

WILL CHANGES TO THE INTERNATIONAL TAX SYSTEM BENEFIT LOW-INCOME COUNTRIES?

In recent months tax has climbed up the political agenda in ways that would have been unthinkable only a couple of years ago. Creating a fairer international tax system was a central ambition of both the Lough Erne declaration and the Leaders Declaration that came out of the respective G8 and G20 meetings in 2013. Yet several questions remain about how this rhetoric will be translated into reality. Does the political will exist to drive through these proposed changes? Do poorer nations have the resources and capacity to benefit from these initiatives? What more can low-income countries (LICs) do themselves to create national tax systems that are more efficient, effective and fair?

From the marginal to the mainstream

The final Lough Erne Declaration that came out of the 2013 meeting of G8 countries is notable for three reasons. First, although the official themes for the meeting were trade, tax compliance and transparency, the Declaration focuses mainly on tax. Second, developing countries receive a great deal of attention. Third, it represents a substantial shift in official opinion. For some years organisations like the **Tax Justice Network**, **Action Aid**, **Christian Aid** and **Oxfam** have been campaigning vigorously for more information sharing internationally among tax authorities; for ending legal secrecy around the ownership of companies and trusts, especially in tax havens; and for more transparency about the actual locations where transnational companies earn their profits – as opposed to the locations where profits are ‘booked’ by accountants for tax purposes. Even two years ago, these proposals were often dismissed as unrealistic and unreasonable. Within a short space of time, they were receiving official endorsements – first from the UK Prime Minister’s Office, then from the **G8 in June**, and finally from the more **broad-based G20** who met in Moscow in September.

The G8 and G20 have helped to produce a significant shift in the international tax policy debate, by focusing much-needed attention on some important tax issues and acknowledging that:

- Arrangements for taxing transnational economic transactions are in serious and growing disarray.
- This disarray makes possible extensive tax avoidance and evasion by some large companies and ultra-rich individuals.
- The burdens of financing governments are allocated arbitrarily and unfairly among taxpayers.
- These allocations are economically inefficient and, especially in a number of OECD countries, politically unsustainable.

A question of implementation

Will the G8 and G20 tax reform program be implemented? There is certainly considerable will and capacity to do something. The leadership of the G8 countries is critical because they provide most of the world’s cross-border financial services. Most G8 and OECD governments are motivated to act at present because they face a bleak long-term fiscal outlook, and are hungry for tax revenue. A number have taken steps toward fulfilling the Lough Erne commitments.

The Irish government has announced that it would close the tax loophole that allows companies registered in Ireland also to be stateless, and thus to pay tax nowhere. The Swiss government has signed the **Multilateral Convention on Mutual Assistance in Tax Matters**, thereby committing to cooperate with other governments to exchange information relating to cross-border tax issues. Support is also emerging in unlikely quarters. A number of large transnational companies are now openly arguing that all transnationals should publish more information on where they actually earn their profits.



Collaboration vs competition

If the G8/G20 tax agenda is to be implemented, then the governments of countries with large GDPs and large financial sectors will need to cooperate in a sustained way. National governments will need to work together to change and coordinate their laws and procedures to enhance the flow of information that is available and useful to national tax authorities. However, experience suggests that the governments of the economically and financially powerful OECD countries will behave ambiguously. They find it relatively easy to close some international tax loopholes by pressuring jurisdictions that have little geo-political clout, like Ireland, Luxembourg, Switzerland, and tiny Caribbean tax havens. They are less likely to accept limits on their own capacities to attract investment and ultra-rich tax immigrants by granting tax 'incentives' of many kinds. Virtually all governments compete heavily for investors and investment, and are willing to forego quite a lot of their potential tax revenue in the process. While the British Prime Minister has been promoting the G8/G20 tax reforms, the UK Treasury has continued actively to develop new tax 'incentives', such as reduced corporate taxes on income attributable to intellectual innovation, to attract capital from abroad. Competition for investment and tax revenues encourages governments to create complex and opaque laws and procedures that provide particular companies or economic sectors with tax privileges or some degree of secrecy.

The chances of greater international collaboration would be higher if there were clear standards by which the performance of the main actors could be judged. However, there is no tax equivalent of the World Trade Organisation: no organisation with the authority to nudge independent nations to cooperate in the collective interest. Furthermore, the G8 and G20 declarations on tax are about broad principles and directions of travel. They imply few specific commitments or targets. There seems little doubt that the G8/G20 tax agenda will result in real change, but it is unclear to what extent, and over what period.

Who will benefit from the proposed changes?

The proposed changes are directed almost exclusively at making more information about the potential tax base available to national tax authorities more easily and at lower cost. This is highly desirable, but the benefits will not be shared equally. Richer countries, the BRICS, and a few other large emergent economies stand to gain the most because their tax authorities have the resources to use more information to reduce tax avoidance and evasion. As Mick Keen, Deputy Director, Fiscal Affairs Department, IMF **highlighted recently**, "When we talk of developing countries, we have to recognise the importance of capacity constraints...We should not think that this [agenda] is a kind of silver bullet for all the revenue problems of developing countries. We know that many of the most advanced tax administrations in the world struggle with many of these issues."

The tax authorities of most poor, smaller countries rarely seem to use the facilities they already have to request information from other national tax authorities on particular companies or wealthy individuals. They can easily purchase data processing systems to deal with additional information, but they lack the staff needed to make good use of them, above all because they find it hard to retain experienced people. Qualified auditors able to access third party information to challenge tax accounts presented by transnational companies are likely to end up working for those companies, or for a transnational bank or one of the **Big Four** (Deloitte, PwC, KPMG and Ernst & Young) professional services firms, that are expanding fast in Africa.

Joining information exchange clubs

Tax authorities in LICs will improve their capacity to process and use information from overseas, not least because OECD governments now seem seriously committed to assist them. But recent events suggest that it will be a long time before most of them have the easy access to the wealth of information that their colleagues in the OECD and BRICS are beginning to enjoy. The G8 and the G20 committed to the principle of automatic information exchange on tax matters, and have mandated the OECD to make this a reality. Rapid progress has been made in recent months, but LICs are still very much outsiders.

Until recently, if the French tax authorities wanted to request information about the tax affairs of French citizens or companies located in Canada, they needed to have in place a bilateral tax treaty covering information requests. If the treaty allowed for automatic information exchange, the French tax authorities would routinely report to their Canadian counterparts any information relevant to potential Canadian taxpayers, and vice versa. The governments of OECD countries and some offshore financial centres have very recently been experimenting with arrangements for multilateral automatic information exchange whereby all countries in the group routinely report to all others. The G8 and G20 held out the promise of automatic information exchange on a global scale. That is the target to which the OECD is working.

The lead mechanism is the **Global Forum on Transparency and Exchange of Information for Tax Purposes**. The Forum extends well beyond the OECD, and now has 121 members. However, membership itself means little. The Forum is working, through painstaking processes of peer review, to qualify members to participate not in automatic information exchange but in a multilateral mechanism that involves the right to request specified tax information from other members, and their obligation to reply. This mechanism represents real progress, but it has two major limitations.

First, the right to obtain information on request is considerably less useful than automatic information exchange. In tax, as in crime investigations, a certain amount of base information is generally required before you know exactly what to look for. Tax authorities often do not have enough information on suspected cases of tax evasion to frame a specific information request to another tax authority. Second, no small low-income developing country is yet within sight of joining the club of nations who will exchange tax information on request. To date, the final phase of peer review for club membership has been completed for 41 countries. Only 18 countries were judged 'fully compliant'. BRICS and other large emerging economies came out well. China, India and South Africa were judged 'fully compliant', and Brazil 'largely compliant'. The remainder of mainland Africa – and small, LICs generally – are absent.

Why can most LICs not qualify faster for membership of first the 'information on request' club and then the 'automatic information exchange' club? The major reason is that information relevant to the tax affairs of a company or a wealthy individual can easily be abused. Although they are reluctant to state this publicly, the governments of the richer countries want to be sure that they will not end up routinely providing information to tax authorities that might leak it to the wrong people. Even if only partially implemented, the tax and transparency programmes of the G8 and the G20 should benefit almost everyone. Although well-intentioned, they were not drawn up by the majority of smaller LICs, do not address their immediate needs, and will benefit them mainly in the long term.

What can LICs do themselves?

LICs need not be passive participants in a global tax system designed by the OECD countries and the BRICS. There is a great deal that they can do collectively and at a regional level to develop national tax systems that are more efficient, effective and fair.

1. The 'tax incentives' opportunity

Governments grant exemptions of all kinds for specific categories of taxpayers, activities or individual companies and projects. Exemptions granted to companies are often termed 'incentives', because they are nominally given to attract new investment, especially from overseas. Exemptions are particularly widespread in LICs. A recent OECD paper used figures from six African countries. On average, incentives amounted to 33 per cent of the total value of tax collections. Tax experts have been arguing for decades that governments could solve their revenue problems by cutting back severely on tax exemptions. Research evidence continually supports them, and underpins a strong expert consensus that:

- Tax incentives are often given in ways that are inefficient and not transparent.
- They are widely used by politicians to reward political supporters and businesses willing to contribute to political party funds or private bank accounts.
- If genuinely granted to encourage private investment, incentives would be tied more closely to the investments actually made by their beneficiaries. They would not, for example, be given as general tax holidays for particular companies regardless of their business performance.
- Many – if not most – tax incentives have little impact on investment levels.
- It is likely that many governments could attract more private investment if they were to grant fewer tax incentives and use the additional revenue to address the problems that rank high in the minds of potential investors. In particular these include the poor quality of road, port, transport, electricity and water services.

While very critical of most tax exemptions, organisations like the IMF and the OECD have not taken the lead in campaigning against them. In particular, they have not actively promoted the international adoption of guidelines on when and how tax exemptions could best be granted.



If the G8/G20 tax agenda is to be implemented, governments of countries with large GDPs and large financial sectors will need to cooperate in a sustained way.



Such guidelines could be used by policy makers and civil society organisations to mount credible challenges to dubious exemption practices. There is nothing to prevent Southern regional organisations – e.g. for Africa: the African Union, the African Development Bank and the African Tax Administrators Forum – from developing and adopting their own guidelines for the use of tax exemptions. The Tax and Development Programme of the OECD has recently produced a draft document that could easily be adapted: **Draft Principles to Enhance the Transparency and Governance of Tax Incentives for Investment in Developing Countries**. Not only would a more disciplined approach to tax exemptions boost tax revenues, but the process of agreeing the guidelines would strengthen the claims of developing countries to a greater voice over global tax policy issues.

2. The property tax opportunity

Property taxes are recurrent charges on the ownership or occupation of land and buildings – especially on urban residential, commercial and industrial premises. In contemporary LICs, property tax collections are extremely low by comparative and historical standards. Tax specialists like property taxes because they distort patterns of economic activity less than most taxes, the main burdens fall on more wealthy people, and they are difficult to evade. They are the main revenue source for sub-national governments, and thus an essential component of effective decentralisation. However more action on property taxes has not been taken. Wealthy people do not like them, and they lack, both nationally and internationally, the powerful institutional champions that could persuade government of their benefits. This raises the question, is it time for an African Property Tax Initiative?

Recommendations

- G8 and G20 countries need to provide continued and sustained leadership on implementing the tax and transparency agenda.
- Greater tax collaboration between countries will require more specific targets and commitments to be developed to which governments can be held to account.
- More regional and local level networks should be created so that tax experts and policy makers from LICs can share best practice and establish a stronger collective voice that will have more influence in international tax debates.
- More needs to be done to challenge entrenched views about the benefits of ‘tax exemptions’, particular within the governments of richer nations. LICs could play a leading role in this process with organisations such as the African Union, the African Development Bank and the African Tax Administrators Forum working together to develop and implement a set of guidelines regarding the use of tax exemptions.
- More needs to be done at a regional level to increase property tax collections in LICs i.e. establishing an African Property Tax Initiative.

Further reading

Moore, M. (2013) **Obstacles to increasing tax revenues in low income countries**, ICTD Working Paper

Lough Erne Declaration
G20 Leaders Declaration

New Rules for Global Finance (2013), **Global Financial Governance and Impact Report**

OECD Draft Principles to enhance the transparency and governance of tax incentives for investment in developing countries

Bahl, R., Martinez-Vasquez, J., & Youngman, J. (Eds.). (2008). **Making the Property Tax Work. Experiences in Developing and Transitional Countries**. Cambridge MA: Lincoln Institute of Land Policy.

Credits

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The material has been funded by UK aid from the UK Government. However the views expressed do not necessarily reflect the UK Government’s official policies.

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AG Level 2 Output ID: 268



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Institute of Development Studies, Brighton BN1 9RE UK
T +44 (0) 1273 606261 F + 44 (0) 1273 621202 E ids@ids.ac.uk W www.ids.ac.uk

