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Tenth Annual Eurasia Fiscal Experts' Seminar

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Vienna

Summary Report

by

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Introduction



Eurasia Fiscal Experts' Seminar

ITIC's tenth annual *Eurasia Fiscal Experts' Seminar* (EFES)

was held on 8-10 July 2014 in Vienna, in partnership with the Institute for Austrian and International Tax Law at WU (Vienna University of Business and Economics). Approximately 80 participants gathered in Vienna, including:

- Officials from governments and parliaments of Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Mongolia, Russia, Tajikistan, and Ukraine;
- Representatives from the Eurasia Economic Commission, Intra-European Organisation of Tax Administrations, World Bank, and the World Customs Organisation;
- ITIC sponsors; and
- Independent international fiscal experts.



ITIC's partnership with WU recognized the important role that civil society can play, in dialogue with government

and business, in providing critical “thought leadership” and informed capacity-building in pursuit of the constructive evolution of tax policy, law and administration throughout the regional jurisdictions. As the countries and businesses of the Eurasia region continue to move towards closer economic integration amongst themselves and with the global economy, their participation in the international tax system and their interest in its development are intensifying, while their capacity to engage comfortably with it is being challenged. Through its tri-partite dialogue-of-equals among senior officials and legislators, international experts and investors, EFES 10 provided a unique opportunity for these stakeholders to address actual and potential issues of tax policy, law and administration involved with international business and economic integration, sustainable economic development and climate change, revenues adequacy and compliance.

This summary report should be read in conjunction with:

- The detailed *Seminar* presentations that can be accessed on the ITIC website by [clicking here](#).
- ITIC's 19th annual *Special Report*, titled, *Some Fiscal Parameters of the Investment Climate in Select Countries of Eurasia*, published on 8 July 2014. A copy of the *Report* can be [downloaded here](#).



Over 80 participants gathered in Vienna for the tenth annual Eurasia Fiscal Experts' Seminar.

Conclusions

1. EFES remains important to regional countries, including for its “thought leadership,” exchange of experience, and professional networking (particularly under current conditions of closer economic integration). The *Seminar* should be convened again next year.
2. EFES 11 will be held on 30 June - 2 July 2015 in Brussels, in partnership with the World Customs Organization (WCO) and in association with key regional institutions: EEU, EU, European Parliament, and the Energy Charter Secretariat.
3. By the end of October 2014, ITIC will draft an EFES 11 “Issues Agenda” around five designated themes and circulate it for consideration and comment.
4. Elements of such themes could include review of:
 - Technical and consultative requirements for effectively designing fiscal policy and translating it into comprehensible law and coherent administration, analyzing and taking into account the potential regulatory impact while bearing in mind socio-economic and environmental realities and pressures;
 - Directions in the evolution of the international tax system, including implementation (variously nationally, regionally, globally) of elements of the OECD BEPS scheme and the implications for business of any such “smorgasbord” approach;
 - The increasingly-important interrelationship between tax and trade, with specific attention to related fiscal and commercial policies of regional WTO member and non-member states;
 - The continuing significance of the taxation-x-investment equation for business formation and development;
 - Progress in the modernization of the tax systems of the regional countries, including policy innovations in respect of the design of indirect taxation applying to specific sectors (e.g. attention to the respective merits of specific and ad valorem systems of tobacco taxation) and administrative systems of e-accounting and audit;
 - The enhanced regional economic integration and the detail of its requirements for the coordination of member states’ tax systems;
 - Respective achievements in compliance results under comparative tax systems of greater-or-lesser transparency, education, cooperation and coercion;
 - Effectiveness of policy measures to combat revenues’ base erosion by limiting the use of offshore jurisdictions to reduce tax liability; and
 - Scope and size of capacity-building measures to raise the level of expertise and comprehension in regional countries’ administrations faced with regulating sophisticated business arrangements.
5. Participating countries and investors should try to maintain some continuity of their participating personnel, so as to facilitate constructive deliberations at EFES 11.
6. Thinking laterally, however, and taking into account Point (4) above, EFES 11 would benefit from an infusion of ideas on tax policy and regional operations, hence participation by others, including additional experts from outside the region, should be encouraged.

Seminar Themes

The *Seminar* themes comprised of:

1. Fiscal parameters of the closer economic integration and interaction of Europe and Eurasia, involving examination and scope for coordination of respective tax and customs practices, review of achievements in expanding cross-border trade and investment, and cooperation in combating illicit activities.
2. Reflecting the forward-looking nature of the *Seminar*, priorities for reform of tax policy and administration in pursuit of sustainable economic development, taking into account climate change considerations, protection of the revenue base, and inter-agencies' cooperation.
3. Recognizing the persistence of fiscal disputes and their negative impact on official and commercial operations, review of national and international arrangements and procedures for minimizing and resolving such disputes.
4. Noting that achieving good tax compliance can be a complex issue, examination of the interaction between taxpayer/tax official attitudes and tax system design including its (in)appropriate purposes as well as service and enforcement elements.

Seminar Proceedings

Opening Session



Mr. Daniel Witt welcomed participants, reviewed the global and regional contexts in which the *Seminar* was being conducted, and suggested ways in which its deliberations could contribute positively to the primary cause of sustainable and equitable economic development across the region. Major policy concerns for participants related to the economic integration processes intensifying the interconnections of the regional countries and challenging their comparative competitiveness.

In this regard, Mr. Witt stressed the critical role of tax (as lubricant or grit) in the legal functioning of trade and investment, promoting or stifling free trade, and fair competition. Given the gravity of tax, its design and delivery needed to be facts-based rather than “ideological” or “populist,” conducted by the professionals of Finance Ministries and resistant to the “special interests” of other official Agencies and outside pressure groups.

ITIC stands ready to support the paramountcy of regional countries' Finance Ministries.

Mr. Witt concluded with the expectation that participants would end the *Seminar* with a far better understanding of the key fiscal and trade issues affecting their responsibilities and operations, as well as an enhanced mutual trust between business and government. This would only give each of the participating countries a solid foundation from which to pursue the pro-growth policies that would deliver prosperity for their citizenry.



Dr. Jeffrey Owens reviewed the condition of the global economy as a further scene-setter for the *Seminar*, concluding (among other things) that:

- The regional jurisdictions needed to build sound institutions (including tax administrations);
- Promote further economic integration;
- Pursue greater regional cooperation to address common challenges of climate change, water scarcity, income inequality, and food security; and
- Maintain fiscal health in terms of public debt and deficit levels.

Concerning the tax challenges facing the regional economy, Dr. Owens noted in particular that BEPS implementation would generate uncertainty for business and governments. Few regional economic actors seemed aware of ways in which BEPS would change the international tax environment within which they operated. Furthermore, these actors were unaware of the fact that major trading partners were already introducing, unilaterally and/or multilaterally, (1) limitations on the tax treatment of losses; (2) tighter transfer pricing and thin capitalization rules; (3) changes to withholding tax regimes; (4) tougher CFC rules; (4) limitations on the deductibility of interest and business expenses; and (5) restricted relief on payments made to “low tax” jurisdictions.

Tax administrations were also increasing tax enforcement to protect and enhance the revenue base by improving

disclosure and transparency, focusing on business “substance” within transactions and introducing measures to combat revenues’ base erosion by limiting the use of offshore jurisdictions to reduce tax liability.



Possible results of the G20 Finance Ministers’ meeting in September, according to Dr. Owens, also could include a “grand vision” of a new way to report on and tax the digital economy, involving:

- Proposals for extensive country-by-country reporting and a “master file” for transfer pricing;
- A general anti-abuse rule in the model tax treaty, as well as a limitation on benefits provision; and
- Recommendations on hybrid mismatch requiring a multinational corporation to document the tax treatments of each cross border inter-company transaction in two or more jurisdictions.

Participants took note of the overview, including for consideration in the context of the remaining *Seminar* agenda. In particular, the tax relationship between fostering growth while diminishing inequality was seen as complex (e.g. the cost of competition for business talent and its affordability involving both detailed CIT provisions and PIT treatment of compensation). Arguments over the distribution of the tax “burden” among classes of PIT payers were stimulating highly-subjective judgments which were not helpful for the policy objective of revenue-raising.

Theme One: Fiscal Parameters of Closer Economic Integration and of Interaction of Europe and Eurasia



Minister Timur Suleimenov outlined the objectives of the EEU, its economic integration principles, the advantages it offered (including new commercial opportunities), and the overall positive impact it would have for the economies of the member states. In summary, the

creation of the economic union was aimed at the development of mutual trade and economic relations and the provision of mutual assistance in responding to global competition. It was an economic construct, not a political initiative.

Addressing specifically the Taxation Chapter XVII of the EEU Treaty (signed in Astana on 29 May 2014), “Taxes and Taxation” Articles 71-73 and its associated Protocol Appendix 18, Minister Suleimenov emphasized that the strategy of member states of the Customs Union and the Common Economic Area (CEA) in the field of tax policy was directed towards promoting competitiveness on the part of taxpayers and eliminating tax barriers which influenced the development of economic relations between member states of the Customs Union and the CEA.

As to respective competences, tax was a national power and the Union simply implemented according to the treaty provisions (e.g. it had a role to harmonize indirect taxation, which would play a vital part in achieving EEU success). Concerning tobacco and alcohol excises, EEU member states agreed on the long-term policy (the 2020 policy “Road Map” was for determination in September), taking into account the interests of industry and consumers, as well as health and welfare considerations.



Stimulated by the Minister’s presentation, participants responded across a range of issues, including:

1. The comparative international experience (e.g. EU, ECOWAS and others);
2. Double (non)taxation potential;
3. Indirect taxation purposes and directions;
4. Harmonization/coordination/sovereignty; and
5. Tax competition and investment.

Concerning No. 1, coordination and improved implementation were watchwords for the EU. Integration required transparency and rules on exchange of information, with time limits and clearing mechanisms. Interaction between the EEU and EU was inevitable, owing to their involvement with DTAs and the Mutual Assistance Convention, as well as practically in framing excises and cooperating to combat cross-border illicit activity.

Concerning No. 2, the EEU Treaty tax provisions in respect of the treatment of residents/non-residents (subject to differing treatment in the Russian Federation tax system) seemingly had the potential to create either double taxation or “double-dipping” with respect to

the loss/benefit operation of the DTAs. This had been accepted by the EEC as requiring clarification. WU stood ready to help the Commission with this task, which also had implications for the sharing of fiscal sovereignty.

Concerning No. 3, coordination of implementation was more achievable and valuable than equalization of rates. This basic regulatory approach could include identical/similar conditions (for licensing, payment procedures, and penalties), with the aim of building cooperation through developing structures. The EEU seemed to be moving along the coordination route, which would be more beneficial for the business environment. However, there were issues with member states' VAT refund procedures, which could be acting as a barrier to investment and trade.

Concerning No. 4, achieving harmonization was a long-term project, given the need to work through such fundamental issues as:

- Standardization vs. a common system;
- The nature (e.g. natural resources-rich/poor, differing demography, etc.) of the participating economies; and, consequently,
- Their varying tax “mix.”

Nonetheless, in the common interest of combating illicit trade, conceding of some sovereignty in respect of excises seemed necessary. Achieving the 2020 “Road Map” called for establishing the parameters of a unified approach, perhaps involving some limit to sovereignty but without destroying individual member state competitiveness. This could involve general agreement on rules (e.g. for VAT, on cross-border transactions, reverse VAT, VAT refunds but not on rates; for transfer pricing on valuation, documentation; and for international taxation, on thin capitalization, interest deductibility).



Concerning No. 5, elements of national tax systems (e.g. the taxable base and the role of reliefs/exemptions/incentives) needed to be comparatively analyzed. While the best incentive was a modern, certain tax policy and a competent tax administration, more familiar incentives (including VAT exemptions) should be provided only through a process transparent as to the policy considerations and, as appropriate, detailing quantum, term, delivery process, monitoring and evaluation elements. The latest (June 2014) Kazakhstan incentives program demonstrated a number of these features.

Theme Two: Tax Reform – Priorities for Policy and Administration



Chairman **Dave Hartnett** introduced the session by emphasizing the sheer complexity of tax and the need for closer cooperation among economic actors in order to achieve their respective objectives. He also noted the impediment to objectivity presented by the widespread ignorance of the international tax system and an associated self-defeating, anti-business “animus.”



Dr. Michael Brauninger reviewed the results of current scientific research into tobacco tax policies, a top priority interest for regional countries. He addressed more general “constitutional” issues associated with tax policy responsibilities, both nationally and internationally. His findings, some of which were presented graphically (e.g. see optimal tax curve for tobacco taxation) included the following:

- Consensus on the objectives justifying special taxation of tobacco products (e.g. raising tax revenues and protecting public health).
- Differences in optimal level of tax across countries according to differences in income, regulations, culture, education/risk awareness, and illicit tobacco consumption.
- No single optimal tax level for all countries. Significant country differences mean optimal tax levels could vary vastly, while international coordination and/or harmonization of tax rates made no economic sense and might have negative effects owing to countries' vulnerability to illicit tobacco trade. Analysis of the EU showed there was no correlation between excise yields and smoking prevalence as well as tax yield.
- International consensus that sector-specific taxation should not be subject to regulation by international agreements. Any such outside prescriptive obligations were inappropriate and unacceptable, being excluded by national tax regulations.
- Tax sovereignty implied the ability to raise revenue (i.e. the right to determine tax rates and structures) and full control of fiscal policy (i.e. to determine the use of tax revenues).
- A “tobacco tax” or such “earmarking” would likely lead to non-optimal solutions since it impeded a quick adjustment to changes in costs or demand,

required supplementary aid to adjust for dynamic changes in tax revenue or production cost, and removed a percentage of revenues from the general budget.

- Moreover, earmarking was incompatible with most national constitutions (e.g. as restricting Parliament's budgetary responsibility) and tax laws, while undermining national tax sovereignty.

Recognizing that, as a fact, earmarking and sector-specific taxation were not uncommon across the regional jurisdictions, the research findings prompted reflection about their general applicability, as well as their implications, specifically both for the EEU fiscal arrangements (e.g. the harmonization objective) and for directions in the Eurasia region countries' own tax systems.



According to **Mr. Andrey Bashkirov**, business opined that the regional momentum for tax reform seemed positive, with more cooperative compliance (horizontal monitoring, partnership agreements, and reduced documentation); greater predictability of regulation; and heightened industry knowledge on the part of officials. (Advance) consultation arrangements on critical regulatory developments (national and international) could, however, vary inexplicably, thus prejudicing investment decisions.

For example, while BEPS could overall be positive for improvement of the international tax system, the project had the potential to provide “WMD” (e.g. the proposed CFC rules) for tax agencies, as indicated by Dr. Owens in his opening presentation.

Participants reviewed policy and administrative developments across the regional countries, including those pertaining to VAT/indirect taxation and excises, incentives and preferences, DTAs and international cooperation, as well as national and international programs to combat evasion and illicit activity. Socio-economic analysis and potential regulatory impact assessment were seen as important precepts for reform programs.

In this review, a range of considerations were identified, including the following:

- Incentives, exemptions and preferences were, as a matter of policy, not favored, except perhaps in

the special case of R&D for innovation related to economic diversification.

- Corruption and criminality continued to bedevil fiscal systems, putting a premium on achieving the appropriate mix of “carrots-and-sticks” in order to promote compliance and to combat the “grey/black” economy.
- Optimal tax and a moderate tax “burden,” as well as modern administration and effective cross-border mutual assistance through bilateral and multilateral instruments, were critical considerations.
- The content of “optimal” tax rates and bases, the mix, and the design of its individual components (e.g. VAT systems and specific vs. ad valorem tobacco taxation), and transfer pricing requirements were matters for individual jurisdictions.
- Elements of a modern administration included structures designed to target areas of greatest risk, genuine inter-agencies' cooperation, application of digital technology (including to diminish the “personal” element), and an informed customer service-based approach with fair disputes resolution procedures.

Theme Three: Minimizing and Resolving Fiscal Disputes

Introducing the session, Chairperson **Deputy Ekaterina Nikitskaya** reflected on lessons from the Kazakhstan experience where tax law interpretation authority was deficient, the “burden of proof” was misplaced, tax-expert judges and lawyers were needed, and interest was rising in non-court appeals processes. **Mrs. Fatima Aslan** concurred in this assessment also in the case of Azerbaijan.



Mr. Dave Hartnett comprehensively addressed the issues, beginning with a catalogue of causes of tax disputes, including: (1) inadequate understanding of underlying facts or law; (2) tactical/liability negotiating reasons; (3) a knowledge “gap” between the “cutting edge” of business and tax law; and (4) cultural attitudes. He then recounted their consequences, including uncertainty, often widespread; adverse effect on inward investment; stimulating emigration of companies and wealthy individuals; and costly in time and money.

Concerns could be eased through a customer-focused strategy for the core objectives of the tax system, with services tailored to the needs and behaviors of taxpayers and seeking to maximize revenue flows, reduce costs for all, and increase customer satisfaction.

A customer-focused approach would involve a commitment to help the customer get tax “right,” involve customers in the design of legislation, take account of customer views in preparing guidance, create certainty for honest taxpayers through clearances and rulings, understand customers’ business strategies, and better engage and manage relationships. Such a cooperative approach would help to expose the key facts of any case and promote understanding of the relevant law. It needed to be delivered in an open and transparent manner, including as to timescales, and without confrontation; but with full awareness of a tough stance by the authorities if their cooperation were not reciprocated.



Key elements of this last point included official determination, sound project management, great lawyers, good evidence, and document management systems. Parameters for negotiating a settlement included evaluation of immediate revenue flows and impact on all customers, the opportunity cost of not taking up disputes with others, the impact on avoidance and evasion risks, and cases with less than 50% chance of success. Precepts for settlement included establishing whether the outcome could be sustained, the impact on the rest of the customer base, and whether time spent resolving a dispute would be well-spent when compared with the cost of not taking up disputes with others.

Interest was growing in alternative dispute resolution, including arbitration, mediation, and early neutral evaluation, not least on account of costs, relative bargaining strength, and attention to intent/negligence. Uncertainty hovered over the binding nature of these alternative procedures. In any proceedings, transparency of administration (e.g. publishing results of disputes) was critical for encouraging confidence. Interest also was growing in advance pricing agreements (unilateral, bilateral, and multilateral) and there was now a substantial, positive “track record” in many jurisdictions.

Concerning utilization of MAP, this could be uncertain owing to associated risks, including a Competent Authority (CA) using arbitration as a way out of a difficult decision (leaving the hard work to an arbitration panel),

time-limits pressuring a CA into a sub-optimal adjustment to settle the case and avoid costs, yielding to arbitration without knowing the final position of the other CA, and inexperience in presentation.

The subsequent discussion confirmed the priority of these issues across all the regional jurisdictions, where the quantum of disputes and their complexity were growing. **Dr. Michael Lang** addressed the issues of judicial competence and international disputes.

Arguments for educating the general judiciary in tax, based on legal policy as well as practical considerations of human and other resources, seemed stronger than those for establishing a separate jurisdiction for fiscal affairs. Concerning international disputes, early neutral evaluation could have a valuable role. Conversely, arbitration (as practiced in accordance with the Model Convention, DTAs and incorporated time-limits) had demonstrated limitations, both as to the number of cases settled and the time involved. He noted the ECJ, ultimate arbiter in the EU, was urging the member states’ tax administrations to consider agreeing to disputes being handled through the OECD and UN Tax Committee, which could provide the infrastructure and a panel of arbitrators.



Commissioner Batmagnai Tunrev advised that Mongolia had not yet introduced APAs and did not offer mediation, although it had limited experience with MAP.

Mr. Rahim Oshakbayev noted prospective legislative developments in Kazakhstan for new disputes resolution procedures, including:

1. An independent, expert and authoritative appeals mechanism outside the Tax Committee and (possibly) a specialized tax court;
2. Reform of the Criminal Code and Tax Code to take into account the element of intent vs. negligence and to reverse the burden of proof; and
3. Official recognition of the Tax Consultants professional body.

Such a body was also in prospect in 2015 for Belarus, according to **Deputy Minister Ella Selitskaya**, along with a Mediation Institute for ADR. The commercial courts had a tax competence, while the Ministry of Finance provided an early disputes resolution mechanism.

Delegates Enjoy Opportunities for Fellowship, Informal Discussions, and Local Entertainment



Dave Hartnett, Andrey Bashkirov, Jeffrey Owens, and Daniel Witt (back).



Katarzyna Banaszek; Michael Brauning; Liz Allen and David Woods.



Michael Pal and Jeffrey Owens address the participants during the welcome dinner on 8 July.



Participants enjoy the welcome dinner at Weingut George and Petra Wolf Vineyards.



ITIC staff members from the regional offices and Washington, DC headquarters: Alexander Savitsky (Ukraine); Elena Novak (WDC); Anna Sklyarova (Russia); Fatima Aslan (Azerbaijan); Daniel Witt (WDC); Mukhit Akhanov (Kazakhstan); Irene Savitsky (WDC); and Douglas Townsend (UK).

The Tax Code included a presumption of innocence on the part of the taxpayer.

For business representatives, the comprehensiveness, fairness and certainty of a dispute's settlement (e.g. total of finalized liability, including treatment of interest and penalties and no re-opening once settled) were essential conditions. The attractiveness of advance rulings and APAs depended in large part on their certainty and the time and effort required to achieve them. They noted that MAP was not a "second chance" in the event of failure in domestic proceedings, but that it could arise if the domestic decision would create inter-jurisdictional difficulty.

Theme Four: Behavioral Economics and Tax Policy

Professor Stephan Muehlbacher reviewed the findings of a range of behavioral studies in some OECD countries and considered how these results might have application both to the issue of regulating taxpayers' compliance and that of seeking to alter individual behavior through the imposition of special/earmarked taxes.



Traditionally, measures for regulation of compliance included exertion of state power through audits and fines, as well as efficient audit strategies, while those of trust-building included fairness (distributive, procedural, retributive); participation and transparency; and service orientation. The results had been mixed, according to the practical experience of tax administrations.

Regulating undesirable behavior by taxes, in combination with some other measures, seemed to work. Further analysis did not however support this conclusion, since it revealed unwanted consequences (e.g. switching to worse alternatives and an increase in smuggling) and with "legitimate" consumption becoming affordable only for privileged citizens. "Feeling guilty" could have had a stronger impact on behavior than the price increase via taxation.

In respect of both issues, research attention had focused on "nudging" as a better way for regulating (un)wanted

behavior, perhaps because it left "freedom of choice." Specifically, in one of a number of "nudging" projects, a field study of controlling UK taxpayers in arrears, HMRC had sent standard tax letters to the control group reminding them to pay the amount they owed in arrears. The treatment groups received the same letters but with an added social normative message: "9 out of 10 people in your country/postcode /town pay their tax in time."

The town treatment group had achieved the highest compliance rate.

Discussants advised a variety of national experiences with taxpayer behavior, including around the twin behavioral objectives treated by Professor Muehlbacher, but also ranging more widely.



Mr. Sergey Shtogrin briefly outlined the elements of the 28 May Russian Federation Tax Policy 2015-2017 (e.g. prospective VAT/Sales Tax developments; horizontal monitoring, but based on the taxpayer's compliance record and agreed for three years ahead; e-systems for registration and audit). He presented the experience of the official Russian program of preferences and incentives, both as to the particular taxes involved and the eligible geographical regions of the Federation.

Mr. Akif Musaev detailed the decade-long public/taxpayer education programs conducted by the Ministry of Taxes of Azerbaijan and the more recent e-system innovations and partnership agreements. Overall, taxpayer compliance results were most positive. Female SMEs and younger entrepreneurs were more compliant than the highly-paid.

Ms. Assel Zhunossova reported that Kazakhstan showed minimal behavioral changes, whether with the programs of punitive tax treatment designed to "green" the economy or with the programs of incentives to stimulate social employment. Cooperative compliance also required honesty and competence, if it were to work.

Mr. Suren Karayan was pessimistic that taxes, with or without other non-fiscal regulatory measures, had been effective in changing behavior among taxpayers in Armenia, with the possible exception of fuel excises' increases. A good start had been made administratively, with elements of a cooperative compliance program in place and horizontal monitoring in prospect for conscientious taxpayers. Equality/equity considerations excluded special measures such as exemptions and amnesty.

Pre-Seminar Roundtable

Combating the Illicit Trade of Excisable Goods and Protecting the Domestic Revenue Base

Introduction



ITIC President **Daniel Witt** welcomed participants, recalling ITIC's extensive range of research, studies, and publications on this priority issue, most recently, the second edition of *The Illicit Trade in Tobacco Products and How to*

Tackle It, authored by Ms. Elizabeth Allen.

ITIC, in conjunction with Oxford Economics, has also undertaken pioneering work on measuring illicit trade and modeling its impact on government budget revenues for both high income and low income countries. Examples of this work include:

- [Asia-11 Illicit Tobacco Indicator 2012](#)
- [The Linkage between Tax Burden and Illicit Trade of Excisable Products: The Example of Tobacco](#), by Daniel Witt and Adrian Cooper, *World Customs Journal*, September 2012

Correlation between level of tax and illicit trade

Mr. Witt reviewed the key conclusion of the article that he co-authored with Mr. Adrian Cooper (Chief Executive Officer of Oxford Economics) that was published in the September 2012 edition of the *World Customs Journal*, titled, *The Linkage between Tax Burden and Illicit Trade of Excisable Products: the Example of Tobacco*: "There is a direct correlation between the level of taxation and illicit trade."

Mr. Witt added, "When the level of tax ignores the level of consumer affordability, this creates demand for illicit trade." Criminals are eager to provide the supply to meet this demand. The illicit trade, which does not pay taxes, but rather profits the criminals, results in loss of revenue to governments (VAT and excise).

Excise taxes do matter

This was a key point discussed at the ITIC/Lithuania Free Market Institute (LFMI)/Lithuania Customs *International Conference on the Shadow Economy and Taxation* that was held in Vilnius in April 2013.

The report and papers from this conference, which included participation from public sector stakeholders, academics,

and industry representatives, can be downloaded from ITIC's website [here](#).

Russia excise taxation as a "best practices" model

The Russian excise tax regime from 2010-2013 in many ways was a model of best practice and could be examined for its possible applicability in other regional jurisdictions. While it was a mixed system, it had a heavy reliance on "specific." During the three year period, there had been regular tax increases of roughly 15% per annum, providing predictability and stability for both the Government budget and the legitimate industry. The large "specific" component of the tax structure helped advance the health objectives and provided the Ministry of Finance with budget stability. During this three year period, there was virtually no illicit trade. The Russian experience of 2010-2013 on tobacco excise tax was successful in achieving three principal public policy objectives:

1. Budget/revenue – it provided a steady increase of Government revenues. The budget revenues grew by 30%.
2. Health – the tax increases increased the price of cigarettes and resulted in a steady decline in consumption.
3. Law enforcement – there was virtually no illicit trade in the Russian market during this period.

Conclusion

Mr. Witt observed that excise debates can often be emotion-driven. The purpose of the roundtable was to provide an open, intellectually honest forum for fact-based discussions which would hopefully produce fact-based policies. Excise tax policies need to be developed and implemented by Finance and Customs officials. Taxation is serious business, and must be conducted by public finance professionals.

Roundtable Proceedings



Mrs. Elizabeth Allen, in the keynote presentation, identified and addressed the constituent elements of the massive illicit trade in tobacco products and the dangerous socio-economic and regulatory challenges it posed. She also outlined an optimum combat strategy.

As a critical participant in the combat strategy, **Ms. Katarzyna Banaszek** presented an overview of the WCO's illicit trade priority areas and the Organization's key tools and instruments. She coupled this with a description of the unique resource provided by the

WCO RILO network and an outline of various regional initiatives on excisable goods. The subsequent discussion indicated an incipient consensus on the way forward, taking into account the recommendations of the keynote presentations (see summary in final paragraph below), but with further consideration required of some important national and EEU concerns as well as those of legitimate business.

Concerning the last point, **Mr. Sergey Shtogrin** advised that the Russian Federation's tobacco tax policy sought to adjust the critical parameters of consumer affordability (combating the illicit trade), the state's revenue requirements, and producer interests (profit margin). As with others, this approach sought to calibrate rates with the degree of illicit risk. Substantial rates' increases since 2010 had been accompanied by strict enforcement; but containing the level of illicit activity required both (1) with policy, a phasing of increases according to a graduated quality-scale and (2) with operations, ever-more sophisticated border controls. Managing the volume of container traffic without constraining trade was most difficult, with facilitating measures such as "authorized traders" and "special services" hardly diminishing the burden of administration.



Mr. Nurmatbek Mambetaliev viewed the roundtable as building on the findings of the 2013 ITIC Vilnius conference and the 2014 Moscow Tobacco Workshop. Broadly, the EEC sought to pursue policies that would increase the excise revenues of the member states, advance health objectives, and control the illicit trade of tobacco and alcohol products. Improving indirect tax coordination among the member states would help achieve these objectives.

The EEU markets for alcohol and tobacco were very large, but tax/price increases for legitimate products would not diminish these market sizes. Rather, this approach would encourage illicit trade, depress revenues, and raise administrative costs. Falling tax rates might encourage a fall in illicit activity. Disentangling the conflicting public policy objectives of tobacco trade regulation was a challenge. Further, as a practical matter, the amount of smuggling (as with the intensity of border controls) varied between member states, requiring the EEC to prioritize tighter controls.

Responding to a question concerning the implications (e.g. for harmonization and affordability) of the impending Armenia accession to the EEU, taking into account the asymmetrical condition of the member states' economies, Mr. Mambetaliev advised efforts were being made to

handle these flexibly, with rates being allowed to fluctuate within a range over a seven year period. Harmonization by 2020 would involve a move to the higher Russian Federation rates.

Responding to the question of **Mr. Alexander Lioutyi** about the response of the EEC (given its responsibility for achieving the EEU harmonization objective) regarding the substantial 2013 increases in Russian Federation alcohol excises (and "bootlegging"), **Mr. Shtogrin** noted defense of national priorities was not excluded by the integration arrangements and confirmed the EEC had been consulted. Mr. Shtogrin and Mr. Mambetaliev advised that the Russian Federation's excise rates for 2015-2017 were for decision later in July and that the EEC had approved the relevant consultations procedures.



In summary, a comprehensive and continuing strategic approach was urged, involving at the national level:

- Top-level political appreciation of the problems and commitment to their resolution;
- "Real-world" design of legislation and implementing institutions in consultation with legitimate business;
- Balanced and appropriately-designed tax policy and effective tax collection;
- Zero tolerance of corruption;
- Effective customs and other controls on manufacturing, export, free zones and transit;
- Support by an informed Judiciary with appropriate enforcement tools;
- Genuine and thorough inter-agencies' cooperation; and
- A powerful public education program.

And, internationally, recognizing the global nature of the illicit trade, important measures including:

- Strengthened partnerships with WCO, Interpol/Europol, other countries, and legitimate industry;
- Regional programs to tackle illicit tobacco;
- Implementation of international "best practice" conventions, guidelines and standards on trade compliance and facilitation;
- International exchange of information and intelligence across government agencies;

- Ratification of the ITP and clarification and introduction of its key implementation requirements (e.g. Unlawful Conduct, Competent Authority, and Data Exchange).

Academy for Public Finance for Eurasia Tax Officials



Dr. Jeffrey Owens introduced the discussion which concluded most positively and with a number of recommendations for the *Academy's* further development, broadly concurring with those suggested, as follows:

- Need for closer engagement of Tax Commissioners, business and business associations;
- Involvement of the Judiciary and, perhaps, the Legislature;
- More operationally-targeted courses including E-Audit, Horizontal Monitoring (e.g. Partnership Agreements & other forms), and sector-specific (e.g. textiles, tobacco) goods' ID systems for revenue purposes.



For background, the *Academy of Public Finance for Eurasian Tax Officials* is a partial response to the global challenges facing Tax Administrations, including:

- Adapting to a borderless world, including global MNEs and high-net wealth individuals;
- The digital economy: balancing good service and good enforcement;
- Handling corruption and political interference; and
- Financial and human resource constraints.

Responses to these challenges have included: (1) more integrated tax administrations with specialized units; (2) new technologies to improve taxpayer service; (3) better risk management through EOI domestically and internationally; (3) putting tax compliance on the good corporate governance agenda; (4) more joined-up tax administrations internationally (CIS, FTA, JITSIG, IOTA); and (5) and horizontal monitoring.

Constraints demonstrated include lack of: (1) well-trained staff, especially in international issues; (2) dialogue between Tax Commissioners and business; and (3) targeted research to benchmark and improve the performance of tax administrations.

The *Academy* is a public-private partnership focusing on training of tax officials; providing a platform for dialogue and initiating relevant research; and delivering a long term program with an initial focus on tax treaties, transfer pricing, VAT and excises. The involvement of Tax Commissioners is critical for helping to direct the program, identify issues for dialogue and research, and nominate participating officials. Additional to its own program, the *Academy* could contribute to national working groups (e.g. on benchmarking/innovation/Pis).

Documents Available on ITICnet.org

The following documents can be [downloaded here](#):

- EFES 10 Conclusions and Recommendations
- Combating Illicit Trade in Tobacco Products by Elizabeth Allen
- WCO tools/strategy to combat illicit trade by Katarzyna Banaszek
- Tax sovereignty and feasibility of international regulations for tobacco tax policies by Professor Michael Bräuninger (English)
- Tax sovereignty and feasibility of international regulations for tobacco tax policies by Professor Michael Bräuninger (Russian)
- Academy of Public Finance - A Eurasian public-private partnership by Professor Dr. Jeffrey Owens (English)
- Academy of Public Finance - A Eurasian public-private partnership by Professor Dr. Jeffrey Owens (Russian)
- Eurasian Economic Union Agreement is the way to non-discrimination in taxation by The Honorable Timur Suleimenov (English)
- Eurasian Economic Union Agreement is the way to non-discrimination in taxation by The Honorable Timur Suleimenov (Russian)
- Managing Tax Disputes by Dave Hartnett
- What Policymakers can learn from Tax Psychologists by Stephan Muehlbacher
- On the practice of subjects of the Russian Federation tax preferences to encourage investment in the development of regional economies by Sergey Shtogrin

Meeting Agenda

Day One - 8 July

Pre-Seminar Roundtable: *Combating the Illicit Trade of Excisable Goods and Protecting the Domestic Revenue Base*

Chair: Mrs. Elizabeth Allen, Program Advisor, ITIC; author of the joint ITIC-WCO booklet, *The Illicit Trade in Tobacco Products and How to Tackle It*

Presenter: Dr. Paul Nillesen, Partner, PWC Advisory N.V.

Panel

- Ms. Katarzyna Banaszek, World Customs Organization RILO (WCO)
- Mr. Daniel Witt, President, ITIC
- The Honorable Sergey Shtogrin, Auditor of the Accounts Chamber of the Russian Federation
- The Honorable Nurmatbek Mambetaliev, Head of Division for Tax Policy, Eurasian Economic Commission (EEC)

Cultural Program and Welcome Dinner

Dinner Speakers

- Professor Jeffrey Owens, Institute for Austrian and International Tax Law, WU (Vienna University of Economics and Business) and Distinguished Fellow, ITIC
- Mr. Daniel Witt
- Mr. Michael Pal, recent Head of the Austrian Consulate in Astana

Day Two - 9 July

Opening Session

Speakers: Mr. Daniel Witt and Professor Jeffrey Owens

Theme One: Fiscal Parameters of the Closer Economic Integration and Interaction of Europe and Eurasia

Co-Chairs: Professor Jeffrey Owens and Mr. Mukhit Akhanov, President, ITIC-Kazakhstan

Presentation: The Honorable Timur Suleimenov, Member of the Board, Minister of Economy and Financial Policy, Eurasian Economic Commission (EEC)

Panel

- Professor Alexander Rust, Institute of Austrian and International Tax Law, WU (Vienna University of Economics and Business)

- The Honorable Dmitry Kyko, Deputy Minister, Ministry of Finance, Belarus
- The Honorable Akif Musayev, Advisor of Minister of Taxes, Head Tax Counsellor, Azerbaijan

Theme Two: Tax Reform – Priorities for Policy and Administration

Co-Chairs: Mr. Daniel A. Witt and Professor Michael Bräuninger, Hamburg Institute of International Economics (HWWI)

Presentations: Mr. Mukhit Akhanov and Professor Michael Bräuninger

Panelists:

- The Honorable Jamil Alizada, Head of Tax Policy and Revenues Department, Ministry of Finance, Azerbaijan
- The Honorable Oksana Prodan, First Deputy Chairman of the Verkhovna Rada of Ukraine on Taxation and Customs Policy, Ukraine
- The Honorable Giorgi Tabuashvili, Deputy Finance Minister, Ministry of Finance, Georgia
- Mr. Andrey Bashkirov, Associate Director of Taxes, Procter & Gamble
- Mr. David Woods, Technical Adviser, Intra-European Organisation of Tax Administrations

Update and Discussion on Academy for Public Finance for Eurasia Tax Officials

Wednesday, 10 July

Theme Three: Minimizing and Resolving Fiscal Disputes – Pre-Audit Settlement, APA, Rulings, Mediation, Arbitration, MAP, and the Courts

Co-Chairs

- The Honorable Yekaterina Nikitinskaya, MP, Deputy, Chairperson of the Finance and Budget Committee of the Majilis of the Parliament, Kazakhstan
- Ms. Fatima Aslan, ITIC representative in Azerbaijan; President, Anglo-American/ATTAS Alliance

Presentation: Mr. Dave Hartnett, Former Permanent Secretary, HMRC and Member, ITIC Board of Directors

Panel

- Professor Dr. Michael Lang, Head, Institute for Austrian and International Tax Law, WU (Vienna University of Economics and Business)

- The Honorable Batmagnai Tunrev, Commissioner, General Department of Taxation, Mongolia
- The Honorable Rakhim Oshakbayev, Deputy Chairman of the National Chamber of Entrepreneurs, Kazakhstan
- The Honorable Ella Selitskaya, Deputy Minister, Ministry of Taxes and Revenues, Belarus

Theme Four: Behavioral Economics and Tax Policy: What Policymakers can learn from Tax Psychologists and Sociologists

Co-Chair: Mr. Daniel Witt

Presentation: Professor Stephan Muehlbacher, Faculty of Psychology, University of Vienna

Panel

- The Honorable Assel Zhunussova, Head of the Central Office of the “Nur Otan” party, Kazakhstan
- The Honorable Sergey Shtogrin, Auditor of the Accounts Chamber of the Russian Federation
- The Honorable Suren Karayan, Deputy Minister of Finance, Ministry of Finance, Armenia
- The Honorable Academician Ziyad Samadzade, Chairman, Economic Policy Committee, Azerbaijani Parliament Milli Majlis
- Mr. Dave Hartnett

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Countries and International Organizations Represented

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France	Georgia
Kazakhstan	Kyrgyzstan
Mongolia	Russia
Switzerland	Tajikistan
Ukraine	United Kingdom
United States	World Bank
Eurasia Economic Commission	World Customs Organization

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WORLD CUSTOMS ORGANIZATION
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The 11th annual *Eurasia Fiscal Experts' Seminar* will be held on 30 June - 2 July 2015. The meeting will be co-hosted by the World Customs Organization at their headquarters in Brussels.

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ITIC Mission Statement

The International Tax and Investment Center (ITIC) serves as a clearinghouse for information on best practices in taxation and investment policy, and as a training center to transfer such know how to improve the investment climates of transition and developing countries, thereby spurring formation and development of business and economic prosperity.

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