

---

## Discussion Group VI: Illicit Financial Flows

### Follow-up on the High-Level Event on Financing for Development in the Era of COVID-19 and Beyond

---

#### *Background Document*

##### **Background**

Background document on measures to expand fiscal space and foster domestic resource mobilization by preventing illicit financial flows, base erosion and profit shifting, and facilitating contributions of the digital economy in the emergency and beyond.

## **1. Policy options to address IFFs in the context of COVID-19**

Illicit financial flows (IFFs) exacerbate the sustainable development financing gap, both by reducing revenue and by misdirecting expenditure. The accelerating pace of technology advancement has greatly changed the landscape of the IFF challenge. In addition to providing a platform for new types of criminal activity, new digital technologies have offered a number of unique tools to facilitate IFFs at all stages of funds generation, transfer, and ultimate use. The situation may deteriorate as COVID-19 response measures are enacted, as they have included relaxation of expenditure controls to speed responses. Measures to control illicit transfers may also reduce the availability of financial services, by increasing the costs of the financial sector; policy options to address this issue may be considered by Discussion Group I: External Finance and Remittances, Jobs and Inclusive Growth.

### 1. Transparency and integrity in COVID-19 financial responses

**Context:** Unprecedented levels of domestic financial response and international liquidity support may stretch the ability of oversight and audit functions to ensure transparency and integrity. Existing fraud and organized crime schemes are adapting to the COVID-19 context, while political and private actors are taking advantage of states of emergency and emergency response financing. Risks may rise across the range of economic crimes related to supply chains, procurement, corruption, trade, the financial sector, and terrorist financing. They will vary based on the type of financial response and the different risk profiles of countries based on their public financial management capacities, subnational systems for delivery of resources, geographic accessibility, levels of financial inclusion, and comprehensiveness of the existing social protection systems. These challenges are more pressing in developing countries, especially where governance and regulatory oversight are weak.

**Proposal:** develop a rapid response mechanism which can prioritise policy oriented anti-corruption and anti-money laundering solutions to immediate problems related to aid disbursement, protection of stimulus measures, financial inclusion, public procurement and fraud. Cross-institutional mission teams, involving field staff and experts, would stand ready to dedicate time to countries that request assistance with promoting accountability of response funds.

**Benefits:** Ability to tailor assistance to country characteristics and build on existing country knowledge. Leverage the expertise of the different institutions. Possible to match responses to liquidity support provision, ensuring that international liquidity is transparently and effectively managed and spent.

**Risks and challenges:** Coordination across institutions can be challenging. May result in unclear lines of accountability within rapid response teams when staff are from different institutions. Finding resources for the technical assistance. Inability to travel due to COVID-19 related restrictions. Siloed approach to COVID-19 funding may not spill over into broader public financial management (PFM) reforms. May risk creating extra-budgetary processes, rather than reinforce country ownership by making use of and improving existing country systems.

## 2. Promoting withholding taxes to ensure fair taxation

**Context:** International tax norms are under renegotiation, but there is high uncertainty of the direction and likelihood of agreement. Meanwhile the fundamental issues of high relevance to developing countries, related to allocation of taxing rights, were not addressed in the OECD/G20 BEPS process. Withholding taxes have played an important part in the UN Model Double Tax Convention and in developing (and developed) country practice. They can be the only feasible options when taxation based on profits is difficult or easily manipulated. Withholding taxes are particularly effective when a taxpayer is located offshore but a withholding agent is within the jurisdiction.

**Proposal:** Develop proposals for easily administered withholding tax approaches and mechanism(s) that assist in combatting tax abuses. The proposal should include efficiency improvements for taxpayers, such as use of increased use of electronic filing for refunds (as physical paperwork is very difficult given social-distancing requirements).

**Benefits:** Ability to tailor withholding tax regimes to country characteristics and build on existing country knowledge. Leverage the expertise of the different institutions. Ability to promote systems better adapted to taxpayer needs, while ensuring they are as effective as possible for developing countries. Recognition of validity of withholding tax systems and of taxation based on revenue rather than profits where the latter is not feasible.

**Risks and challenges:** Developing countries tend to favour withholding taxes, and broader use of them, more than developed countries. This difference will need to be addressed in the coordination process, perhaps by a general preference for profit based tax where feasible but a recognition that this is not always the case.

## 3. Increasing capacity building

**Context:** Implementation capacity at the national level is crucial to tackling illicit financial flows. In low income countries, capacity can be limited by the scarcity of resources in general, as well as human capacity constraints. In many countries with high corruption, tax evasion and money-laundering risks, capacity across competent authorities is uneven and shallow. Given the need for coordinated action at national level, capacity gaps in just one agency can enhance risks across the board. Lack of necessary knowledge, skills and capacities is also a major impediment to successful international cooperation, such as on tax information exchange and asset recovery and return.

**Proposal:** A large scale and coordinated push for capacity building relevant to national contexts and across tax administration, tax policy, financial intelligence units and asset recovery specialists, financial regulators, judges, prosecutors, customs, and other relevant agencies. This could come through multiple channels, such as a re-doubling of ODA for tax capacity under a second round commitment by the Addis Tax Initiative, greater resources in the UN regular budget dedicated to capacity building on UN instruments, and/or an expansion of the Tax Inspectors Without Borders programme.

**Benefits:** Demand-driven capacity building can strengthen ownership of policies and practices. Capacity can focus on greater national coordination in enforcement, closing loopholes, improving asset recovery and strengthening revenue mobilization. Increased enforcement and perceptions of a cleaner system can increase trust and have positive feedback loops for both voluntary tax domestic compliance and international cooperation.

**Risks and challenges:** Donors are already stretched and may not have greater resources to dedicate, meaning that allocations to IFFs-related capacity building may undermine funding for other SDGs. Coordination challenges lead to duplication. Supply driven TA does not result in lasting capacity increases.

#### 4. Addressing systemic shortcomings in the medium term to recover better

**Context:** There has been a significant array of recent efforts to address some of the vulnerabilities and loopholes that allow IFFs. Most of the institutional efforts have focused on evolution of existing systems. However, as evidenced by recent scandals and cases, these efforts have been insufficient. Some Member States call for reforming systems that they feel are not working as designed. In the medium and long-term, Member States should be open to reforming the international institutional and legal frameworks to make them less vulnerable to tax avoidance, tax evasion, money-laundering, and corruption. This will likely require better implementation of the existing internationally-agreed norms and standards, with stronger review of country compliance, as well as changes to the rules to prevent the exploitation of gaps, vulnerabilities and loopholes. Addressing systemic shortcomings will require significant political will and a careful approach to prioritization. In early March 2020, the President of the General Assembly and the President of the Economic and Social Council jointly launched a High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel), which is mandated to help develop this political will and provide recommendations for addressing gaps, vulnerabilities and impediments in relevant international legal and institutional frameworks.

**Proposal:** Member States should begin to develop the political consensus to address systemic shortcomings related to IFFs. This can be developed through engagement with the FACTI Panel, an open approach to its recommendations, and inclusive discussion/negotiation on its proposals in the General Assembly, ECOSOC and relevant UN forums.

**Benefits:** An open and inclusive approach allows the needs of all countries to be considered. The FACTI Panel can help bring countries together to begin to build understanding and political will. The FACTI Panel is halfway through its work towards recommendations.

**Risks and challenges:** Member States will not be able to find common ground on the proposals.

## 2. Financing for Development outcomes and other relevant agreements

Addis Ababa Action Agenda (2015)

Combatting illicit finance:

- Good governance, rule of law, human rights, fundamental freedoms, equal access to fair justice systems, and measures to combat corruption and curb illicit financial flows will be integral to our efforts. [AAAA 18]
- We will redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. [AAAA 23]
- We will strive to eliminate safe havens that create incentives for transfer abroad of stolen assets and illicit financial flows. [AAAA 25]

Combatting corruption:

- We urge all countries that have not yet done so to ratify and accede to the United Nations Convention against Corruption and encourage parties to review its implementation. We commit to making the Convention an effective instrument to deter, detect, prevent and counter corruption and bribery, prosecute those involved in corrupt activities, and recover and return stolen assets to their country of origin. [AAAA 25]

Asset recovery and return:

- We encourage the international community to develop good practices on asset return. We support the Stolen Asset Recovery Initiative of the United Nations and the World Bank, and other international initiatives that support the recovery of stolen assets. [AAAA 25]

International tax cooperation:

- We will also reduce opportunities for tax avoidance, and consider inserting anti-abuse clauses in all tax treaties. [AAAA 23]
- We commit to scaling up international tax cooperation. We encourage countries, in accordance with their national capacities and circumstances, to work together to strengthen transparency and adopt appropriate policies, including multinational enterprises reporting country-by-country to tax authorities where they operate; access to beneficial ownership information for competent authorities; and progressively advancing towards automatic exchange of tax information among tax authorities as appropriate, with assistance to developing countries, especially the least developed, as needed. [AAAA 27]
- We stress that efforts in international tax cooperation should be universal in approach and scope and should fully take into account the different needs and capacities of all countries, in particular least developed countries, landlocked developing countries, small island developing States and African countries. We welcome the participation of developing countries or their regional networks in this work, and call for more inclusiveness to ensure that these efforts benefit all countries. [AAAA 28]
- We emphasize the importance of inclusive cooperation and dialogue among national tax authorities on international tax matters. In this regard, we welcome the work of the Committee of Experts on International Cooperation in Tax Matters, including its subcommittees. [AAAA 29]

[United Nations code of conduct on cooperation in combating international tax evasion \(2017\)](#)

The United Nations code of conduct on cooperation in combating international tax evasion, produced by the UN Committee of Experts on International Cooperation in Tax Matters, has the following goals:

- (a) To ensure that all States following the present code of conduct, in an effort to combat international tax evasion and avoidance, and to protect their tax bases from non-compliance with their tax laws, provide that high levels of transparency and exchange of information in tax matters are adhered to, in particular, automatic exchange of information;
- (b) To assist in the development of international norms, practical steps and capacity building programmes that those States may follow, with a view to preventing and combating international tax evasion and protecting their tax bases from non compliance with their tax laws.

[United Nations Convention Against Corruption \(2003\)](#)

The United Nations Convention against Corruption is the only legally binding universal anti-corruption instrument. The Convention's far-reaching approach and the mandatory character of many of its provisions make it a unique tool for developing a comprehensive response to a global problem. The Convention covers five main areas: preventive measures, criminalization and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange. The Convention covers many different forms of corruption, such as bribery, trading in influence, abuse of functions, and various acts of corruption in the private sector. A highlight of the Convention is the inclusion of a specific chapter on asset recovery, aimed at returning assets to their rightful owners, including countries from which they had been taken illicitly. The vast majority of United Nations Member States are parties to the Convention.