10 PRINCIPLES FOR INTERNATIONAL ENGAGEMENT IN SUPPORTING DEVELOPING COUNTRIES IN TAX MATTERS

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Preamble

Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services directed toward the physical and social infrastructure required to enhance long term growth. Strengthening domestic resource mobilization is not just a question of raising revenue: it is also about designing a tax system that promotes inclusiveness, encourages good governance, improves accountability of governments to their citizens, and cultivates social justice. Tax system design and delivery is also closely linked to domestic and international investment decisions, including in terms of transparency, anti-corruption and fairness, as it may serve to improve the framework for attracting increased private investment.

Low income countries face a number of challenges to increase their tax revenues such as a small tax base, a large informal sector, misuse of transfer pricing, low levels of per capita income, domestic savings and investment plus weak governance and capacity. Though many economies have made noticeable progress in collecting taxes in the past decade, half of sub Saharan African countries mobilise less than 17% of their GDP in tax revenues, below the minimum level considered by the UN as necessary to achieve the Millennium Development Goals. Several Asian and Latin American countries fare little better[1]. Moreover, in Africa, the increase has been primarily driven by resource-related tax revenues in oil-producing countries[2].

Developing countries and development partners have identified the mobilization of domestic financial resources for development as a priority (for example, the Doha Declaration on Financing Development and the Busan Partnership for Effective Development Cooperation). The international development community is gearing up support to developing countries in the area of domestic resource mobilisation and taxation. The track record is not poor but performance could be improved, not least to keep up with rapidly evolving policy environment, changing needs and new players. The principles which follow below offer some guidance based on the experience of different countries and recent research. Over time, the principles could be used as a lens to examine the changing behaviour of the main assistance providers and to help them reflect on, and improve, their collective efforts in developing countries.

1. Follow the leadership of government and agree on country level co-ordination mechanisms

Governments in developing countries are responsible for articulating their tax policy and administration needs. For their part, international assistance providers should operate according to the principles of ownership and alignment as set out in the 2005 Paris Declaration on Aid Effectiveness. International

[1] A Report from the International Organisations mandated by the G20 to the support the development of more effective tax systems

[2] OECD, African Economic Outlook 2010

partners should collaborate to ensure that their advice, on tax policy in particular, is coherent, delivered at the right time, appropriately sequenced and covers both the source of tax revenues and their use. International partners have the responsibility to continue to build on existing efforts to organise their assistance in a harmonised way, with an agreed division of labour, using appropriate co-ordination and dialogue mechanisms at the country level.

2. Do no harm

A priority responsibility of international partners is to be alert to the risks of their actions damaging the revenue prospects of developing countries. For the main aid donors, the risks include the possibility that aid may in extreme cases dampen the tax effort in aid dependent countries and distort accountability between governments and their citizens. In delivering their advice, most donors have acknowledged political will as the essential determinant of reform and of whether outsiders can help. In practice, a smarter approach is needed to ensure that pressures on reformers match political realities. Political economy analysis can help determine opportunities for change. For instance, when a country confronts a fiscal crisis or political transition, such analysis can pinpoint whether support for reform might crystallize or fragment. All international partner countries can make efforts to assess changes to their own policy (trade agreements for example) in light of the possible negative implications for developing countries.

3. Promote transparency in tax matters

Transparency can improve accountability and answerability in various ways. At the country level, the public disclosure of revenue statistics and budgets can help to build accountability for taxes paid and public services delivered. At the international level, greater transparency can help to address issues such as misuse of transfer pricing, financial reporting by Multinational Enterprises and tax evasion. Encouraging transparency of exemptions and tax incentives (for example, exemptions on aid funded goods or tax holidays for Multinational Enterprises) is consistent with encouraging debate on tax simplification objectives and efforts to reduce discretionary decision making.

4. Balance revenue collection imperatives with governance and social objectives

How tax is collected matters as much as how much is collected. International support should aim to encourage compliance but avoid unwarranted coercion and an over targeting of the most easily taxed corporate entities based in capital cities. More broadly, international support should encourage consideration of the trade-offs between revenue imperatives and other objectives. For example, taxation of the informal sector may be labour intensive but could drive broader governance objectives by linking more people and traders to the state. Equally, extending the geographical coverage of the state may be costly but could promote state legitimacy through furthering the reach of the state. International partners can also promote fairness and equity in tax systems (progressivity, or the mix of direct and indirect taxes, for example). Although taxation is not the panacea for reducing inequalities in income and wealth, perceptions of fairness mean that taxation is a key instrument for addressing this issue. International partners can also help make the links between taxation and broader issues of sustainability, by considering natural resource revenues and environmental issues in national tax systems for example.

5. Encourage broad-based dialogue on tax matters that includes civil society, business, and other stakeholders

Combined national and global actions are critical to progress on tax matters. Most international partner interventions focus, sometimes exclusively, on capacity building efforts in revenue administrations in developing countries. This is important work but some donors are well placed to engage other stakeholders in their efforts to participate in tax dialogue, to monitor the operations of tax administrations, and to hold governments to account for their revenue and expenditure policies. Actions to support civil society, labour unions, media, parliaments, and business associations, for example, complement the efforts made to build revenue capacity. Such actions can strengthen the policy dialogue on domestic resource mobilisation and builds broad coalitions for reform.

6. Strengthen revenue and expenditure linkages

Although the primary purpose of taxation is to fund the activities of government, especially those in pursuit of economic and social development objectives, the revenue and expenditure sides of the public finance equation are often treated separately. The way assistance is provided can strengthen these linkages or can drive the two sides further apart. Donors can encourage such linkages by, for example, linking support in the tax area with other Public Financial Management reforms, reinforcing the role of audit institutions, bolstering parliamentary scrutiny over both revenue and expenditures and supporting non-state actors to monitor and track the effective use of public revenues. International assistance missions can provide analysis of the distributional effects of tax and spending reforms, highlighting how they achieve multiple objectives (including fiscal and poverty reduction), and encourage the communication of the impacts of such reforms.

7. Take account of international aspects of taxation

International assistance providers have a reasonably strong track record in supporting domestic tax policy and administration in developing countries. The consequences of globalisation, however, are creating a set of new and complex international cross-border tax challenges that include the taxation of multinational enterprises, tax evasion and illicit financial flows. In turn, these challenges are generating new demands and needs which require responses from international partners. Transfer pricing, exchange of information for tax purposes and a range of conventions and treaties require international providers to engage both at the country level and with international-level processes where international tax matters, norms and standards are debated and agreed. More could be done to support developing countries Ministries of Finance on tax policy, including through north-south and south-south cooperation. More broadly international providers can work with developing countries to strengthen their capacity to influence and participate in international debates, and therefore to gain the benefits from the G-20 inspired era of transparency in international tax matters. In particular, international assistance providers can work together to support developing countries efforts to join to new instruments such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters which allows for exchange of tax information between countries.

8. Consider a range of assistance

Experience suggests that international providers of assistance have a range of instruments at their disposal to support revenue matters. These include technical assistance, policy dialogue, basket funds and financial instruments, including general budget support. Donors should assess needs and respond with the right instrument, or mix of instruments, according to each case, as opposed to taking an instrument-driven approach. There are no quick fixes, and sustained results have come from cases where external support has taken a comprehensive institutional approach and been delivered over a period of years, if not decades. In cases where capacity substitution modalities are agreed (with long term advisors operating in line positions in extreme cases, for example), exit strategies should be in place and regularly reviewed. Active involvement of developing countries in regional organizations of revenue administrations such as ATAF and CIAT can play a critical role in promoting the exchange of experience.

9. men approach.

International tax matters increasingly require international partners to take a 'whole-of-government' approach within assistance providing countries. This includes mobilising tax practitioners to help deliver technical assistance to build capacity in developing countries and maximising policy coherence on international tax matters. For example, Ministries of Finance in assistance providing countries can require Multinational Enterprises operating in developing countries to improve transparency and fully comply with applicable tax laws; they can also contribute to the debate on the impact that non co-operative jurisdictions have on developing countries; they can agree to spontaneous information sharing in international tax fraud cases. Good practice includes regular co-ordination mechanisms between different ministries in assistance providing countries in which development, tax and finance officials all have a voice.

10. Measure progress and build the knowledge base on tax matters

Developing countries and their partners, including regional organisations, should develop indicators for measuring progress in tax matters. International partners are under increasing pressure to demonstrate results from their own assistance efforts, thereby sharing common concerns with developing countries in terms of measuring progress. Although tax/GDP provides a valuable indicator to measure overall progress over time, there is a need to look to other indicators. Indicators relating to the tax effort; compliance; progressivity; poverty reduction and perceptions of ordinary tax players – all measure different aspects of revenue progress and permit both developing countries and international partners to move beyond narrow tax collection targets towards other governance and social objectives. The development and use of joint diagnostic and monitoring tools should be encouraged. In addition, international providers should build on existing efforts to ensure that externally funded interventions are evaluated and lessons are shared for use at both the country and international levels.