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THE EU POSITION IN TAXATION AND DEVELOPMENT

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Introduction - Why Taxation matters for Development*

Tax is a core part of a state building and one of the most visible signs of the social contract between citizens and the State. Fair, transparent and efficient tax systems demonstrate good governance and shape government legitimacy by promoting accountability of governments to tax-paying citizens and by stimulating effective state administration and good public financial management.

Supporting developing countries in mobilizing domestic resources and fighting tax evasion is crucial in efforts to eradicate poverty and to achieve the Millennium Development Goals (MDGs) as well as help developing countries reduce dependency on foreign assistance.

According to a Norwegian Government Commission, it is estimated that in 2010 illegal money flows from developing countries amounted to a total between 640 and 980 bn US $, thus at least 7 times higher than the Official Development Assistance. This huge volume of illegal cross - border financial transactions is facilitated by tax systems vulnerable to harmful tax practices, various incentive systems and the attractiveness of an increasing number of “tax havens” and other non - cooperative jurisdictions (many of them having a “developing country/ emerging market” status and, therefore, eligible to receive Official Development Assistance). “Tax havens” are commonly understood to be jurisdictions which are able to finance their public services with no or nominal income taxes and offer themselves as places to be used by non-residents to escape taxation in their country of residence. The OECD has identified three typical confirming features of a “tax haven”:

- lack of effective exchange of information,
- lack of transparency, and
- no requirement for substantial activities.

In addition they often offer preferential tax treatment to non –residents in order to attract tax bases from other countries. “Tax havens” therefore compete unfairly and make it difficult for non -” tax havens” to collect a fair amount of taxation from their residents.

In the developing countries the average tax- to- GDP ratio ranges between 10 to 20% as compared to 25 to 40% in more advanced economies. Broader, more effective, transparent and well managed tax systems are needed.

Tax issues and more effective tax regimes and administrations are also central to the implementation of the “Monterrey consensus” on Development Finance by which developing countries committed themselves to improve their tax efforts in order to mobilize the domestic resources required for poverty reduction.

Growing constraints

However, we must recognize that the developing countries in implementing their tax strategies at national level, are confronted with a number of rather serious constraints linked to

- the competitiveness and structure of their economy which often conceals a large informal sectors, predominance of agriculture over industry and services etc.
- political and macro-economic instability, poor public services delivery, low quality of public finance management, the impact of corruption, poor governance and deficient rule of law including in resource-rich settings, and particularly severe in countries in situation of fragility.

* The author is member of the European External Action Service (EEAS). The views expressed here are solely those of the author.

- the feature of the tax system and its management that may explain the limited effectiveness and responsiveness of tax reforms:
    - narrow tax base often leading to an uneven distribution of tax burden between economic factors and taxpayers,
    - balance between direct and indirect taxation that may not always appropriately reflect the structure of the economy,
    - weak link between tax policy and tax administration,
    - lack of capacity of tax administration to operate and supervise the tax system which can result in low tax compliance and collection.

There are also a number of international factors which may interfere with a sound, credible and sustainable tax policies in both the developed and the developing countries. For instance, the implementation of domestic tax rules becomes difficult in a world with an increasing geographical mobility of taxpayers, the volume of trade and capital flows and the use of new technologies.

In addition, transition from revenue systems largely dependent on customs revenue to broader and more modern ones creates adjustment issues. Countries may be tempted to encourage FDI through too costly tax incentives and derogations that often fail to attract real and sustainable investment.

Finally, the existence of non-cooperative jurisdictions and harmful tax practices both in developed and the developing countries is detrimental also to the developing countries by having not only a negative impact on their revenues but also by undermining good governance and institutional development.

International initiatives

As regards the most recent initiatives in this field, in 2011 the OECD launched a collaborative project with the EU and the World Bank to enhance the transfer pricing capabilities of developing countries. Other collaborative schemes take place between the EU and the IMF regional bodies.

In October 2011 the OECD Global Forum on Transparency and Exchange of Information adopted Guidelines on the best ways to conduct technical assistance (TA) to ensure that all jurisdictions are in the position to implement and benefit from good governance standards. Responding to the call of the G20 Development Working Group, the Global Forum will serve as a platform to facilitate coordination of assistance provided in the area of transparency and exchange of information to developing jurisdictions, aid capacity building and reinforce the legal infrastructure necessary for tax transparency and international cooperation.

The G20 places Tax and Development high on its agenda as well. The report to the G20 “Supporting the development of more effective Tax systems “ examines how more effective tax systems can be created for the developing world. The report was co-authored by the IMF, World Bank and the UN in conjunction with the OECD. It considers how to increase tax capacity of administrations in the developing world and how to deal with transfer pricing problems.

Finally a report “Innovation with impact: Financing 21 st century Development” produced by Bill Gates was published shortly before the G20 Summit in Cannes (Nov 2011). The section of the report on “Mobilizing domestic resources” notes that well designed tax systems do not hinder economic growth and can provide additional resources. It notes that the IMF has estimated that basic tax reform in sub-Saharan Africa would raise some 20 bn $ annually.

Global governance issues in tax matters: UN cooperation with the OECD. The UN Committee of Tax Experts

On the UN side, a UN Committee of Tax Experts was created in 2004[1]. It comprises 25 members nominated by Governments (and appointed for four years by the Secretary General) acting in their capacity as experts and therefore not representing the official position of their government. They are selected to reflect an adequate equitable geographical distribution and representing different tax systems[2].

The Committee has been meeting on a yearly with the objective

- to review the UN Model Double- Taxation Convention,
- to provide a framework for dialogue to promote international tax cooperation,
- to make recommendations on capacity building and the provision of technical assistance to developing countries undertaking reforms in fiscal policies and tax regimes.

A first step towards the strengthening of institutional arrangements was taken at the 5th annual session of the Committee in October 2009 with the creation of 9 sub-committees[3]. The UN has asked the EU (as well as other international organisations) to cooperate with the sub-Committees by sharing information, studies and best practices.

Considering the broadening in scope of its work as well as the growing interest of international actors in achieving concrete outcomes in the field [4], it appears that the existing UN Tax Committee is making every effort (in terms of human and economic resources) to carry out its current functions in the most effective way. This should include a comprehensive evaluation and prioritization of the work performed by the Committee and its sub-Committees.

A more ambitious option could be to up-grade the Committee into an Inter-governmental Commission – similar to the Statistical Commission of UNDESA but this is not exempt from a number of risks. On the positive side a Commission could better fulfill its mandate and provide more visibility to the priority to ensure better cooperation and coherence in tax matters at global level. On the negative side there is a risk of creating a new, heavy and expensive extra-layer of UN bureaucracy with a little impact on effectiveness and concrete outcomes and raising new governance issues.

On the OECD side progress in the implementation of international tax standards made through its Global Forum on Transparency and Exchange of Information has been steady. Some 116 countries, including emerging and developing countries, are now part of the Global Forum, which conducts peer-reviews to assess progress in the implementation of the standards.

Proponents of an upgrade of the UN Tax Committee claim that the OECD lacks legitimacy to set international standards as it does not represent developing countries' point of views. One example is the slight differences in their model double taxation Conventions (both, the OECD and the UN Committee of tax experts have developed model conventions on double taxation). Members from the UN Committee claim that the OECD approach on the attribution of profits to permanent establishments may limit the taxation rights of the source country in an undesirable way for

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1 The Committee is based on resolution 2004/69 of the Economic and Social Council of the UN and will expire on 30 June 2013

2 The Committee includes five European experts : Belgium, Bulgaria, Germany, Italy and Spain.

3 The sub-committees will focus on : (1) UN Model Tax Convention Update (2) Tax Treatment of Services (3) Exchange of Information (4) Dispute Resolution (5) Transfer Pricing (6) Revision of the Manual for Negotiation of Tax Treaties (7) Article 14 of the Model (8) Capacity Building (9) Capital Gains

4 Domestic resource mobilisation is included in the G 20's Multi-annual Action Plan for Development – the UN, as well as other international organisations, have been asked (inter alia) to make recommendations on capacity building to combat tax avoidance and evasion, and to identify ways to help developing countries to tax multinational enterprises.

developing countries. The European Parliament has repeatedly called for an improvement of the OECD standards, notably to prevent abuses of the "residence principle".

The call for a greater involvement of developing countries has been heard by the OECD. In order to ensure that the perspectives of emerging and developing countries are better taken into account in the standards setting process, the OECD has created an informal multi-stakeholder Task Force on Tax and Development which includes participants from advanced, emerging and developing countries, as well as from the private sector and Civil Society. The Task Force features four sub-groups which discuss "Exchange of information", "Transfer pricing", "Transparency in the reporting of financial data" and "Taxation, state-building and aid". The result of the work undertaken in these sub-groups will feed into the work of the OECD Committee of Fiscal Affairs and the Development Assistance Committee (the OECD also manages a Center for Tax Policy and Administration whose work could also be interesting from UN and developing countries' perspective).

It is however still too early to assess how effective the OECD Forum is to help developing countries to express their views on issues of international cooperation in tax matters, and to what extent the Task Force contributes to an effective participation of developing countries in the standard setting process.

On its side the EU has expressed a more cautious and prudent attitude on the creation of new UN bodies by stressing that there are already a number of international fora pursuing similar objectives in the field of international tax cooperation. Therefore, according to the EU, efforts should be made to increase efficiency and impact of the existing bodies and achieve better synergies among them. In particular the EU insists on the need to ensure better synergies and cooperation between the UN and the OECD on-going activities in this field. In addition, a strengthened dialogue and cooperation could **b**e achieved with regional fora such as the African Tax Administration Forum, the Inter-American Center of Tax Administration, IMF regional technical centers and with related initiatives such as the Extractive Industries Transparency Initiative- EITI.

EU Member States, on their side, are concerned as any suggestion to upgrade or expand the mandate of the UN Committee of Tax experts would lead to a substantial increase of resource commitments.

Role of the EU to support developing countries' efforts in the field of taxation

As regards cooperation in tax matters, the EU supports the three principles of good governance in tax matters:

- transparency of tax systems,
- exchange of information on bilateral and multilateral level, and
- "fair" tax competition among countries, i.e. removal of harmful tax practices to avoid the risk of "tax dumping".

Within the EU, good governance in tax area has been implemented both by legislation (for example the Directive on Administrative Cooperation or the Savings Taxation Directive) or by "soft" law (the Code of Conduct for Business Taxation). Beyond the EU, tax clauses in relevant EU Agreements with third countries aim to ensure that these countries commit to good governance in tax area.

The cornerstone of the EU policy of good governance in tax matters is represented by the EU Communications on "Promoting Good Governance in Tax matters" (2009) and on "Taxation and Development: cooperating with developing countries on promoting good governance in tax matters" (2010), supported by the European Council and the European Parliament in 2010.

EU provides additional support to the developing countries which are committed to implement the principles of good governance including in the tax area. For instance standard clauses on good governance (including tax matters) are now inserted in EU Agreements with third countries in Eastern Europe, the Caucasus, Asia and Latin America. [I suppose you checked the references to these agreements, otherwise let me know]

Also the EU support to the democratization process in the countries in the Mediterranean region - in the framework of the G-8 Deauville "Open Governance and Anti-Corruption" Initiative - make express reference to the need to enhance governance standards, including in the area of taxation.

The EU Neighbourhood and Partnership (ENP) Governance Facility based upon Art. 2(1) and 7 of the ENP Instrument provides funding, in addition to national allocations, to those partner countries that are assessed to have made the most progress in implementing governance - related objectives of their agreed reform agenda as set out in their ENP Action Plans.

An incentive is now also provided under the 10th European Development Fund (EDF) through the "Governance Initiative" whereby the EU offers additional funding to support governance dialogue and reform, including in the tax area. Countries eligible for development aid which undertake detailed commitments (Governance action plans) may receive an additional allocation depending on the quality of their commitment. A number of Caribbean and Pacific countries have now undertaken such commitments but others have, to date, refused or have not at any rate, yet taken up this offer.

A number of Overseas Countries and Territories (OCTs) for which Member States have responsibilities have made commitments to the OECD on standards of transparency and exchange of information.

The EU is also supporting an international cooperation strategy in tax matters which aims at assisting developing countries to be associated with (and participate in) multilateral and regional initiatives (promoted by the UN, OECD, the African Union etc.). In this respect EU provides TA to strengthen public finance management, deepen regional integration, improve donor coordination and encourage developing countries to participate in international fora. The EU also promotes the role of civil society in demanding better tax systems.

From an EU perspective both capacity building and technical cooperation are key elements of the support provided to the developing countries. Close cooperation is taking place within "existing bodies and initiatives such as the IMF regional TA centers, the Extractive Industries Transparency Initiative etc. EU also encourages closer cooperation between relevant bodies of the OECD and the UN in order to ensure that the needs and capacities of developing countries are taken into account.

As a follow- up to these initiatives, the EU provided extra financing for promoting good governance in the tax area in developing countries both in 2010 and 2011. The EU also launched a study on transfer pricing and developing countries which was completed in July 2011. Based on it, and provided that selected countries commit to the three principles of good governance in tax matters, the EU offers financial assistance on enhancing their capacity to adopt and effectively implement transfer pricing rules.

By the end of 2012 the EU intends to come forward with an action plan against tax fraud and evasion, including in relation to third countries.

Conclusions and policy orientations

- Efficient and fair tax systems are crucial for growth, poverty eradication, good governance, social cohesion and State building. They tend to result in higher and more stable revenues, more sustainable investments and improved competitiveness of economies. They alter the incentives for work, investment, savings and innovation. In addition, tax revenues that increase with economic growth ensure sustainable funding of essential public services for poor people and public goods, such as security, health and education, on which economic growth and social development depend. In particular the nexus between tax reform and the improvement of business environment is critical by making it easier for business to invest, trade and create jobs. Moreover, in countries encountering capacity difficulties, it seems particularly important to design tax systems that are easy to operate with limited resources.
- Efficient and fair tax systems are also essential to promote democracy and state legitimacy since tax payers tend to hold their governments accountable. They help build a strong fiscal social contract between citizens and their government at all levels that encourages tax compliance, leads to improved democratic and economic governance, higher revenues through higher economic growth and broad tax bases, and allow for combating tax evasion and avoidance, fighting money laundering, corruption and financing for terrorism.
- More efforts would be required to achieve an appropriate balance between direct and indirect taxes, the size of the tax base and tax burden distribution.
- It would be also necessary to address issues referring to the informal economy, productive investments and facilitating employment generation notably in micro and small enterprises. Tax administrations should be given the necessary means to effectively process tax information and ensure tax compliance for all the economic actors, national and international alike.
- The EU is committed to continue helping developing countries deliver on their “Monterrey Consensus” commitments and combating tax evasion as well as undertaking reforms that reflect taxation such as state building, good governance, economic growth and social cohesion. Moreover, the EU is committed to promote fair and transparent domestic tax systems in its country programs, in line with the EU principles of good governance in the tax area, alongside international resources.
- Although recent initiatives (in particular at the OECD and its Global Forum) have improved countries’ capacity to tackle tax evasion carried out through the exploitation of off-shore financial centers and banking secrecy, there is still a need to continue in advancing these initiatives. At time of strong pressure on public finances all governments are committed to protect their public finances and the global financial system from the risk posed by “tax havens” and non - cooperative jurisdictions.
- As regards promoting EU standards at international level, it would be important to ensure coherence between EU policies in general so that EU partners under international trade and cooperation or development agreements will commit to good governance principles in the tax area. These principles should continue to be included in all relevant EU level Agreements with third countries as well as promoted through development cooperation incentives.

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