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Mbeki Briefing on Illicit Financial Flows from Africa

How Should Tanzania Tackle Illicit Financial Flows

In February 2015 the High Level Panel on Illicit Financial Flows from Africa, chaired by President Thabo Mbeki, submitted its report to the African Union Commission/United Nations Economic Commission for Africa (AUC/ECA). The report found that African countries loses on average $50 billion annually through illicit financial flows. Commercial activities by the private sector are by far the largest contributor to IFFs, followed by organized crime, then public sector activities. Corrupt practices play a key role in facilitating these outflows. According to the report, Multinational corporations shift profits to subsidiaries in low-tax or secrecy jurisdictions where in many cases, those subsidiaries exist on paper only, mostly with one or two employees, while the bulk of the activities of the company occur in another country.

This briefing presents the report's main findings and recommendations to African governments – also to Tanzania.

Main Findings

- ✓ *Illicit financial flows from Africa are large and increasing*
- ✓ *Ending illicit financial flows is a political issue*
- ✓ *Transparency is key across all aspects of illicit financial flows*
- ✓ *Commercial routes of illicit financial flows need closer monitoring*
- ✓ *The dependence of African countries on natural resources extraction makes them vulnerable to illicit financial flows*
- ✓ *New and innovative means of generating illicit financial flows are emerging*
- ✓ *Tax incentives are not usually guided by cost-benefit analyses*
- ✓ *Corruption and abuse of entrusted power remains a continuing concern*
- ✓ *New and more efforts are needed in asset recovery and repatriation*
- ✓ *Money laundering continues to require attention*
- ✓ *Weak national and regional capacities impede efforts to curb illicit financial flows*
- ✓ *Incomplete global architecture for tackling illicit financial flows*
- ✓ *Financial secrecy jurisdictions must come under closer scrutiny*
- ✓ *Development partners have an important role in curbing illicit financial flows from Africa*
- ✓ *Illicit financial flow issues should be incorporated and better coordinated across United Nations processes and frameworks*

Recommendations to the Tanzania Government

1. **Tackle trade mispricing:** African countries should ensure that they have clear and concise laws and regulations that make it illegal to intentionally incorrectly or inaccurately state the price, quantity, quality or other aspect of trade in goods and services in order to move capital or profits to another jurisdiction or to manipulate, evade or avoid any form of taxation, including customs and excise duties

Actions needed:

- ✓ Ensure that all corporations, big and small, are registered for tax purposes;
- ✓ The databases of the companies' registration office and the tax authority should be linked.
- ✓ Customs authorities should use available databases of information about comparable pricing of world trade in goods to analyze imports and exports and identify transactions that require additional scrutiny.
- ✓ Begin collecting trade transaction data and creating databases from that information, which can then be searched and shared with other States.

2. **Monitor transfer pricing:** Effective implementation of the "arm's-length principle" depends on the availability of comparable pricing data on goods and services.

Actions needed:

- ✓ Make fully and freely available, and in a timely manner, data on pricing of goods and services in international transactions, according to accepted coding categories.
- ✓ Establish transfer pricing units as a matter of extreme urgency. These units should be appropriately situated in revenue authorities and should be well equipped in accordance with global best practices.
- ✓ Require multinational corporations to provide comprehensive reports showing disaggregated financial reporting on a country-by-country or subsidiary-by-subsidiary basis.

3. **Tackle profit shifting by multinational companies:** The practice by which multinational corporations shift profits to subsidiaries in low-tax or secrecy jurisdictions is one of the biggest single sources of illicit outflows. In many cases, those subsidiaries exist on paper only, mostly with one or two employees, while the bulk of the activities of the company occur in another country.

Actions needed:

- ✓ There should be an automatic exchange of tax information among African countries.
- ✓ Call for an automatic exchange of tax information globally, subject to national capacity and to maintaining the confidentiality of price-sensitive business information.

4. **Increase transparency:** Transparency of ownership and control of companies, partnerships, trusts and other legal entities that can hold assets and open bank accounts is critical to the ability to determine where illicit funds are moving and who is moving them.

Action needed:

- ✓ Make it mandatory that beneficial ownership information should be disclosed when companies are incorporated or trusts registered or when parties are entering into government contracts.

5. **Review Double Taxation Agreements:** Double taxation agreements can contain provisions that are harmful to domestic resource mobilization and can be used to facilitate illicit financial outflows.

Actions needed:

- ✓ Review current and prospective double taxation conventions, particularly those in place with jurisdictions that are significant destinations of IFFs, to ensure that they do not provide opportunities for abuse.
- ✓ Consider using the Model Double Taxation Agreement developed by the African Tax Administration Forum.

6. Stop the regional "race to the bottom" on tax incentives:

Actions needed:

- ✓ EAC cooperation should be used to introduce standards for tax incentives to prevent harmful competition in the effort to attract foreign direct investment.
- ✓ Join the African Tax Administration Forum (ATAF) and provide it with the necessary support, including political standing in African regional processes such as the AU/ECA Conference of Ministers of Finance

7. Pay special attention to the extractive sector

Action needed:

- ✓ Join voluntary initiatives like the Extractive Industries Transparency Initiative (EITI).
- ✓ Push for mandatory country-by-country and project-by-project reporting requirements immediately in the extractive sectors and in the near term across all sectors.

8. Strengthen and establish institutions responsible for preventing IFFs

Actions needed:

- ✓ Strengthen or establish financial intelligence units, anti-fraud agencies, customs and border agencies, revenue agencies, anti-corruption agencies and financial crime agencies.
- ✓ Create methods and mechanisms for information sharing and coordination among the various institutions and agencies of government responsible for preventing IFFs, with such coordination being led by the country's financial intelligence unit.
- ✓ Put in place supervision of banks and nonbank financial institutions by central banks and financial supervision agencies. Such regimes must require mandatory reporting of transactions that may be tainted with illicit activity.

9. **Stop illicit financial flows through crime:** Poaching; drugs, arms and human trafficking; oil and mineral theft; and other forms of crime that generate money contribute to IFFs, sometimes employing the same commercial mechanisms used to evade taxes and customs duties to move the proceeds of these crimes out of African countries

Actions needed:

- ✓ Ensure that investigators responsible for identifying the criminals engaged in these activities are also required, trained and empowered to investigate the financial aspects of these cases, prosecuting those who facilitate the movement and laundering of the proceeds of these crimes as well.
- ✓ Share information with other African financial intelligence units about cases of people and companies being prosecuted for facilitating the movement and laundering of the proceeds of these crimes so that cross-border illicit activities and patterns can be identified.

10. **Stop illicit financial flows through corruption:** Global standards in anti-corruption and anti–money laundering require financial institutions to subject accounts held by certain persons to greater scrutiny and monitoring, including senior government officials, leaders of political parties, executives at state-owned enterprises and others with access to large amounts of state assets and the power to direct them (often called politically exposed persons, or PEPs).

Actions needed:

- ✓ Publish lists of PEPs, as well as any asset declarations filed by PEPs and information about whether the country's laws prohibit or restrict the ability of their PEPs to hold financial accounts abroad.
- ✓ Require foreign financial institutions to provide details of accounts held by their listed PEPs, preferably as part of automatic exchange of financial information.
- ✓ Ensure that the public can access national and subnational budget information, and that processes and procedures for budget development and auditing are open and transparent to the public.
- ✓ Adopt best practices in open contracting to reduce IFFs through government procurement processes.

The above recommendations are necessary but not sufficient conditions for African countries to combat IFFs. Additional strategic measures are apparently needed.

11. Additional strategic measure to combat IFFs from Africa

Strategic actions needed at national and regional levels:

- ✓ African countries should adopt a normative instrument in the form of a declaration to commit to combating IFFs and urging similar actions at the global level

- ✓ Given the vital and positive role of civil society organizations (media, non-governmental organizations, academia and think tanks) in efforts to curb IFFs, it is essential that they should be given the operating space and legal freedoms required for advocacy, activism and research in this area.

- ✓ Include IFFs in Article 22 of the African Union Convention on Preventing and Combating Corruption.

- ✓ The African Peer Review Mechanism should incorporate issues of IFFs in its questionnaires for the country review process.

- ✓ Undertake a study of potential methodologies and reforms available globally and regionally and to individual African countries to facilitate taxation of multinational corporations in accordance with where their economic activities occur, bearing in mind current international standards and pragmatic opportunities for the improvement of these standards.

- ✓ Mandate the ECA to undertake research on the cost-benefit analysis of tax incentives to help guide African countries in drawing up such frameworks intended to attract foreign direct investment.

- ✓ African countries should consider coordinating efforts and presenting regional or larger unified positions in response to OECD consultations and meetings. Where measures are adopted by the OECD that African countries determine will hurt their countries or the continent as a whole, African governments should recommend and publish measures that all African countries can take to counter profit-shifting practices detrimental to African countries.

Policy Forum
P.O. Box 38486, Dar es Salaam
Tel: +255 22 2780200/255 782317434
Email: info@policyforum.or.tz | Website: www.policyforum.or.tz

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