EU Code of Conduct for Business Taxation.</p>
Loophole	A technicality that allows a person or business to avoid the scope of a law without directly violating that law. Loopholes are crucial to tax avoidance since they are the mechanism by which people 'get around the law' – which is what tax avoidance really involves.
Low tax	A term that is hard to define since it is subjective. Low tax is often used to describe tax regimes where no tax is due; for example the Cayman Island where there is no direct taxation. More commonly it refers to a particular tax rate that is low in comparison to prevailing norms in other equivalent jurisdictions. Because of this subjectivity the term has little practical use.
Materiality	An accounting term that refers to a measure of the significance of an item. An item is material if an alteration in its value, or its non-disclosure, would change the users' view of the data that they are considering. This does not mean that a number needs to be large to be material. For example, the non-collection of a tax, meaning that the correct figure for revenue might be zero, can be material if it indicates a policy or administrative failing, and omission of this data would in that case be material to a user. Materiality should be determined from the perspective of the user or data and not its creator. Materiality is always a qualitative judgement.
Memorandum of association	See constitution
Money-laundering	The process of 'cleaning' money from criminal or illicit activities (including tax evasion) to give it the appearance of originating from a legitimate source.

<p>Monetary policy</p>	<p>One of the two generally recognised policy options available to a government to influence the behaviour of the economy for which they are responsible, the other being fiscal policy (see separate entry).</p> <p>Monetary policy involves a government, or its central bank, setting the interest rate at which that bank will pay for funds held by commercial banks on short term deposit with it. This is then seen as a way of influencing interest rates charges in the economy at large.</p> <p>The assumption is that increasing interest rates reduces demand within an economy, so reducing the overall level of economic activity. This then reduces inflationary pressure, which is the policy goal most commonly associated with monetary policy. Reducing rates has the opposite effect by encouraging demand and investment and so stimulates economic activity.</p> <p>Official interest rates have been at or near zero per cent for more than a decade in many economies. In that case what are called alternative monetary policies, such as quantitative easing (see separate entry), are used now as an alternative to direct interest rate intervention in many cases.</p>
<p>Multilateral information exchange</p>	<p>Exchange of information between the tax authorities of states can be done bilaterally or multilaterally. When done bilaterally, two main types of agreements are used. The first is Double Taxation Agreements (DTAs). The second is Tax Information Exchange Agreements (TIEAs). Bilateral Double Taxation Agreements and Tax Information Exchange Agreements are agreed between the two participating states: no other state is party to the agreement. In multilateral agreements more than two states are parties to the agreement.</p>
<p>National government</p>	<p>The highest tier of government within a jurisdiction. Compare with sub-national government.</p>
<p>National income</p>	<p>See Gross domestic product (GDP)</p>
<p>National insurance contributions</p>	<p>See social security contributions. Often called NIC.</p>
<p>Natural person</p>	<p>A human being. Compare with a legal person, such as a limited company or corporation.</p>

Nominee owner	<p>A nominee owner of an asset is a person who allows their name to be used for the purposes of recording legal ownership of the asset in question but who at the same time enters into an agreement with the beneficial owner of the asset to confirm that they will always act following the instructions of that beneficial owner with regard to the exercise of the rights derived from their legal ownership of that asset and will at any time surrender that ownership to another person upon direction of the beneficial owner. It is common place for nominee owners to pre-sign documentation authorizing the transfer of legal ownership of the asset which the beneficial owner may use to effect that change at any time of their choosing. The nominee is usually paid a fee for their services but otherwise has no interest in the transactions that relate to assets which they publicly or legally profess to own. Nominee owners are commonly used in secrecy jurisdictions when ownership of an asset has to be recorded on public registers and the beneficial owners wish to disguise their identity. Nominee owners are not trustees as they have no discretion available to them with regard to the exercise of their duties: they are mere agents of the beneficial owners.</p>
Nominee directors	<p>Nominee directors act as the legal managers of limited companies and other legal persons. When doing so they act on behalf of the real managers of these entities, who will in many cases be the beneficial owners of them. It is commonplace for nominee directors to pre-sign letters of resignation from the companies for which they supposedly act, which the beneficial owner may use to effect that change at any time of their choosing. The nominee is usually paid a fee for their services but otherwise has no interest in the transactions that relate to the company which they publicly or legally profess to manage, apart from appending their signature to legal documentation including board minutes when requested to do so. Nominee directors are commonly used in secrecy jurisdictions when directorships have to be recorded on public registers and the beneficial owners wish to disguise their identity. Nominee directors are not trustees as they have no discretion available to them with regard to the exercise of their duties: they are mere agents of the beneficial owners.</p>
Nominee company	<p>See nominee directors: the situation of a nominee company secretary is similar.</p>
Nowhere	<p>The part of the secrecy space where by design or chance the combination of unregulated entities used results in transactions being unregulated or only lightly regulated.</p>
OECD (Organization for Economic Co-operation and Development)	<p>The OECD brings together the governments of countries committed to democracy and the market economy from around the world. Established in 1961 it has developed a particular role with regard to tax related issues where it has established most of the rules with regard to taxation of transnational corporations, to systems for information exchange now in use, the most commonly used models for double tax agreements and Tax Information Exchange Agreements and has played a significant role in the attack on tax havens / secrecy jurisdictions. It has, however, been criticised for being a 'rich country club' and for being too lenient on its own members.</p>
OECD Global Forum on Taxation	<p>The Forum is part of the work of the OECD's Centre for Tax Policy and Administration, but with particular emphasis on negotiation, application and interpretation of tax treaties, transfer pricing and effective exchange of information between tax administrations.</p>

OECD Transfer Pricing Guidelines	Guidance first created by the OECD in 1995 to define rules for multinational corporations' use of transfer pricing, including the "arm's length" principle.
Off balance sheet	Off balance sheet usually refers to an asset and its associated debt or financing activity which have been excluded from inclusion in the balance sheet of a company. Leasing arrangements are amongst the most common off balance sheet arrangements, although accounting standards are meant to have tackled this issue in theory if not in practice. Other arrangements can include whole subsidiaries excluded from consolidation because they are 'orphan entities' or contingent liabilities such as letters of credit, derivatives, futures, swaps and other complex financial instruments.
Offshore	<p>There is no agreed definition of offshore. It can only be described.</p> <p>The term has often been used to describe any jurisdiction (regardless of whether they are islands) which provides tax and regulatory privileges or advantages, generally to companies, trusts and bank account holders on condition that they do not conduct active business affairs within that jurisdiction.</p> <p>In its 2008 report 'Creating Turmoil' the Tax Justice Network tackled this issue. It suggested that offshore does not describe geography. It most certainly does not refer to island locations. The term 'offshore' refers to the location of the customers of an offshore financial centre i.e. those people the tax haven / secrecy jurisdiction intended should make use of the structures they permit under their law. What characterises these customers is that they are not in the tax haven where the OFC is located. They are 'elsewhere' i.e. they are located in another jurisdiction. This concept was first recognised in London, and as far as the UK was concerned that 'elsewhere' was always 'offshore'. The term stuck, even when the geography to which it originally related had little or no meaning.</p> <p>What this amounts to is the following: an offshore transaction is recorded in one place (a secrecy jurisdiction) on behalf of parties who are actually elsewhere. Those transactions might have the legal form of taking place in the tax haven in which they are recorded. The reality is that their substance, and benefit, occurs elsewhere.</p> <p>The term 'offshore' does, as a result, describe a disconnect between the place where a transaction is recorded and the place where its economic substance occurs.</p> <p>It is for this reason that the world's secrecy jurisdictions were able to say that the economic crisis that developed from 2007 onwards was not of their creation. By definition that had to be true. Nothing recorded in an OFC actually takes place there. In consequence those secrecy jurisdictions that host OFCs can fairly claim they are not responsible for what is recorded in the OFC for it always takes place elsewhere.</p>
Offshore banking	The supply of banking services from an offshore financial centre located in a secrecy jurisdiction to customers who are not located in the jurisdiction.

Offshore Financial Centre (OFC)	<p>Although most tax havens like to call themselves Offshore Finance Centres (OFCs) the terms are not synonymous.</p> <p>Tax havens offer low or minimal rates of tax to non-residents.</p> <p>This does not however mean that they also host a range of financial services providers.</p> <p>An OFC offers low tax rates and hosts a functional financial services centre, usually including branches or subsidiaries of major international banks as well as the offices of accountants and lawyers to service offshore clients.</p> <p>States and microstates that host tax havens and OFCs dislike both terms, preferring to call themselves International Finance Centres.</p> <p>See also 'secrecy providers'.</p>
Parent company	<p>A company that controls another company (which is then called its subsidiary company) either by owning more than 50% of the second company or by controlling the composition of its board of directors. A parent company may have thousands of subsidiary companies, some of which will themselves be parent companies, in which case they are called intermediate parents. In that case the company not subject to control at the top of the hierarchy is called the ultimate parent company.</p>
Partnerships	<p>Any arrangement where two or more people agree to work together and share the resulting profits or losses. A partnership can be between individuals, companies or a mixture of both.</p>
Payroll taxes	<p>See social security contributions.</p>
Permanent Establishment	<p>An office, factory, or branch of a company or other non-resident. Under double tax treaties business profits are taxable at source if attributable to a Permanent Establishment. May include construction sites or oil platforms in place for over 6 months. Rules regarding permanent establishments can be dependent upon arrangements concluded in double tax treaties.</p>
Politically Exposed Person (PEP)	<p>A person entrusted with a public function, such as a politician or employee of a government agency. The term is sometimes inclusive of their relatives and close associates. Banks are supposed to treat PEP clients as high-risk clients, applying enhanced due diligence at both the inception of the relationship and on an ongoing basis to ensure that the money in their bank account is not proceeds of corruption.</p>
Poll tax	<p>A tax that levies the same sum on each person irrespective of their ability to pay. Poll taxes tend to be seen as regressive and unjust.</p>
Predicate offence	<p>An underlying crime, such as drug trafficking, which generates the illicit money to be laundered and is a necessary element of building a criminal money-laundering charge. According to the FATF 40 recommendations, tax evasion should be classified as a predicate offence for money laundering.</p>
Preferential tax treatment	<p>A situation in which individuals or companies can negotiate their tax treatment in the state in which they have a tax liability. Pioneered by Switzerland in the 1920s, the arrangement is commonplace in tax havens.</p>

Private company	A company not quoted on a stock exchange. Shares cannot usually be sold without the consent of the company or its owners; in many countries little or no information need be disclosed on the activities of such companies even though their members enjoy the benefit of limited liability.
Private legal entity	See private company. Limited liability partnerships and foundations are also private legal entities.
Profit laundering	The process of transferring profits from a territory in which they would be taxed to another in which there is either no tax or a lower tax rate. Mechanisms for achieving this include transfer-pricing, re-invoicing, licensing, thin capitalisation, corporate restructurings and inversions.
Progressive taxes	A tax system in which, as income rises, the amount of tax paid increases in proportion to the income as well as in absolute amount i.e. the percentage tax rate increases as the income rises. Also referred to as Graduation. Compare with flat and regressive taxes.
Protected cell company	See cell company.
Public company	A company whose shares are available to be bought and sold by anyone who wishes without consent being required from the company itself. In many cases, public companies are also "listed" or "quoted" companies which means that they are quoted on a recognised stock exchange. They are generally required to be more transparent than private companies.
Public good	A public good is defined as a commodity or service that is provided without profit to all members of a society, usually by a government.
Public record	Information is available on public record if it is freely available to any interested party or for a fee that does at most represent the handling costs of the supplier without any profit element being added. To qualify as publicly accessible data, internet availability is essential. The opposite to information being on public record is that the information is kept confidentially without public inspection. Layers of legal secrecy provisions may enable and further enhance the secretive quality of such 'non-public' information and prevent foreign authorities and the public from accessing information.
PPP (Purchasing Power Parity)	Purchasing Power Parity describes a measurement method that is designed to improve the cross-country comparability of economic and social data. When comparing the level of economic development between two countries it is hard to compare the GDPs in two different currencies with each other. In order to achieve a "common denominator" for comparison, recourse is taken mostly to the US-Dollar. However, current exchange rates might distort greatly the values of the GDP when converting the domestic currency in US-Dollars. Therefore, the domestic price level needs to be taken into account before meaningful comparisons of GDPs (and other monetary data) can be undertaken. This is what PPP analysis achieves. It integrates the domestic price level into the computation of the applicable exchange rate. If GDP is expressed in PPP-terms, it conveys a more accurate picture of the economic disparity between two countries.
Qualitative data	Non numerical data on phenomenon that can be observed but not directly measured. Indirect measurement can, however, take place, for example by surveys. Tax spillover analysis is qualitative data on a tax system. So too is polling data and survey based data on income distribution. Qualitative data is likely to be more explicit as to the normative judgment implicit in its collection than is quantitative data, but that may be a strength and not a weakness.

Quantitative data	Information supplied in numerical form. Accounts, budgets and tax gap analyses are quantitative data. This does not mean that they are necessarily objective. What is counted quantitatively is a matter where judgement is exercised.
Quantitative easing	<p>An alternative monetary policy (see separate entry). Quantitative easing is a process where a central bank buys the debt or bonds of the government to which it is responsible (and occasionally commercially issued debt as well) and then holds it. The aim is to force up the price of this debt, which reduces the effective interest rate upon it. The theory is that this will then force investors seeking an adequate return to move their funds to riskier assets, so providing money for investment in private markets.</p> <p>An alternative to this form of quantitative easing is called green quantitative easing or People's Quantitative Easing. In this version the central bank buys bonds issued by a government owned investment bank which provides funds for direct investment into the economy, including to projects to fund green infrastructure investment.</p>
Quoted company	See public company.
Race to the bottom	<p>The downwards trend of tax rates and regulatory requirements on capital arising from competition between sovereign states to attract and retain investment. Considered to be 'tragically ironic' by many development theorists, as empirical analysis shows that low tax regimes are in fact not determinant factors in whether or not multinational corporations invest in a particular jurisdiction.</p> <p>More important are factors such as infrastructure quality, political stability and workforce capability. It is a feature of the race to the bottom that jurisdictions now attempt to "compete"</p>
Redomiciliation	Corporate redomiciliation is the process by which a company moves its domicile from one jurisdiction to another by changing the country under whose laws it is registered or incorporated, while maintaining the same legal identity. This can pose problems when a company is able to redomicile without leaving trace of its previous existence, allowing it to evade investigation by law enforcement and other authorities.
Registered office	The official address at which a company may be contacted. Unfortunately this is very often the address of a lawyer or accountant and as a result no clue as to the real whereabouts of the company is provided in such cases, which assists with creating a veil of secrecy over their activities.
Registration	Formal registration is the process required to create a legal person such as a limited company or corporation, limited partnership or foundation. It is usually achieved by submitting the registration data (see below) required by the jurisdiction in which it is to be legally located. Such arrangements rarely apply to trusts, for which it is uncommon for there to be a formal registration process, and which are created by trust deed in most cases without formal consent of a state.

Registration data	<p>Registration data is the information that must be filed with the regulatory authorities of a state to establish a limited liability entity, trust, foundation or other legal person or entity.</p> <p>In the case of a limited liability entity this might be the constitution, details of members, directors and secretary: in the case of a trust the constitution, name of settlor, the trustees and any instructions such as side letters regarding management of the arrangement, and so on.</p> <p>The quality and quantity of registration data required differs vastly depending on the type of legal entity or arrangement chosen and the jurisdiction where this structure is created. In some cases little or no data need be filed with central authorities. In others rather more is required, and even proof of identity of beneficial owners must be made available. Usually data requirements are more onerous for companies and foundations than for trusts, where in most cases little or no registration data is needed. The requirement to hold such data is devolved to those professional persons helping establish such entities in many jurisdictions.</p> <p>The weaknesses in registration data are not exclusive to tax havens / secrecy jurisdictions. Neither the UK nor USA requires data on the beneficial ownership of limited liability entities to be made available to regulatory authorities when companies or corporations are formed within their domains.</p> <p>The weaker registration data is, the more likely it is that 'shell corporations' will be created for the purposes of abuse that will be difficult to trace.</p>
Regressive taxes	<p>A tax system in which, as a person's income from all sources increases, the amount of tax they pay reduces in proportion to their income even if it increases in absolute amount i.e. their percentage tax rate falls as their income goes up. Compare with progressive taxes and flat taxes.</p>
Regulated entity	<p>An entity that is located within the regulated space and is regulated both in its jurisdiction of registration and in all other jurisdictions in which it trades.</p>
Regulated market	<p>A market in which regulated entities trade with each other.</p>
Regulated space	<p>That area otherwise known as onshore in which all transactions are knowingly and openly regulated by one or more national agencies.</p>
Reinsurance	<p>Some large companies decide not to insure their risks with the conventional insurance markets but instead set up their own insurance companies. When insurance companies do this it is called reinsurance. By setting up a captive or reinsurance company offshore, a tax deduction for the premiums paid is available in the country where the risk is located whilst the premiums are received offshore where there is little or no tax. This is another form of tax avoidance.</p>
Re-invoicing	<p>Re-invoicing involves invoicing a sale to an agent, typically based in a tax haven or OFC, who subsequently sells on to the final purchaser. In practice the agent pays part of their mark up to the original vendor or to the purchaser, usually to an offshore account. This is a widely used process for laundering profits to a tax haven. The process is dependent upon secrecy for its success. It is now commonly denied that such practices occur but it is only secrecy that prevents such claims from being tested.</p>

Remittance basis	The remittance basis is one of the ways in which income earned outside the country in which a person resides can be brought within the scope of tax in that place. The remittance basis says that tax is only due in the year when income is remitted to the country in which the taxpayer is resident: it is not taxable when it actually arises. The remittance basis enables a person to avoid tax indefinitely in their country of residence provided their overseas income is kept and / or spent abroad. Compare with the arising basis. Both have relevance within the context of the residence basis of taxation.
Remittance basis, companies	The remittance basis for companies is a compromise between the residence basis for companies and the territorial basis for companies. All the income of the subsidiaries of the parent company subject to the remittance basis can be taxed in the jurisdiction in which it is resident under the remittance basis but only when it is paid by way of dividend back to the parent corporation. The result is that there is a very strong incentive to keep funds subsidiaries outside the parent company jurisdiction and to rein-vest them overseas rather than remit them, where they would be taxed. This is having a massive impact on US multinational company behaviour where this system is in operation.
Residence	For an individual, the person's settled or usual home; for simplicity a presumption may be applied based on a rule-of-thumb, such as presence within the country for six months or 183 days in any tax year. It may be possible to be resident in more than one country at one time (though double tax treaties aim to prevent this in legal terms). Some individuals may also try to avoid being resident anywhere. For companies, residence is usually based on the place of incorporation but can also be where the central management and control of the company is located, if they are different. Tax haven companies formed for non-resident owners are usually defined not to be resident in their country of incorporation. If they use secrecy to deny their presence in another state where they really trade they can achieve non-residence through stealth. This is, of course, tax evasion, and is a major cause of the tax losses attributable to tax havens / secrecy jurisdictions.
Residence basis (individuals)	Under the residence basis of taxation residents of a territory pay tax in that place on all their worldwide income wherever it arises, usually with a credit being given for tax already paid overseas. The aim is to discourage residents from investing abroad in lower tax countries, by ensuring that income is taxed at the resident country rate if it is higher. Compare with source and unitary basis.
Residence basis (companies)	The residence basis for companies is in some ways more complex than for individuals as companies can be made up of many individual subsidiaries all reporting to a parent company. The term 'residence basis' will usually be applied in this situation to the tax regime that applies to the parent company. If it is taxed on a residence basis then the jurisdiction in which it is based will seek to charge the income it earns to tax, either through taxing dividends received from those subsidiaries when they are remitted to that jurisdiction or through the operation of controlled foreign company rules. In combination with transfer pricing arrangements these provided a triumvirate of controls to make sure all group income was likely to be eventually be taxed in the parent company jurisdiction, with credit having been given for foreign tax already paid. Compare with remittance basis and territorial basis for companies.
Revenue expenditure	That expenditure incurred by a government that would be charged as an expense in its accounts if they were prepared under most generally accepted accounting principles.

Ring-fencing	Ring fencing describes situations in which different and preferential tax and regulatory treatments are given by tax havens to companies and trusts owned by non-residents compared to the treatment given to companies and trusts owned by their own residents. In most cases the latter will be prevented from taking advantage of the arrangements available to non-residents.
Robin Hood Tax	See Tobin tax.
Safe harbor provisions	<p>A safe harbor provision is granted under statute or a regulation on the condition that the party performed its actions in good faith.</p> <p>In effect they excuse inadvertent breaches of the law when undertaken in good faith and without intention of securing advantage.</p> <p>In US tax it can mean an accounting method that avoids legal or tax regulations and allows for a simpler method of determining a tax consequence than those methods described by the precise language of the tax code.</p>
Sales tax	Taxes on sales can be levied in two ways. Firstly, as a general sales tax added to the value of all sales with no allowance for claiming a rebate on tax paid. Secondly, as a value added tax (VAT) (sometimes called a goods and services tax – GST) charged by businesses on sales and services but which allows businesses to claim credit from the government for any tax they are charged by their suppliers. The burden of VAT therefore falls almost entirely on the ultimate consumers. GST and VAT are both regressive taxes since lower income households always spend a higher proportion of their income on consumption and therefore invariably spend a greater proportion of their income on this tax than do better off households. VAT is by far the most widely used form of sales tax.
Sanctions	<p>Measures a country might take against a non-cooperative tax haven. Measures endorsed by the G20 include:</p> <ul style="list-style-type: none"> <li>- increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions;</li> <li>- withholding taxes in respect of a wide variety of payments;</li> <li>- denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction;</li> <li>- reviewing tax treaty policy;</li> <li>- asking international institutions and regional development banks to review their investment policies; and,</li> <li>- giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programmes.</li> </ul> <p>See <a href="http://www.g20.utoronto.ca/2009/2009ifi.html">http://www.g20.utoronto.ca/2009/2009ifi.html</a></p>

Secrecy jurisdiction	Secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of people and legal entities not resident in their geographical domain. That regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use secrecy jurisdictions also create a deliberate, legally backed veil of secrecy to ensure that the people from outside the jurisdiction making use of its regulation cannot be identified.
Secrecy provider	The lawyers, accountants, bankers, trust companies and others who provide the services needed to manage transactions in the secrecy space.
Secrecy space	The unregulated spaces that are created by a secrecy jurisdiction that are suggested to be outside their domain and so are treated by them as being 'elsewhere' or 'no-where'. Both of these are domains without geographic existence.
Secretly unregulated	An unregulated transaction undertaken by an entity created using the law or regulation of a secrecy jurisdiction that is not reported to those authorities elsewhere that have legitimate interest in it despite there being an obligation for such report to be made.
Securities	The legal instrument (paper or electronic) that proves entitlement to a financial property right is a security. It might relate to share or stock ownership in a limited liability entity such as a company or corporation, to a bond issued in respect of debt or to the contract for a future right, derivative or other financial instrument. In each case the document indicates a right to ownership of the asset and a right to receive the income derived from it.
Seized assets	Assets appropriated by regulatory authorities from those found guilty of or suspected of money laundering offences.
Settlor benefit	Any benefit from a trust that is returned to the settlor. Under UK law such benefits are prohibited but many secrecy jurisdictions now permit the creation of trusts from which the settlor may benefit as a beneficiary or by way of return of the trust property. There is some doubt about whether arrangements of this sort can properly be considered to be trusts.
Shadow economy	The unreported activity that takes place within an economy that would, if it were to be reported as required by the law of the jurisdiction in which it occurs, be within the scope of taxation, whether or not tax was actually due as a result, or not.
Shareholders	The owner of the shares in a company. In many instances the registered shareholders of companies registered in secrecy jurisdictions are nominees, which prevents identification of the real-life beneficial owners.
Shell bank	A bank without a physical presence or employees in the jurisdiction in which it was incorporated.

Shell corporation	A limited liability entity usually formed in a tax haven / secrecy jurisdiction (including the UK and USA) for the purposes of hiding illicit financial flows, tax evasion or regulatory abuse. The entity is highly unlikely to have a real trade, its sole purpose being to hide transactions from view. No one knows how many such corporations there are, but they are commonplace. Other names are sometimes used e.g. 'brass plate companies', indicating a legal entity whose only real presence is the plaque on the wall of a lawyer's office recording the location of its registered office.
Social policy	<p>The objectives of a government with regard to the comparative wellbeing of its population, including the setting of targets for, amongst other things:</p> <ul style="list-style-type: none"> <li>• Reducing inequality, whether it be economic or created by gender, ethnic, race, sexual orientation or religious discrimination;</li> <li>• Providing a social safety net to mitigate the economic impacts of unemployment, ill health, ageing, parenthood and low pay;</li> <li>• The provision of housing;</li> <li>• Access to transport and other resources;</li> <li>• Educational attainment;</li> <li>• Availability of work;</li> <li>• Etc.</li> </ul>
Social security contributions	Payments made towards a fund maintained by government usually used to pay pension and unemployment benefits. Health benefits are sometimes covered as well. Social security contributions are generally considered to be taxes. They are covered by the more generic name payroll taxes since they are often collected alongside income taxes from the payments made to employees but they can also be charged on the self-employed as well.
Somewhere	A place other than that in which a regulated entity resides in which it undertake transactions that are both reported and regulated, with transparent interaction between that place and the location in which the regulated entity is registered or resides taking place, at least on request.
Source basis	Taxation of income in the territory where it is earned. Compare with residence and unitary bases. Under double tax treaty rules, income attributable to a Permanent Establishment is taxable at source. Some countries tax only on a source basis, and consider income earned outside the country exempt; but some tax on the basis of both source and residence (subject to a foreign tax credit) to ensure a more comprehensive approach and to tackle obvious opportunities for tax avoidance arising from shifting a source of income out of a country if a residence basis is. Compare with residence and unitary bases.
Special purpose vehicles	Any company, trust, LLP, partnership or other legal entity set up to achieve a particular purpose in the course of completing a transaction, or series of transactions, typically with the principal or sole intent of obtaining a tax or regulatory advantage, for which reason many are located in tax havens / secrecy jurisdictions.
Stakeholder (generally)	A person impacted by or with an interest in or concern about the activities of another person or entity.

Stakeholder (Tax)	<p>The stakeholders of a tax system are considered to be:</p> <ul style="list-style-type: none"> <li>• The government of a jurisdiction;</li> <li>• The legislators of that jurisdiction who are not in the government;</li> <li>• The tax authority of a jurisdiction;</li> <li>• The electorate of that jurisdiction;</li> <li>• Taxpayers within a jurisdiction, whether they are within the electorate, or not;</li> <li>• Researchers, whether they are academics, journalists, civil society or those from other backgrounds;</li> <li>• International agencies and others in countries other than the jurisdiction being reviewed.</li> </ul>
Stamp duty	A tax on the value of contracts. Usually charged on contractual dealings on shares and other stocks and securities and on dealings in land and property.
Stolen Asset Recovery Initiative (StAR)	A partnership between the World Bank and the U.N. Office on Drugs and Crime that supports international efforts to end safe havens for corrupt funds. In the fall of 2011 StAR released the landmark report, “The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It” which focused on the adverse impact of legal structures.
Sub-national government	<p>The government responsible for any tier of government below the national level within a jurisdiction. Examples include:</p> <ul style="list-style-type: none"> <li>• Village councils</li> <li>• Town and city councils</li> <li>• Country councils</li> <li>• Regional councils</li> <li>• Sub-national state governments in federal states</li> <li>• Devolved national governments (e.g. in the United Kingdom)</li> </ul>
Surplus	The amount by which government income from taxation exceeds government expenditure during a period, usually a year.
Suspicious Transactions Report (STR)  Also called Suspicious Activity Reports (SAR)	STRs are used by those engaged in the financial services industry (including in many countries those engaged in tax activity) to report transactions involving money laundering to the relevant regulatory authorities for them to investigate further. An STR does not require the person submitting the report to have proof that money laundering is taking place: they must report simply if they suspect that it is taking place. It is for the authorities to prove the case. The number of reports varies widely between jurisdictions and between professions and firms within jurisdictions suggesting that universal awareness and compliance of the obligation to report does not exist. Many seem to think tax abuse need not be reported, especially if in another jurisdiction. That is usually not true, but the number of STRs on this issue in tax havens / secrecy jurisdictions seems remarkably low despite that fact.
Subsidiary company	A company 50% or more owned or controlled via its board of directors by another company which is then called its parent company.
Tax administration	See tax authority
Tax allowances	The statutory deductions available for offset by a taxpayer against their taxable income provided within the tax law of a jurisdiction. Examples include annual tax free allowances for income taxes and capital gains taxes. There may also be allowances for specific types of income e.g. investment income to a set annual limit.

Tax arbitrage	<p>The process by which a sophisticated taxpayer plays off the tax systems of two different countries to obtain a tax benefit. Most commonly tax arbitrage is between the tax laws of different jurisdictions but it can also relate to exploiting different accounting regulations to achieve tax beneficial effects or to trading one tax off against another within a jurisdiction e.g. income tax against corporation tax.</p>
Tax authority	<p>The agency appointed by tax legislation to have the authority to calculate tax liabilities owing and to collect the resulting sums owing. This can be the Treasury of a jurisdiction but is more commonly a government agency with specific responsibility for undertaking this task. It is commonplace for there to be checks and balances in place to prevent political access to the personal data held by a tax authority and as such tax authorities frequently appear to have the appearance of being quasi-autonomous agencies.</p>
Tax avoidance	<p>The term given to the practice of seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud). The practice may be summarised as ‘seeking to get around the law’.</p> <p>Tax avoidance usually entails setting up artificial transactions or entities to re-characterise the nature, recipient or timing of payments. Where the entity is located or the transaction routed through another country, it is international avoidance. Special, complex schemes are often created purely for this purpose. Since avoidance often entails concealment of information and it is hard to prove intention or deliberate deception, the dividing line between avoidance and evasion is often unclear, and depends on the standards of responsibility of the professionals and specialist tax advisers.</p> <p>An avoidance scheme which is found to be invalid entails repayment of the taxes due plus penalties for lateness.</p> <p>Some claim that this term refers to any activity that reduces the amount of a person’s income subject to tax, for example, claiming of allowances and reliefs clearly provided for in national tax law. This is not true. If the law provides that no tax is due on a transaction then no tax can have been avoided by undertaking it. This practice is now generally described as tax compliant. Instead the term tax tax avoidance should refer to the practice of seeking to not pay tax contrary to the spirit of the law.</p> <p>This term is one of the most contentious in the tax lexicon.</p>
Tax avoidance gap	See tax gap
Tax base	<p>The range of transactions that a country chooses to tax. A broad base includes a wide range of transactions. A narrow base includes relatively few transactions.</p>
Tax base gap	See tax gap
Tax competition	<p>Tax competition is the pressure brought to bear on governments to reduce taxes, usually to attract investment, either by way of reduction in declared tax rates or through the granting of special allowances and reliefs such as tax holidays or the use of export processing zones.</p> <p>In practice tax competition largely benefits mobile activities or businesses, but the competition to attract investment may result in an overall decline of corporation tax rates and in the amounts of corporation tax paid, often resulting in a switch of the tax from the owners of capital to workers and consumers.</p>

Tax compliance	<p>A term that means making payment of tax due without engaging in tax avoidance or evasion. It is used in contrast to the terms tax avoidance and tax evasion.</p> <p>Tax compliance in this context is used as a test of a person's intention before they undertake a transaction. It asks whether the person is seeking to comply with the spirit of the legislation concerning the transaction into which they are entering. If they are, then it should be presumed their intent was to be legal.</p> <p>If, on the other hand, they are seeking to comply with the letter but not the spirit of the law (and it is usually possible to determine this from the form the transaction takes) then it should be presumed their intent was to get round that law, the onus of proof otherwise falling upon them.</p> <p>This test can be used in connection with a general anti-avoidance principle to determine whether that principle should be applied to a transaction, or not. A person who has used an appropriate motive is 'tax compliant'.</p> <p>The term can also refer to the process of complying with the administrative requirements of tax law e.g. completing a tax return.</p>
Tax efficiency	<p>A term used by tax professionals to suggest getting away with paying as little tax as possible. It is often used as a euphemism for tax avoidance.</p>
Tax evasion	<p>The illegal nonpayment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities; it entails criminal or civil legal penalties.</p>
Tax evasion gap	<p>See tax gap</p>
Tax exemptions	<p>Parts of a tax base that are not subject to tax as a result of legislative decisions. These may occur in any tax e.g. income from overseas is exempted from income tax by some jurisdictions, whilst some types of sale are exempted from value added tax or other sales taxes.</p>
Tax gap	<p>Tax gap analysis explains the difference between the tax revenues that a jurisdiction might be able to collect and the tax revenues it actually recovers during the course of a period. There are five tax gaps that can be measured:</p> <ul style="list-style-type: none"> <li>• Tax base gaps;</li> <li>• Tax spend gaps;</li> <li>• Tax evasion;</li> <li>• Tax avoidance;</li> <li>• Tax known to be owing but not settled i.e. unpaid tax.</li> </ul> <p>Tax base gaps represent the cost of tax bases that a jurisdiction decides for its own reasons not to tax. Wealth is a common tax base that is not taxed, but there are many other examples.</p> <p>Tax spend gaps represent the cost of the exemptions, allowances and reliefs granted within tax bases that are otherwise subject to tax.</p> <p>The tax evasion gap is the tax cost of the illegal non-declaration of income, that should be taxed, by a taxpayer or the tax cost of their illegal claim for a tax exemption, allowance or relief to which they are not entitled.</p> <p>The tax avoidance gap is the tax cost arising from a taxpayer arranging their affairs in such way that they pay less tax as a result of their manipulation of the tax laws of a jurisdiction in a way that the tax authority of that jurisdiction thinks is contrary to the spirit of the laws in place.</p> <p>The unpaid tax gap is the tax cost of sums known to be owing to the tax authority that are not paid e.g. due to the insolvency of a taxpayer before payment can be collected.</p>

Tax expenditure (sometimes social tax expenditures STEs)	The total value of the tax reliefs, exemptions and allowances a government grants to promote social, economic, industrial and other policy objectives. The above can be referred to as tax expenditures in recognition of the fact they represent foregone revenue and can therefore be viewed as an equivalent to spending with social objectives, that constitute a form of fiscal welfare to their recipients.
Tax haven	<p>Any country or territory whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws.</p> <p>The Organisation for Economic Cooperation and Development defines tax havens as jurisdictions where:</p> <ul style="list-style-type: none"> <li>• Non-residents undertaking activities pay little or no tax;</li> <li>• There is no effective exchange of taxation information with other countries;</li> <li>• A lack of transparency is legally guaranteed to the organisations based there;</li> <li>• There is no requirement that local corporations owned by non-residents carry out any substantial domestic (local) activity. Indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated.</li> </ul> <p>Not all of these criteria need to apply for a territory to be a haven, but a majority must.</p> <p>See also secrecy jurisdiction for wider discussion of this issue because the term tax haven is widely disputed as to meaning.</p>
Tax holidays	A period during which a company investing in a country does not have to pay tax under an agreement with that country's government.
Tax Information Exchange Agreement (TIEA)	TIEAs are bilateral agreements under which territories agree to cooperate in tax matters through exchange of information. In practice the model was little used until the G20 applied considerable pressure to tax havens / secrecy jurisdictions to sign such agreements. There have been hundreds signed since 2009 as a result but the evidence is that they are little-used because of the considerable obstacles to making requests that are inherent within the agreements themselves.
Tax legislation	A term that usually refers to the laws, regulations, and other notices with statutory effect issued by a national government that require that tax be paid, or which specifies the mechanisms to be used to facilitate such payments. It can however also refer to the equivalent laws, regulations and other notices issued by subnational governments that have the same effect.
Tax mitigation	A phrase used by tax professionals when describing the desire to pay as little tax as possible. Another euphemism for tax avoidance.
Tax morale	Tax morale is a qualitative measure of taxpayer perceptions regarding tax in general, a tax system in particular and their attitude towards paying and evading taxes.
Tax non-compliant	A person, natural or legal, who is not seeking to be tax compliant. See tax compliance.
Tax planning	A term used in two ways. It can be used as another term for tax mitigation. When, however, tax legislation allows more than one possible treatment of a proposed transaction the term might legitimately be used for comparing various means of complying with taxation law. If that is the motive then tax planning is consistent with tax compliance.

Tax policy	<p>The tax policy of a jurisdiction determines what objectives a government wishes to achieve using tax as an instrument of policy delivery. This means tax policy is likely to address:</p> <ul style="list-style-type: none"> <li>• The social, economic and fiscal goals that a government wishes to achieve through the use of tax as a policy instrument;</li> <li>• How it sees the role of tax within its overall fiscal management of the economy;</li> <li>• The government's objectives with regard to redistribution of income and wealth using the tax system;</li> <li>• How the government intends to use the tax system to compensate for market failures, most especially on taxing harmful products and providing subsidies through tax reliefs and exemptions;</li> <li>• How the government decides what to tax; its philosophy on setting tax rates and how tax exemptions, reliefs and allowances are decided upon;</li> <li>• The government's approach to its tax administration, its management and its funding.</li> </ul>
Tax rate	<p>The rate at which a tax is charged. This is usually expressed as a percentage of the chargeable tax base e.g. x% of income. It can, however, be expressed as a fixed sum e.g. \$Y per transaction undertaken.</p>
Tax reliefs	<p>The expenditure incurred by a taxpayer permitted for offset against taxable income by a jurisdiction. Examples include expenses incurred in the course of trade, subject to restrictions imposed to prevent abuse or for policy reasons. Allowances also include those permitted expenses of employees that are deemed appropriate for relief and expenses capable of deduction against sales, capital gains and other taxes.</p>
Tax reporting	<p>The data to appraise the effectiveness of a tax system within a jurisdiction. See Tax Transparency Framework.</p>
Tax return	<p>The official document on which a taxable person must declare either their liability to tax or details of the transactions which should give rise to tax. Historically these were paper based returns, and that remains true in many parts of the world, but on-line electronic filing is now becoming more commonplace. In either case the return will usually require the person submitting it to make a declaration that the information supplied is correct with criminal penalties arising if that statement is proved to be incorrect.</p>
Tax shelter	<p>An arrangement designed to protect part or all of a person's income from taxation. The offer of such an arrangement may result from a government desire to encourage some types of behaviour or activity, but it could equally may be a commercial or legal ruse, often artificial in nature, used to assist tax avoidance activity.</p>
Tax spend (see Tax expenditures)	<p>Tax revenues forgone as a result of tax exemptions, reliefs and allowances</p>
Tax spend gap	<p>See tax gap</p>

Tax spillovers	<p>Tax spillovers are the consequences of the interactions between different tax systems, or different parts of the same tax system, that can often, sometimes unintentionally, reduce tax revenues and the size of a tax base. In short, spillovers are the often hidden externalities that result from efforts by governments to pursue more competitive tax policies in an effort to attract investment and paper profits, but can have harmful consequences for the coherence and effectiveness of the tax system as a whole, or for the tax systems of other jurisdictions. Tax spillovers can therefore be of domestic and international form. They have been talked about in relation to corporation tax by the International Monetary Fund, but in reality exist between a wider range of taxes and tax practices. Tax spillover assessment is a risk assessment tool, that seeks to document and evaluate the extent of tax spillovers, thus helping to explain how tax gaps arise. It does so by appraising the way in which one part of a tax system within the jurisdiction being appraised undermines another part of the same tax system, or a part of the tax system of another country. It also appraises whether the tax system of the jurisdiction being considered is undermined by the tax system of other locations, treated as a whole. A tax spillover assessment is designed to identify the areas of greatest risk and vulnerability within a tax system and, because of the documentation process used in the appraisal methodology, makes it relatively straightforward to identify which issues need to be addressed to improve the quality of the tax system. In doing so it makes a significant contribution to tax transparency and represents a significant level of tax transparency in its own right.</p>
Tax strategy	See tax policy
Tax system	<p>The integrated elements that must exist if tax is to be charged, including:</p> <ul style="list-style-type: none"> <li>• A government</li> <li>• Tax legislation</li> <li>• A tax authority</li> <li>• Tax collection mechanisms including tax return systems and payment processing mechanisms</li> <li>• Tax courts to enforce tax law</li> <li>• Appeal mechanisms</li> <li>• Tax reporting mechanisms for government and tax authority accounts</li> <li>• Processes to make change to the tax system, including mechanisms for legislative reform; consultations on those processes; budget setting processes and accounting mechanisms to provide feedback on the effective of the reform process.</li> </ul>
Tax transparency	<p>Tax transparency is the process that supplies the quantitative and qualitative data that a society needs to ensure that its tax system is working for the benefit of its tax authority, government, legislators, those who elected them, those who pay taxes and all other stakeholders of its tax system.</p>
Tax transparency framework (TTF)	<p>A Tax Transparency Framework is a high-level statement of policy. The object of a Tax Transparency Framework is to set out those reports that should exist within a tax system if it is to meet the standards of transparency that are required to assist all of its stakeholders attain the level of desired understanding of the way in which the tax system is both operating, and intended to operate.</p>
Territorial basis	<p>A basis for taxation that only charges the income of the residents of a territory to tax if it comes from a source also located in that territory.</p> <p>The obvious weakness in this basis for tax, which is uncommon for individuals but increasingly common for companies, is that it encourages the artificial relocation of a source of income out of a territory and to a tax haven.</p>

Territorial ring-fencing	<p>The tax and regulation regime in a jurisdiction may vary depending on where the business activity geographically takes place.</p> <p>Territorial ring-fencing is created by a jurisdiction that offers designated territorial areas in which non-residents and/or foreign business activity is privileged over locals and/or domestic economic activity. This privilege may take the form of lower tax rates or of lower reporting and/or regulatory requirements. For example, a jurisdiction may create "export processing zones" in which all production must be exported and/or only foreigners can invest. Most of this production is untaxed and applicable environmental and social standards are often low.</p>
Theoretical taxable income	<p>The gross value of a tax base multiplied by the standard rate of tax applied to it.</p> <p>For example, the value of total personal incomes in the Gross Domestic Product of a country multiplied by the standard (or basic) rate of tax used for the taxation of those personal incomes by the jurisdiction in question before the offset of exemptions, allowances and reliefs and without allowing for varying rates of tax that might be applied.</p> <p>A calculation of the value of a tax base used as the starting point for tax gap measurement.</p>
Thin capitalisation	<p>Thin capitalisation describes the process of financing a company with a high proportion of loans rather than shares. Used by transnational corporations to reduce the business profits of a subsidiary in a relatively highly taxed location, since the interest on loans is usually allowed as a deduction against profit, so reducing tax paid, whereas dividends on shares are paid out of after-tax income. The interest is usually paid to another subsidiary of the transnational corporation located in a tax haven where no tax is paid upon its receipt, resulting in an overall reduction in the tax charge of the group of companies.</p>
Tobin tax	<p>A Tobin Tax (also called Currency Transaction Tax, Financial Transaction tax and Robin Hood Tax) is a tax on trading on the foreign exchange markets named after the late James Tobin, the Nobel Prize winning economist, who proposed the idea as a means of reducing high frequency low margin trading on currencies. It may also be applied trades in other financial products such as shares, bonds, gilts, derivatives and hedges. The case for adopting a financial transaction tax is gaining political support in Europe.</p>
Tourist tax	<p>A tax aimed at tourists to a location. These can include airport taxes, landing fees and hotel and other accommodation taxes.</p>
Tracing of assets	<p>The process of recovering illicit funds relocated to jurisdictions in which they do not belong as a result of illicit financial flows. See also freezing of assets and seizing of assets.</p>
Trade mispricing	<p>The act of misrepresenting the price or quantity of imports or exports in order to hide or accumulate money in other jurisdictions. The motive could be to evade taxes, avoid customs duties, transfer a kickback, launder money or some other purpose.</p> <p>Abusive transfer pricing: A transfer-pricing scheme in which trade mispricing has occurred. Used by multinational corporations to shift profits from high-tax jurisdictions to low-tax jurisdictions.</p> <p>Trade-based money laundering: A technique where trade mispricing is used to hide or disguise income generated from illegal activity.</p>

Transfer- pricing	<p>A transfer pricing arrangement occurs whenever two or more businesses (whether corporations or not) which are owned or controlled directly or indirectly by the same people trade with each other. The term transfer pricing is used because if the entities are owned in common they might not fix prices at a market rate but might instead fix them at a rate which achieves another purpose, such as tax avoidance. If a transfer price can be shown to be the same as the market price then it is acceptable for tax purposes. What are not acceptable for tax purposes are transfer prices that increase the cost or reduce the sales value in states which charge higher tax rates and increase the sales value or reduce the costs in states with lower tax rates.</p> <p>The difficulty for many corporations at a time when over 50% of world trade is within rather than between corporations is that there is no market price for many of the goods or services they trade between their own subsidiaries. This situation arises because they are never sold to third parties. This gives rise to complex models in which attempts are made to allocate value to various stages within the supply chain within a company, which process is wide open to potential abuse. For this reason it is argued that such firms should be taxed on a unitary basis.</p>
Transnational corporations (TNCs)	A corporation with subsidiaries or divisions in two or more nations. Also known as multinational corporations (MNC).
Trusts	<p>A trust is formed whenever a person (the trust settlor) gives legal ownership of an asset (the trust property) to another person (the trustee) on condition that they apply the income and gains arising from that asset for the benefit of a third person (the beneficiary). Trusts can be established verbally but typically take written form. Trustees are frequently professional people or firms charging fees. Trusts are usually of one of three types:</p> <ul style="list-style-type: none"> <li>- discretionary trust</li> <li>- charitable trust</li> <li>- interest in possession trust</li> </ul>
Trustee	A person who holds the legal title to assets held in a trust and who administers it. The first trustees of a trust will be appointed by the settlor. The trustees may be paid for their work but are not usually allowed to be beneficiaries of the trust they administer. In secrecy jurisdictions trustees are often hired nominees who sign papers sent to them by the real controllers of the trusts they administer. In many cases that is the settlor.
Trust beneficiary	Anyone who may obtain a benefit from a trust. A person who has a right to receive a benefit from the trust has an 'interest in possession'. If someone can receive a benefit but has no legal right to do so they are called a discretionary beneficiary. They only get a benefit if and when the trustees decide to pay it to them.
Trust company	A trust company provides the services of trustees and /or administrative staff who manage the affairs of trusts on behalf of those trustees.

Trust deed	<p>The agreement that governs the management of a trust. The trust deed is usually in written form and sets out the wishes of the trust's settlor. It will specify who are to be the trustees, how they will manage their affairs, how their successors will be appointed, for whose benefit the trust property is to be managed and when they shall be entitled to receive it. If the trustees are afforded discretion on any such issue it will state this and the limits of that authority. The trust deed will also state the period for which the trust may operate, the law of many jurisdictions requiring that this be limited.</p> <p>Despite appearances trust deeds are frequently not comprehensive and are often accompanied by a 'letter of wishes' which states what the trustees are actually to do with the trust property. As such the legal form of the trust specified in the trust deed can frequently be negated by the letter of wishes issued by the settlor.</p>
Trust settlor	<p>The person who establishes a trust by gifting assets to it. Having made the gift they are usually supposed to have no further influence over a trust but in many tax havens that is not the case and the settlor often remains in complete control of the assets of the trust despite having supposedly gifted them for the benefit of others.</p>
Unitary basis	<p>Unitary taxation treats the income of a group of companies as being one combined sum subject to tax. That taxable income is then apportioned for tax to be assessed by applying a formula to determine in which countries it might best be considered to have been earned (hence the term 'formulary apportionment' is widely applied to this process). Each state may then apply the rate of tax to it that it wishes. Unitary taxation is an alternative to the residence and source bases of taxation.</p> <p>Unitary taxation has been used in federal countries such as the USA where an allocation formula based on a ratio of sales, employment costs and assets employed within each state is used. It has been opposed by tax authorities (and MNCs) because they consider that it would be too difficult to reach international agreement, most especially on the formula. However, taxation of highly integrated MNCs may in practice entail a formula-based allocation of profits, albeit through negotiation of the sums allocated to each state under the arm's length method of transfer pricing for which there is frequently no realistic basis for determination because of the absence of alternative market based evidence of third party pricing.</p>
Unlimited company	<p>An entity incorporated in the same way as a limited liability company or corporation except that the members have unlimited liability for the debts of the company. Rarely found, they exist in some Anglo Saxon law jurisdictions where they have been little used. However, in exchange for unlimited liability they offer in locations such as the UK and Ireland the chance to have the status of being a separate legal entity taxable in its own right but without having obligation to place accounts on public record. This has been exploited by some corporations with major subsidiaries in Ireland to avoid details of their tax avoiding activities in that state from being disclosed.</p>
Unpaid tax gap	<p>See tax gap</p>
Unregulated entity	<p>An entity created within a secrecy jurisdiction intended for use in the unregulated market that operates in the secrecy space. This entity will not be accountable for its transactions either because that has been engineered to be the case, in which case it is operating nowhere, or because there is deliberate omission to make that declaration in a place elsewhere to that in which it is legally located, which place elsewhere is unaware of the unregulated entity's obligation to make that declaration because of the existence of the secrecy space.</p>

Unregulated market	An alternative term for 'offshore'. It is the sum of the commercial operations created to exploit the secrecy spaces created by secrecy jurisdictions. Unregulated entities trade within the unregulated market, either with other unregulated entities or with regulated entities.
Value added tax (VAT)	<p>A tax levied on transactions designed to cumulatively tax value added within jurisdictions. This is achieved by charging VAT on imports into and on the sales of registered traders within a jurisdiction but by allowing those same registered traders to make claims for all VAT charged to them for offset against the VAT they collect from their customers. The result is that VAT should only be charged to end-consumers within the jurisdiction (exports invariably being exempt from charge).</p> <p>The range of goods and services on which VAT is charged varies from states. Reduced and zero rates are used in some jurisdictions to reduce the regressive impact of the tax which otherwise imposes the greatest proportionate burden on those with lowest incomes in a society.</p>
Vertical ringfencing	<p>Vertical ring-fencing exists in the tax system of a jurisdiction if non-resident people and/or foreign owned business entities are provided with privileged taxation status and this privilege is dependent upon their using certain types of legal entity and / or their undertaking specified economic activity.</p> <p>International Business Corporations (IBCs) are an example of a vertical ring fence commonly available in many secrecy jurisdictions. Only those not resident in the secrecy jurisdiction are allowed to own IBCs and their income is exempt from tax in the secrecy jurisdiction in which they are incorporated on condition that they do not trade there.</p>
Wealth tax	A tax on a person's declared wealth, typically imposed annually at a very low rate. Once commonplace in Europe these are now little-used since they are thought to encourage people to hide assets offshore. However, there is renewed interest in their use and how they might play a role in reducing inequality and tackling the public finance deficits around the world.
Withholding tax	Tax deducted from a payment made to a person resident outside the jurisdiction in which the payment originates. Generally applied to investment income, such as interest, dividends, royalties and licence fees.