Tax and Development: New Frontiers of Research and Action

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Abstract

In recent years, increasing attention has been paid to tax cooperation for development. At the same time international tax issues such as corporate profit shifting, and the role of tax havens have hit the headlines. It is often suggested that international issues are the most important factor holding back domestic resource mobilisation. This paper looks at estimates of the potential gains from taxing across borders, alongside largely domestic measures such as property tax, personal income tax, VAT, and tobacco taxes. It finds that while action on cross-border taxation could yield additional tax take in the region of one percent of GDP, in many countries measures targeting the domestic tax base might deliver something in the region of nine percent. The main enabler is political commitment.

Development actors face a dilemma; international tax issues are salient and accessible, but an intense focus on (and sometimes inflated perceptions of) incremental tax revenues from the "overlapping tax base" between countries, can distract both government and civil society from a clear focus on how tax revenues within a country are collected and spent. International actors should act to close loopholes in the international tax system, and be open to considering whether a more fundamental redesign is needed. But there is also underexplored potential to support and enable improvements in tax policy and administration by seeing key taxpayers (including multinational corporations and investors using international financial centres) not only as potential sources of percentage points of additional revenue, but as potential players in constituencies for reform.

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Summary

In recent years, there has been a dramatic increase in attention to international tax issues, and in tax cooperation for development, with the interlinked goals of:

- **Enhancing the ability of a country** to collect revenues.
- **Improving the tax system for taxpayers** (tax certainty, rule of law, ease etc.)
- **Enabling accountability to citizens** over tax policy and public spending

National development fundamentally is the pathway from being a poor, low tax country where voters do not expect fair treatment from revenue authorities or decent services from government, to being a prosperous country where public goods are secured by a government held accountable for tax and spending. It requires sustained economic growth *and* development of accountable institutions. This should be common ground for the players from all sides involved in debates and action on tax and development.

However in practice debates between those seeking to invest and grow businesses, those seeking to improve investment environments, and those seeking to secure public revenues and accountability through domestic resource mobilisation have often been fractious, disconnected and antagonistic. A symptom of this is the tendency for inflated expectations about the scale of revenues at stake in relation to multinational corporations and tax haven assets, in the poorest countries.

It is often suggested, by both international actors and domestic politicians that international tax issues are the most important factor holding back domestic resource mobilisation. In fact while estimates of potential gains from taxing multinationals and offshore wealth more effectively approach 1 percent of GDP, overall estimates of the potential for developing countries to collect additional tax both from across their overall tax base are around 10 percent of GDP. Many potential gains are achievable over time with modest financial expenditure and accessible levels of technical expertise. The main enabler, or barrier to change is political commitment strong enough to overcome vested interests among taxpayers, politicians and tax administrators themselves, embedded in informal, off-budget and corrupt transfers, as well as the formal tax system.

Donor countries, international organisations, foundation funders and international NGOs should use the levers available to them to support expertise sharing, close loopholes in international tax rules, ensure that tax treaties are beneficial to poor countries and enhance information sharing. Governments should also be open to considering whether a redesign of the global source-residence tax framework is needed in the longer-term.

But many of these most internationally accessible and salient levers relate to the 1 percent of cross-border taxation rather than the other 9 percent of domestic tax potential. Reforms in areas such as property tax and reducing tax exemptions have often proved resistant to technical assistance and advice, suggesting that the barrier is in the political settlement rather than a lack of technical capacity or best practice advice.

There is a real danger that an intense public focus on the accessible, and morally appealing prospect of collecting incremental tax revenues through international tax action, will distract government and civil society from a clear focus on how tax revenues, broadly, are collected and spent. It can already be seen, particularly from cases in the extractive industries that inflated expectations can lead to vicious circles of policy and administration uncertainty and mistrust between taxpayers and governments, and to fiscal indiscipline and economic underperformance.

This is the opposite of development.

Despite globalisation, around the world most taxation remains domestic, and is not part of the 'overlapping tax base' between countries effected by tax treaties and international tax rules. It is important to prevent people evading taxes through the use of international secrecy, but even more important governments collect tax through consent. The ability to use international mechanisms (or the push of technical advice) to compel people to pay more tax than has been secured through a social contract with their government is (thankfully) limited.

To move beyond antagonism and misunderstandings, policy makers, tax experts, tax payers, tax professionals and advocacy organisations will need to find new ways to engage, debate, collaborate, and learn together. Beyond the existing narratives, we need a new story about tax and development, which can be recognised and provide common-ground for all players.

The pathway of national development has been described as the shift **'from deals to rules.'** Taxation is essentially a rules-based form of extraction. Rather than advocating general improvements to the investment climate or only increasing resources for capacity building there may be opportunities to strengthen the political economy of efficient, rule-based business in key sectors, and leverage the interest of taxpayers as advocates and supporters of reform. In searching for effective levers we should consider the potential of taxpayers (including multinational corporations and those using international financial centres) not only as potential sources of percentage points of incremental additional tax , but as potential players in constituencies for reform in a shift from deals to rules.

Eight ideas

The paper suggests eight ideas worth testing through engagement with interested parties from government, business, civil society, international organisations and the tax profession:

1. **"An MLI for Development."** The Multilateral Instrument (MLI) has shown how tax treaties can be changed multilaterally. Could an MLI for Development be developed based on a set of minimum treaty provisions which developed & developing countries would agree to collectively, tailored to support the needs of developing countries—for example including minimum withholding tax rates and the treatment of indirect transfers of interest (i.e. capital gains).

2. **Peer review mechanism for responsible tax practice.** Multinational corporations are increasingly publishing tax principles and policies, whether driven by legislation (in the UK), or as a means to take a leadership position and stabilise expectations. However there is no means of assurance. Could companies/ sectors develop a peer review and/or broader assurance process on their practice and performance as responsible tax payers?

3. **Dispute resolution for development.** Dispute resolution and mandatory arbitration provide a means of securing tax certainty, and a commitment mechanism that encourages governments to write clearer laws and to enforce them. What steps should be taken to make dispute resolution mechanisms accessible and useful for low income countries?

4. **Improving the effectiveness of the UN Tax Committee.** The UN Tax Committee plays an important role as a forum for developed and developing countries to address tax issues, beyond and in complement to the OECD processes, however it is constrained by lack of resources and some of its own procedures. How should the UN Tax Committee evolve to make it a more effective forum to serve the needs of developing countries, alongside the OECD and other international bodies?

5. **Business tax roadmaps.** Business tax roadmaps by governments set out plans for business taxes over the medium to give businesses the certainty they need to plan and make the long-term investments, they also provide a focus for broader engagement between stakeholders on the basis and challenges for taxation.

6. **Technology solutions for identity assurance**. The ability to identify the ultimate beneficial owners of accounts and of corporations is crucial to detecting, tracking, and preventing illicit financial flows, and for tax administration. However it does not necessarily follow that all ownership details should be obliged to be publically searchable. Could a blockchain or other technology solution be used to provide a solution for compliant confidentiality, and secure identity and beneficial ownership certification?

7. **Tax simplification for project finance.** Tax uncertainty is a key barrier in developing multi-country investments such as power and infrastructure projects. Bespoke deals often have to be worked out with each country to overcome underlying complexity in the tax system. A model for a simplified system for taxation of project finance could be developed through a multi-sector collaboration involving governments, private sector and DFIs.

8. **A 'race to the top' of International Financial Centres**. Can the characteristics of a responsibly competitive international financial centre be identified and measured? Could there be a Index of responsible competitiveness of financial centres demonstrating integrity and ability to mediate and support investment.

1. Introduction

1.1. Tax for development

Taxes are crucial to state building, funding public services, infrastructure and redistribution, and creating a 'fiscal social contract' between governments and citizens. While taxation is not the only source of government revenue, in most countries it is the most important. If revenues are not adequate to cover needed spending in areas such as infrastructure, health, and education, this is a critical constraint. At the same time tax systems can impoverish people, deter investment, and provide both resources, and direct means, to entrench the power of a narrow elite and sustain them in patterns of public policy and administration which hold back broad-based growth.

Tax is a sovereign issue, but international cooperation on tax is important. For much of the twentieth century international tax cooperation has been focused on coordinating cross-border taxation through tax treaties, so that people and businesses do not face a double tax bill on the same income in different jurisdictions. There are thousands of international tax treaties which have the force of law, mostly between pairs of countries, but also among larger groupings, such as the European Union and ECOWAS. At the same time countries have been involved in supporting each other to develop their domestic tax system since the Shoup Mission to post-World War II Japan. Donors are increasingly focused on tax administration as well as policy (Fjeldstad and Moore 2009; ITC 2012; Bird 2008; IMF 2011). Support generally encompasses three approaches; contributing to the enabling environment for tax reform, such as through policy dialogue, civil society support, and support for evidenced-based discussion, technical assistance on tax policy, legislation, and administration and developing individual talent though training and mentoring (IMF/OECD/UN/WBG, 2016). However 'aid for tax' remains a small part of overall aid budgets; amounting to around 0.15 percent of overall ODA. The main donors are the United Kingdom, the United States, Germany, Norway, and Switzerland.[1]

In recent years, there has been a dramatic change in the level of international attention and cooperation on tax as a development issue. Networks of civil society organisations in both the North and the South have championed Tax Justice' and tax transparency. G20 and OECD governments have sought to address the problem of taxpayers hiding their wealth or income offshore and not declaring, and of companies shifting profits to low tax jurisdictions ('base erosion and profit shifting'). Domestic resource mobilisation has also emerged as a key development priority and is a core part of the Sustainable Development Goals which include the goal (17.1) to "strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection." Many developing and emerging economies have joined the 'Inclusive Framework' to implement the G20/OECD initiated Base Erosion and Profit Shifting (BEPS) programme. 'The OECD, IMF, World Bank and United Nations have developed a Platform for Collaboration on Tax in order to enhance cooperation and global dialogue

[1] Based on reporting OECD statistics on ODA under code 15114 'Domestic Revenue Mobilisation' for 2015.

on tax matters. (Global Platform, 2016). Thirty-nine countries have come together to develop the Addis Ababa Tax Initiative to work together on revenue mobilisation (see box below).

The Addis Tax Initiative
The ATI involves membership 39 countries and 12 supporting organisations. Country members by July 2017 were Australia, Belgium, Benin, Burkina Faso, Cameroon, Canada, Denmark, Ethiopia, European Commission, Finland, France, Georgia, Germany, Ghana, Indonesia, Ireland, Italy, Kenya, Korea, Liberia, Luxembourg, Malawi, Namibia, Netherlands, Norway, Paraguay, Philippines, Rwanda, Senegal, Sierra Leone, Slovakia, Slovenia, Solomon Islands, Sweden, Switzerland, Tanzania, Uganda, United Kingdom, United States of America.

- **Donor countries**: collectively double their technical cooperation in the area of domestic revenue mobilisation by 2020;
- **Partner countries**: step up domestic revenue mobilisation as a key means of implementation for attaining the SDGs and inclusive development
- **All countries**: **commit to ensure Policy Coherence for Development**.

1.2. Commitment to "policy coherence": Principles, process or politics?

Rich countries have a broad range of potential policy levers which may impact on domestic resource mobilisation in poorer countries.[2] These include: technical assistance on taxation, contributing to the development of knowledge and debate, contribution to the development of international tax norms, own tax policies and bilateral treaties, implementation of tax transparency measures including information exchange and mutual legal assistance, the practice of dispute resolution, influence on third countries (such as in the case of the UK the overseas territories and crown dependencies), influence on multinational corporations, and engagement in (and reforms to) the governance of international tax rules. Policy coherence concerns the question of how these different available levers can be used together, for maximum effectiveness, and more broadly whether goals and approaches focused on domestic resource mobilisation are coherent with action in other areas (such as private sector development, and enabling energy access).

Both the SDGs and the Addis Ababa Tax Initiative involve commitments to policy coherence. However there is not a clear vision of in practice. The Addis Tax Initiative offers general **principles** ("transparency, efficiency, effectiveness and fairness") which are broadly supported, but very high-level. Several ATi participants articulate their approach in **process** terms, for example the UK says "DFID, Treasury & HMRC take a 'whole of government' approach," Germany says "The Ministry of

[2] In general this paper focuses on the relationship between rich countries and low and lower middle income developing countries. However, as noted in the text some of the available illustrative statistics also draw on middle and high income developing countries.

Finance and BMZ work closely together" and Burkina Faso says " DRM Strategy set out in Economic and Financial Sector Policy" (ATi, 2017) .

Policy coherence is sometimes articulated in terms of avoiding "giving with one hand and taking with the other." In the run-up to the development of the SDGs there was increasing focus on measuring and understanding the diversity of financial flows into and out of developing countries (See for example Strawson, 2013). In particular some estimates appeared to reveal huge sums of illicit capital flight, which were misinterpreted both popularly and at very high levels as multinational tax avoidance (see for example, Africa Progress Panel, 2013 and High-Level Panel on Illicit Financial Flows from Africa, 2015).[3] These were commonly compared with inflows of development aid, or more broadly totted up in a ledger of financial inflows and outflows (Sharples, Jones and Martin, 2014). This vision of policy coherence on tax as 'balancing giving and taking' while morally intuitive is not only based on wishful thinking about illicit financial flows, but encourages development to be conceptualised as a zero-sum game of resource transfer, rather than a process of sustained economic growth; something done *to* people rather than *by* people.

This paper explores whether the idea of 'policy coherence on tax for development' can be more than principles-on-paper, a commitment-to-committees, or a dollar-for-dollar equation of resource flows in and out of a leaky bucket, but rather, whether by aligning to fostering sustainable economic growth, it offers the potential to be the most impactful of the Addis Tax Initiative commitments. The paper focuses on the question of policy coherence by developed country governments, both as donors and as taxing jurisdictions (and those that influence them). It argues that policy coherence can be envisaged not only as a coordination mechanism to avoid unintended wasted effort, but as a means to articulate, pursue and evolve a more effective use of the policy and influence levers that are available, across governments, taxpayers, civil society and international organisations in pursuit of sustainable economic development.

The intended audience for the paper is the broad ecosystem of people concerned with domestic resource mobilisation and the state of tax systems in developing countries; policy makers and administrators from Ministries of Finance and Development, international organisations, revenue agencies and technical assistance, foundation funders and international NGOs, tax professionals and taxpayers, researchers and academics. It is similarly informed by conversations with people across many of these groups.

Section 2 sets out a framework for considering policy coherence on tax for development, and considers the current narratives that shape our understanding of the issues: "the pot of gold," "fix the international tax system" and "tax is political." Section 3 provides an overview of the scope of taxation between developed and developing countries and considers broad estimates which provide a sense of scale of the potential for additional

[3] For details of these misunderstandings and methodological issues, see Forstater (2015) Johannesen & Pirttilä 2016., Nitsch 2016., Reuter 2017. and Forstater 2016. Johannesen and Pirttilä conclude that the 'revenue losses to African governments from illicit financial flows are lower than aggregate official development assistance—and not the multiple that is sometimes claimed.'

revenues related to these narratives and to the domestic and ‘overlapping’ parts of the tax base. Section 4 sets out areas of potential (‘dangling fruit’) across both domestic, overlapping and hidden parts of the tax base and notes the particular opportunities, challenges and barriers in each area. Section 5 highlights the real and potential dangers from an unrealistic perceptions of the potential for generating more tax cross-border taxation—both in terms of undermining the investment environment and the dynamics of accountability. Section 6 sets out the basis for a new narrative on tax embedded in the political economy determinants of economic growth, arguing in particular the need to consider the linkages between business and political elites in different sectors, and the constituencies of support for a shift from ‘deals to rules.’ Section 7 offers eight ideas for how this approach might be developed in practice.

2. A framework for coherence

Policy coherence means using the available policy and influencing levers together, for maximum effectiveness. To judge and promote coherence we need a coherent set of goals, a common fact base for understanding the current situation, and a means for learning from experience and adapting the mix of levers.

2.1. What's the goal?

International actors put forward three linked arguments for investment in strengthening tax systems, a *financing* argument, a *spending* argument and a *governance* argument (Long and Miller, 2017). In other words, that developing countries could tax more, that if they did they would spend more in areas such as health, education and social protection and the achievement of the SDGs, and that states that raise more of their revenue from tax (rather than from aid or natural resource revenues) are better able to promote prosperity.

Research by the International Monetary Fund, finds a tipping point of tax revenues above 12.75 per cent of GDP, where economic growth is signicantly higher (Gaspar, Jaramillo and Wingender, 2016). They argue that tax revenue equivalent to 15 percent of GDP is a "reasonable" minimum level for low-income countries to secure the financing of basic government tasks such as law and order, health, and education (IMF 2005). Countries with some of the lowest revenue-to-GDP ratios are also those where the vast majority of the world's extremely poor people live—Bangladesh, China, India, and Nigeria all have tax-to-GDP ratios below 15 percent (Junquera-Varela et al, 2017).[4]

However this does not mean that taxing *more* is always better. Some developing countries are already collecting more than 12.75 or 15 percent of GDP, and may already be extracting as much tax from the economy as it can bear. Besley and Persson (2014) in their paper "Why do developing countries tax so little?" find that developing countries collect similar amounts of tax to developed countries when compared historically based on GDP per capita.

Although there is a temptation to describe the goal for domestic resource mobilisation simply in terms of raising levels of tax revenue, it is widely acknowledged that tax reforms should focus on *building better tax systems*. For example IMF/ World Bank Group (2016) argue, "Instead of focusing on incremental changes and aiming purely at tax collection, domestic revenue mobilization efforts should take a broader and longer-term perspective. Such efforts should be targeted to create an environment conducive to sustainable revenue mobilization as part of a legitimate social contract between the government and the citizens."

In general good tax systems are considered to be those which (for a given level of revenue and progressivity) are fair and understandable in procedure, do the least amount of damage to economic efficiency and cost least in administration and compliance costs

[4] Mick Moore and Wilson Prichard (2017) point out although this figure sounds precise, in practice is open to interpretation, depending on whether it includes all government revenue, rather than simply central government revenue, total revenue (i.e. including non-tax revenue and social security contributions). Further, GDP figures are often quite unreliable.

(the principles of "transparency, efficiency, effectiveness and fairness" as set out by the ATI). The 2030 Agenda for Sustainable Development recognises that 'domestic resources are first and foremost generated by economic growth, supported by an enabling environment at all levels.' As the UNCTAD (2015) World Investment Report, argued the key question is not how to collect the most money from current economic production, but how to secure immediate tax revenues while maintaining a sufficiently attractive investment climate to enable economic growth and expand the future tax base.

Furthermore, tax revenues do not necessarily translate into benefits for citizens. As Pritchett and Aiyar (2015) point out whether taxes make people better or worse off depends on the quality of the goods and services they are used for. If taxpayers view their payments as an involuntary 'tribute' towards a costly yet ineffective state the solution must be a better state, rather than more taxation. In a situation where politicians are not pursuing broad-based economic growth and progressive development a higher tax take is likely to make people worse-off; both by impeding private investment and directly impoverishing those who bear the costs of the tax. As Slemrod (2016) argues the international community 'must consider whether our best advice will make the intended beneficiaries—often desperately poor people—better off, or will it make corrupt bureaucrats and politicians better off?'

This paper therefore considers that development cooperation on tax has three broad goals:

- **Enhancing the ability of a country** to collect revenues.
- **Improving the tax system for taxpayers** (tax certainty, rule of law, ease etc.)
- **Enabling accountability to citizens** over tax policy and public spending

2.2. Three narratives

While there is relatively broad agreement on these goals, in practice the debates are often incoherent, and antagonistic. Sources of data are improving,[5] and there is a strengthening body of research. But the experience of cross-sector engagement between policy makers, parliamentarians, the private sector, tax practitioners, development and tax academics, NGOs, and the media has often been fraught with misunderstanding, and disconnection. (Forstater, 2015; Forstater and Christensen, 2017).

Debates tend to run along separate tracks, shaped by three narratives, which serve as descriptions and diagnoses;

- The first story is **"the pot of gold":** This is the idea that developing country governments are losing huge sums of potential revenue to tax avoidance by multinational corporations, and to tax evasion by high net worth individuals, and that these could be problem-solving amounts of money for the poorest countries (for example, 'several times greater than aid' or equivalent to health or education budgets). This narrative has a strong moral appeal; comparing rich

[5] Such as the Government Revenue Database maintained by UNU-WIDER https://www.wider.unu.edu/project/government-revenue-dataset

multinational companies with people in poor countries, and emphasizing that the barriers preventing revenues being collected are policy choices made by OECD countries both appeals to a sense of unfairness and offers the prospect of accessible action (See for example Hogg et al, 2008; IBHARI, 2013; Lawson and Pearce, 2016).

- The second story is the **"fix cross-border taxation":** This story highlights that international tax rules and norms have not kept pace with the reality of globally integrated multinational corporations, international investment by high net worth individuals, and digitally enabled business models. Taxpayers are able to manipulate their transactions and tax returns to avoid and evade taxes, or to create outcomes that although legal are not seen as socially beneficially. Overall the system tends to drive tax competition between countries on corporate taxes. Furthermore the current rules and norms shaping the division of taxing rights between developed and developed countries, tend to confer advantages towards 'residence' countries (where investors come from) and away from 'source' countries (which host foreign direct investment). (Picciotto, 2015; Durst, 2015)

- The final story is **"tax is political."** It focuses on the relationship between governments and people. It emphasizes that changes in countries' tax policy and administration in practice, are largely driven by domestic economics, politics, and institutions, and that corporate taxation is only one part of this. Tax systems depend on cooperation and coordination between revenue agencies and other public and private actors, but in practice are often characterised by rent-taking, deal-cutting, and coercive relationships. Change is held back by the difficulty of making quick improvements to this complex network and by the capacity of elites to influence tax policy formulation and administration, as well as the involvement of tax collectors and public servants themselves in rent-taking. These practices tend to bring tax collection into disrepute, and decrease overall willingness to pay (Moore, 2013, Fjeldstad, 2013).

The **'pot of gold'** story became particularly popular and influential in the wake of the 2008 financial crisis and in the discussions on finance for development in the run-up-to agreement of the Sustainable Development Goals. Stories about tax havens, illicit flows, and aggressive tax avoidance have featured onto the front pages of newspapers over recent years driven by exposés such as the UBS Affair, 'Swiss Leaks' and 'The Panama Papers' (Oei and Ring, 2017). The rapidly rising public interest combined with the search for a ready answer to the question of how to mobilise finance for development[6] have often combined into wishful thinking, misunderstandings and inflated expectations. For example, amounts related to corporate "tax dodging" are often presented as being several times the education or healthcare budget of developing countries, or several times the international aid developing countries receive (for example "3 times aid," or even recently "24 times aid").[7] However, these calculations are misleading as they tend to be based on comparing aggregate estimates of sums that mainly relate to major

[6] See for example, Watkins, K. 2013. The G8 Development Dividend https://www.odi.org/comment/7516-g8-development-dividend

[7] See Forstater, 2015 and https://www.cgdev.org/blog/aid-reverse-facts-or-fantasy

emerging economies such as Russia and China with aid received by smaller and poorer countries (Forstater, 2015). Large-scale estimates of apparent illicit financial flows (sums as $1 trillion) are often presented as if they were tax losses, and directly related to MNCs (Forstater, 2016).

The **'fix cross-border taxation'** narrative is often linked to the pot of gold story, but they are in fact not the same. Even if it is not true that huge sums of money are at stake for the poorest countries, it is nevertheless true that the international tax system is struggling to cope with the globalised world economy and digital economy and that this effects developing countries as well as developed countries (UNCTAD, 2015; Crivelli, Mooij, and Keen, 2015; and Johannesen, Tørsløv, and Wier, 2016). There may not be a huge pot of gold, but there is the potential for non-trivial revenue gains from both strengthening domestic application of tax rules (such as transfer pricing), and also from international tax reforms (such as changes to tax treaties to prevent 'treaty shopping'). The G20/OECD led Base erosion and profit shifting (BEPS) project has been developed to strengthen the current system of tax treaties and norms, and to give tax authorities better tools and more information. Many countries are reducing their corporate tax rate, lowering the incentive for profit shifting, while 'broadening the base' by removing exemptions. Some argue that this is an exercise in patching up a system which is no longer fit-for-purpose, and call for a more radical set of reforms in the global system for taxing economic actors that across borders, such as destination based tax (Devereux and de la Feria, 2014) or unitary taxation (Piciotto, Ed., 2017)

The **"tax is political"** narrative has much in common with broader learning about effective states and the wider question of why some countries remain stuck in a spiral of corruption and institutional weakness while others build effective bureaucracies that are able to tackle the challenges of development (Fritz et al., 2014; Booth and Cammack, 2013; Andrews, 2013). It was noted more than fifty years ago that there is striking inertia in tax levels, which reflects not so much the difficulty of raising the effective level of taxation, as the fact that it is not in the interest of the political elite to do so (Kaldor, 1963). The most recent IMF/World Bank/UN/OECD report to the G20 on capacity building on tax argues that "successful strengthening of tax capacity can only be country-driven, requiring continued energy, enthusiasm and commitment from the highest levels. External support can provide critical help. But ultimately it is the country itself that will determine success or failure."

Corruption is recognised as a key barrier to improving taxation in many developing countries. For example research by the African Tax Administrators Forum (ATAF) found that administrative corruption and lack of transparency still pose real challenges and can result in governments losing substantial revenue (Monkam, 2012). On the one hand, many revenue staff are employed on low-yielding activities, effectively taking part of their remuneration in corrupt payment, while funds are also rooted to ministries and individual politicians outside of the public budget Informal "taxes" (bribes and speed payments to officials; levies; user fees; and non-voluntary payments to non-state groups such as community groups, self-help groups, and protection payments to armed groups) are a significant part of the effective tax system in many developing countries and can be more trusted than formal state taxes (Van den Boogaard and Prichard, 2016). Public morale to pay taxes can be low if institutions are not trusted and public revenues are not seen to translate into public services.

This story highlights that changes in formal rules are unlikely result in real change unless they are introduced in a way that is responsive to the dynamics of existing networks and do not mobilise fatal resistance. Donors should be "less pre-occupied with strengthening formal institutions based on OECD models, and pay more attention to existing local capacity including informal institutions that could facilitate productive bargaining and problem solving among local actors." (Unsworth, 2015).

However the predominant approach to international cooperation on tax for development has nevertheless tend to be rooted in improving formal systems and transferring international best practices. It is increasingly recognised that this traditional technical approach should be complemented by approaches such as encouraging constructive engagement between governments and citizens over tax issues, and looking for areas where more efficient taxes and progressive outcomes coincide with some area of elite interests. The OECD Principles (2015) state that "a smarter approach is needed to ensure that support for reformers is in line with political realities. Political economy analysis can help determine opportunities for change." The African Tax Administrators Forum (2012) argues that 'The success of tax reforms should not only be measured by meeting feasible targets, it should also be judged by the extent to which the reforms enhance the institutionalisation of bargaining and policy dialogues between the state and interest groups in society. Consequently, a major challenge is to develop a more strategic, historical and politically informed basis to promote the more difficult tax reform."

2.3. Opportunities, dangers, and synergies

The diagnosis to **"fix cross border taxation"** calls for action to focused on international tax rules (whether incremental advances or in a more radical redesign), while the **"tax is political"** focuses on the influencing and supporting the dynamics of domestic political and economic shifts. If both are, in some sense true descriptions of the challenge of tax for development, this raises the question of how they relate. For donor countries, international organisations, private foundation donors and international NGOs seeking to have a positive impact through action on taxation how they can be approached coherently? This paper proposes three sets of considerations:

On one hand we should look at the **opportunities** and consider how actions should be prioritised, sequenced and combined. While action focused on domestic and international aspects of taxation are complementary, there are opportunity costs between investing time, money and attention in one area or another. The ICAI (2016) review of DFID's work on international taxation argued both that the programme is too top-down in focusing on technical issues relating to cross-border taxation *and* that it did not do enough to involve these same countries in the detailed technical discussions over new guidance and standards on international tax issues. However for a low-income country where the government has few staff with expertise on transfer pricing this raises the question of how much time should they spend on international meetings in Paris and New York and how much on developing an effective audit unit at home? Donors, NGOs, research institutions all face constrained resources and need to decide where best to direct them.

Secondly we should consider the **danger** of negative interactions between different approaches, if they undermine each other; for example attention focused on international aspects of taxation may undermine the domestic political economy of taxing-and-spending, by enabling politicians to deflect accountability, and civil society to become distracted from holding them to account.

Finally, there may also be potential **synergies** between international tax levers (which are most accessible to international actors) and the state building and domestic political economy aspects of taxation.

Thus we can consider a framework for thinking about the three goals on tax and development, and the potential for direct trade-offs, dangers and synergies between actions focused on international and domestic aspects of taxation.

Figure 1: Framework for Policy Coherence on Tax and Development

Goals

Considerations of coherence

	Collecting revenue	**Improve the tax system ("transparency, efficiency, effectiveness and fairness")**	**Improve accountability of governments to citizens**
Opportunities	Where is there greatest potential to collect more tax?	What are the priorities & sequencing for improving the tax system?	Where is there potential to enhance accountability through the tax system?
Dangers	Economic impacts: will collecting more from current economy impoverish people and/or impede investment?	Are constrained capacities being diverted into fashionable areas? Are domestic efforts undermined by international rules/ treaties?	Is political attention and accountability being diverted away from accountability?
Synergies	Are there win-win opportunities from domestic and international tax levers?		

The following chapter provides a broad overview of the scale of revenues at stake in different parts of the tax base to begin to answer these questions.

3. Getting a sense of scale

In thinking about the potential tax base of a small poor economy we can think of three spheres of economic activity and tax administration:

A. **The purely domestic tax base:** *activities and taxpayers whose activities are located in a single jurisdiction such as local businesses, employment, and property ownership.* The ability to tax this activity is not limited by international tax rules and agreements but mainly by domestic factors, such as the size of the informal sector, capacity and integrity of the tax administration, tax compliance procedures and tax exemptions and holidays (Runde and Savoy, 2014). To the extent that economic activities and taxpayers have options of mobility this tax base is vulnerable to tax competition with similar locations.

B. **The overlapping tax base:** *areas where taxpayers activities (and the resulting tax base) potentially overlap between the taxing rights of different countries, for example through international loans, intracompany trade in goods and services, and both intra and intercompany trade in services.* The scale of this overlapping tax base depends on the scale of these activities (i.e. the degree of economic integration of the country, and particularly of inwards FDI), and relies on international mechanisms such as transfer pricing, tax treaties and dispute resolution to prevent double taxation and uncertainty for taxpayers. This is the area where there is a risk of taxpayers engaging in 'base erosion and profit shifting' (BEPS).

C. **The hidden tax base:** *assets and income whose existence or ownership is obscured through international structures, enabling tax evasion.* These are assets and income belonging to domestic taxpayers which are not declared and are actively or passively hidden for example through shell companies or numbered bank accounts, or simply by not declaring this income and relying on the lack of revenue authority capacity not to find it.

The hidden tax base[8] and the overlapping tax base both form part of the 'global tax commons' in that they cross-over between tax jurisdictions and may be subject to international tax agreements and information sharing.

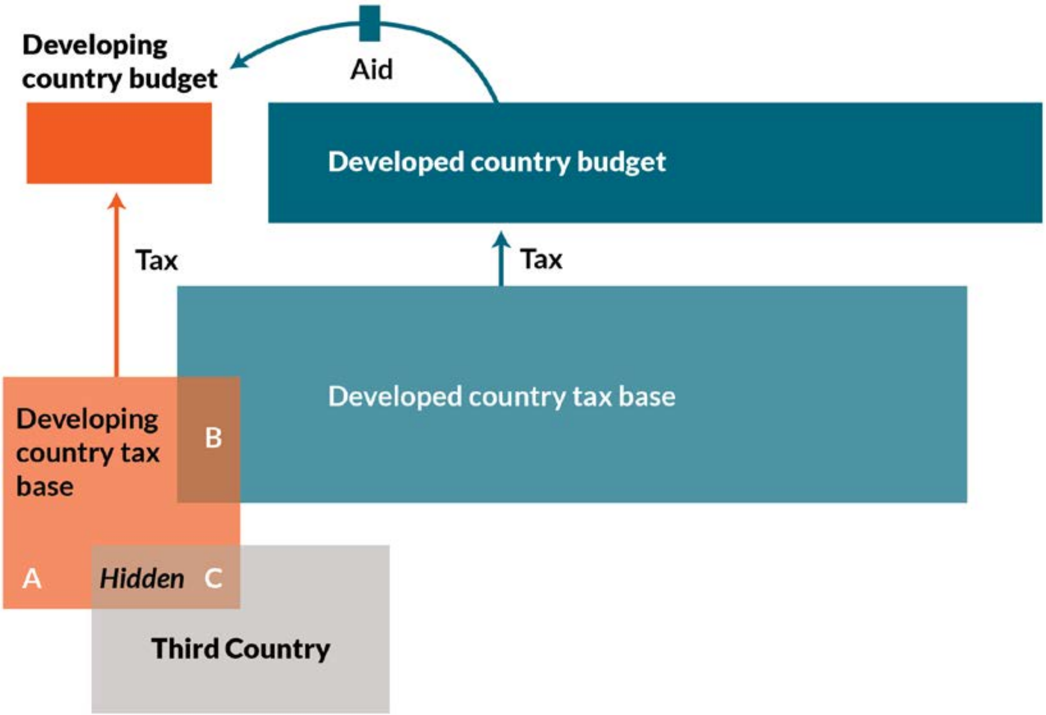
In the diagram below this is illustrated in the relationship between three countries; a low-income country a large rich economy, and a third small economy; (an archetypal tax haven or secrecy jurisdiction).

The system of international tax rules seeks to coordinate taxation in the overlapping tax base between countries, and to reduce the opportunity for income and assets to be obscured in a hidden tax base. **Tax treaties** determine how taxing rights are split between 'source' countries (i.e. where multinational subsidiaries operate factories, plantations, stores and other operations) and 'residence' countries (i.e. where group headquarters are tax resident), while the system of **transfer pricing** concerns the

[8] NB: "Tax base" here is not used in the legal sense as the measure on which the liability for a particular tax is assessed, but in the more general sense of the total of taxable assets and income, within the tax jurisdiction of a government.

allocation of profits between two different source countries (for example in an integrated value chain involving design in one country, manufacturing in another, and retail in a third, each of these countries are 'source' countries, and there are several areas of overlapping tax base between them.

Figure 2: Three areas of the tax base


Developing country budget
Aid
Developed country budget
Tax
Tax
Developed country tax base
Developing country tax base
B
A
Hidden
C
Third Country

Individual taxpayers can have activities in different parts of the tax base. For example the affiliate of a multinational corporation in the developing country might pay payroll taxes, mining royalties and transport tax, which are within the country's domestic tax base (A), as well as corporate income tax which can be part of the overlapping tax base (B).

If one country makes revenue gains by taxing more of the overlapping tax base (B) this comes from income streams that are currently part of the other country's tax base. If uncoordinated, this could lead to double taxation, raising the overall effective tax rate on business, encouraging disputes and potentially impacting investment. If, on the other hand, it is achieved through international coordination (such as through change to transfer pricing rules, favourable dispute resolution or changes in the treatment of source and residence taxation) it would essentially be financed by the developed country giving up the right to tax some income. Equally tax sparing mechanisms allow developing countries to elect to forgo some potential tax revenue through tax exemptions, without seeing the forgone revenue being transferred to the residence country instead of acting as intended as an investment incentive (Azemar and Dharmapala, 2015).

As countries are beginning to exchange of information automatically about the financial accounts and investments held by foreign tax residents, under the new Common Reporting Standard (CRS), and exchange information of the beneficial ownership of companies the 'hidden tax base'(C) will become more like the 'overlapping tax base.'

The scope for collecting additional revenues from each of the three areas of the tax base ultimately depends on the scale of that part of the tax base (i.e. the underlying economic activity) as well as how successfully it is currently taxed, and the potential for better enforcement or changes to tax rules to collect additional revenues, and finally on the elasticity of the activity in the face of effective rises in the tax burden (i.e. the extent to which the actors involved would be incentivsed to stop or move that activity in the face of greater taxation, or indeed to find other ways to avoid or evade tax or to politically organise to prevent the tax rises).

All estimates remain tentative, but there are an increasingly number of studies, and available statistics which provide a sense of scale, and can help to shape more coherent debates.

3.1. The domestic tax base

The domestic tax base concerns all those parts of the economy that ***not*** also part of the tax base of another country. Globally, and in most countries, both developed and developing, this represents the largest part of the economy. To give a very rough sense of this scale; global GDP (i.e. the value added of everything produced in the economy) is around $75 trillion, while the overall value added by foreign affiliates of multinationals is $8.3 trillion (this includes profits and wages) (UNCTAD, 2017). The profits of the Fortune 500 are $1.5 trillion. Considering taxes on businesses in developing and emerging economies UNCTAD estimate that around $3 trillion come from the domestic tax base (through taxes on local firms, and local taxes other than profit tax on multinationals), while around $215 billion is collected from the overlapping tax base (through profit taxes on multinationals).

Not all of a country's GDP can or should be taxed. A large part of the economy in low-income countries relates to small-scale agriculture and the informal sector (Besley and Persson, 2014). These areas are hard to tax on practical grounds, and taxing people on low incomes can lead to greater poverty. As Nora Lustig (2016) highlights, raising additional revenues for infrastructure, and social services, even through progressive taxation can leave a significant portion of the poor with less cash to buy food and other essential goods. It is not uncommon that the net effect of all governments taxing and spending is to leave the poor worse off in terms of actual consumption of private goods and services. Nevertheless there can be areas of the domestic tax base where there is greater capacity for taxation, without pushing people into poverty, and opportunities for taxation grow with economic growth.

Economists estimate 'taxable capacity'; the predicted tax-to-GDP ratio that an economy could be expected to bear, taking into account a country's specific macroeconomic, demographic, and institutional features, such as per capita income, the balance between industrial companies, natural resources and agriculture, extent of urbanization, size of the formal sector, extent of trade openness and balance between large companies and small and micro businesses. Such analyses cover both the domestic and overlapping tax base (but as argued above, a larger share would be expected to be in the domestic tax base). These analyses find that many countries have an unused economic tax potential amounting to several percentage points of GDP (see Langford and Ohlenburg, 2016, Le, Moreno-Dodson and Bayraktar, 2012 and Fenochietto and Pessino, 2013).

Ben Langford and Tim Ohlenburg (2015) find that for the most recent year, across 27 low and lower middle income countries with an average tax to GDP ratio of 15.7, the average tax capacity was 26.4 percent. However the tax effort (i.e. the relationship between actual tax collection and theoretical capacity) was not that much lower for low and middle income countries than for high income countries. Their results suggest that the average level of revenue collected by low and middle income countries is 50-60 percent of capacity (suggesting unused tax capacity averaging 10 percent of GDP) while upper-middle and high income countries collect around 70 percent of capacity. As Belsley and Person (2014) note tax effort does not rise automatically with economic growth and formalisation but depends on political decisions. Several countries have high apparent unused tax potential—but this does not necessarily indicate that these amounts would be political feasible or easy to collect. Langford and Ohlenburg find that corruption, law and order the level of democratic accountability play an important part in determining the extent to which countries meet their overall tax potential.

3.2. The overlapping tax base

The 'overlapping tax base' relates to taxes on profits, income or capital gains which could be attributed to more than one jurisdiction. These are the types of taxes that tend to be covered by tax treaties, and might be subject to international disputes and arbitration, and to profit shifting.

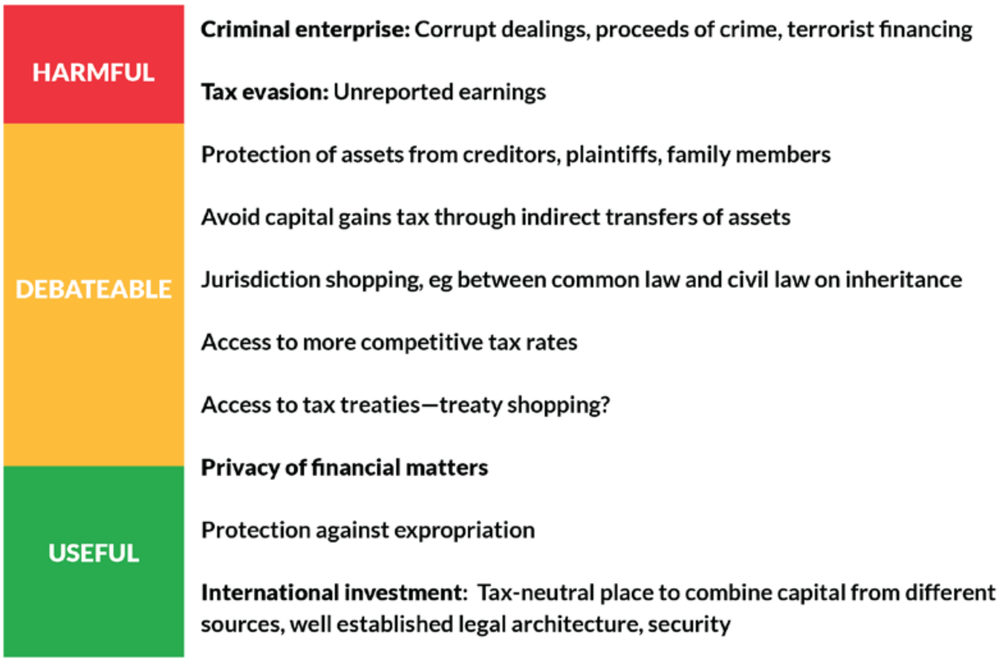
The scale of this tax base depends on the underlying scale of investment and economic activity by affiliates of multinationals in the country (i.e. the extent of foreign direct investment). However a large proportion of the overall tax bill of these multinational affiliates will be in the domestic tax base (through levies, payroll taxes, import taxes etc…). UNCTAD (2015) for example finds that multinational affiliates pay $2 of these other taxes for every $1 of profit tax. Overall they find that the fiscal burden on MNC foreign affiliates—taking into account all taxes and social contributions—represents approximately 35 per cent of commercial profits, or 50 percent if natural resource royalties included (this compares to 56 and 65 percent in developed economies). This suggests that there is some room for collecting additional taxes from this part of the tax base. Experience also finds that when tax administrations mount serious challenges to transfer mispricing, they tend to be rewarded by significant additional revenue.

There are several different approaches to raising more tax from the overlapping tax base. Firstly is to collect more of the tax which is already due under the current tax system, by reducing opportunities for 'base erosion and profit shifting' through such measures as strengthening capacity for transfer pricing audits and anti-abuse provisions in tax treaties. Secondly, is for developing countries themselves to review and revise tax incentive such as tax holidays or other special tax provisions offered to foreign investors. A third approach that is advocated is to reform the basis of the international tax system more fundamentally to shift the balance between taxation rights of source and residence countries.

3.3. The hidden tax base

The hidden tax base is the most difficult to estimate, precisely because it is hidden. Annette Alstadsæter, Niels Johannesen and Gabriel Zucman (2017) estimates that 8 percent of the world's household financial wealth or some $7.6 trillion is located in 'tax haven's (the top locations being Switzerland, Hong Kong, Singapore, UK, Luxembourg, Cayman and the US). However while Zucman assumes that much of the income on this wealth evades tax, there are many reasons for individuals to hold wealth abroad and in international financial centres, including to facilitate international investment and as protection against political and economic instability.

Figure 3: Reasons for using offshore structures


HARMFUL
Criminal enterprise: Corrupt dealings, proceeds of crime, terrorist financing
Tax evasion: Unreported earnings
DEBATEABLE
Protection of assets from creditors, plaintiffs, family members
Avoid capital gains tax through indirect transfers of assets
Jurisdiction shopping, eg between common law and civil law on inheritance
Access to more competitive tax rates
Access to tax treaties—treaty shopping?
USEFUL
Privacy of financial matters
Protection against expropriation
International investment: Tax-neutral place to combine capital from different sources, well established legal architecture, security

Zucman has argued that 80 percent of the income from household wealth held offshore is undeclared in their home country. However this assumption is based on very few data points, and seems difficult to sustain, particularly given increasing information exchange.[9] The economies with the highest levels of offshore wealth as a percentage of GDP tend to be current or recent autocracies, such as UAE, Venezuela, Saudi Arabia, Russia, Argentina, Greece and Egypt, where concern about security and expropriation is likely to be a larger factor than tax evasion.

There is broad agreement that the use of 'shell companies' and opaque financial structures to hide assets from law enforcement (i.e. 'the hidden tax base') for the purposes of tax evasion, corruption or impunity from any other crime should be prevented. Automatic exchange of information on financial account information is closing down opportunities for individuals to use offshore jurisdictions to evade taxes. Jurisdictions are cooperating in the recovery of stolen assets including involving grand corruption by former heads of state and other 'politically exposed persons' (PEPs) (Swiss Confederation, 2014)

While offshore finance can be one means through which high net worth individuals ('HNWIs') evade taxation, it is not the only or necessarily the most important one.

[9] https://hiyamaya.wordpress.com/2016/05/26/190bn-and-counting-measuring-offshore-tax-losses/

Indonesia, for example, held an amnesty on undeclared wealth that brought $379 billion of previously undeclared assets into the tax base by October 2016, and was expected to raise $12.5 billion of additional revenues. Only one quarter of the total of previously undeclared assets were held abroad (mainly in Singapore), and even after citizens declared the assets and paid the wealth tax due, most chose to keep these investments offshore for non-tax related reasons.[10] Research in Uganda by the International Centre for Tax and Development found wealthy individuals had significant investment in local land and property, and under-declare their income from activities such as letting out commercial properties, operating fleets of commercial vehicles, running hardware stores, and engaging in commercial agriculture. The researchers looked at 71 high-ranking government officials owning large domestic business assets (like hotels, schools and media houses), and found that, without resorting to offshore structures only one had ever paid personal income tax between 2011 and 2014 (Kangave et al, 2016). This income then forms part of the domestic tax base, which is not hidden through complex international structures, but is simply undeclared.

3.4. Could there be $9 of domestic tax gains for every $1 of international?

While there are significant challenges to assessing unrealised tax potential in different parts of the tax base (particularly the hidden tax base), some rough quantitative measures can be compared to give a sense of scale at a country level.

Figure 4: Estimating revenue at stake from tax potential of different tax bases

Tax base	Estimate approach	Ballpark figure % of GDP[11]
Overlapping international tax base	**Base erosion and profit shifting—**10% of CIT (OECD)	**0.3%**
	Taxing at source (GDP-GNI) x tax rate * (use 25% as approximation)	**0.9%**
Broad domestic tax base	**'Tax capacity'** difference between IMF Tax Capacity estimates & existing revenues as a percentage of GDP (Fennocieto &Pessino, 2013—using Mundlack Random Effects Model)	10%
Hidden (offshore) tax base	Tax offshore interest attributing Zucman (2015) estimates by region on basis of GDP per capita	0.2%

[10] www.straitstimes.com/asia/se-asia/indonesia-tax-amnesty-hits-90-of-target

[11] BEPs, 'tax the gap' and 'unused tax capacity' measures draw on basic data tax, GDP and GNI data from ICTD and the World Bank from Argentina, Ghana, Thailand, Mexico, Dominican Republic, Honduras, Guatemala, Kenya, Costa Rica, Brazil, South Africa, Peru, Pakistan, Jamaica, Egypt, Morocco, Senegal, Nigeria, Namibia, Tunisia, Philippines, Bolivia and Paraguay (these are the countries where it was possible to undertake all three calculations).

For the **overlapping tax base,** two different approaches are used:

The OECD estimates that base erosion and profit shifting amounts to 4-10 percent of overall corporate income tax receipts (which provide on average 16 percent of government revenues in developing countries, or 2 percent of GDP) (Johansson et al, 2017). Similarly UNCTAD (2015) estimate that profit shifting has a tax effect amounting to some 50 percent of current corporate income tax contributions associated with foreign enterprises (amounting to some 1.4 percent of government revenues overall). Thus a rough ball-park measure of the revenue impact of base erosion and profit shifting in developing countries might be around 0.3 percent of GDP. However the actual burden of this taxation may fall on local people—as the IMF argues, "to the extent that capital is internationally mobile, a small country cannot affect the after-tax return required by foreign investors: trying to do so will simply reduce the income of immobile factors (local labor, most likely)" (Cottarelli, 2011).

A study by Ernesto Crivelli, Ruud De Mooij and Michael Keen of the IMF in 2015 suggest that losses to developing countries from multinational tax avoidance might be several times higher—in the order of 1 percent of GDP ($200 billion overall). However this study does not look any measures of the underlying level of FDI, but applies a general relationship to the headline tax rate and GDP of a country. A study by Alex Cobham and Petr Janský (2017) provides a breakdown by country, and notes that the methodology leads to some hard-to-believe findings. For example, Chad is said to be losing corporate tax revenues worth some 8 percent of its GDP. Pakistan is said to be similarly losing tax revenues worth 5 percent of GDP. For this to be true untaxed profits related to multinational affiliates and home-based multinational corporations would account for 20 percent of GDP in Chad, and 14 percent in Pakistan—suggesting that the multinational corporate sector is be more prominent in these economies than in countries such as the UK and Denmark where the corporate tax base is around 11 percent of GDP.

A recent study in South Africa, using confidential tax return data from 2000 foreign subsidiaries, estimated that they shifted 7 percent of their profits out of the country—this reduces the total corporate tax base by 1 per cent, implying that profit shifting removes 0.2 per cent of the total tax base in South Africa or lowers the tax–GDP ratio by 0.05 percentage points (Reynolds & Wier, 2016).

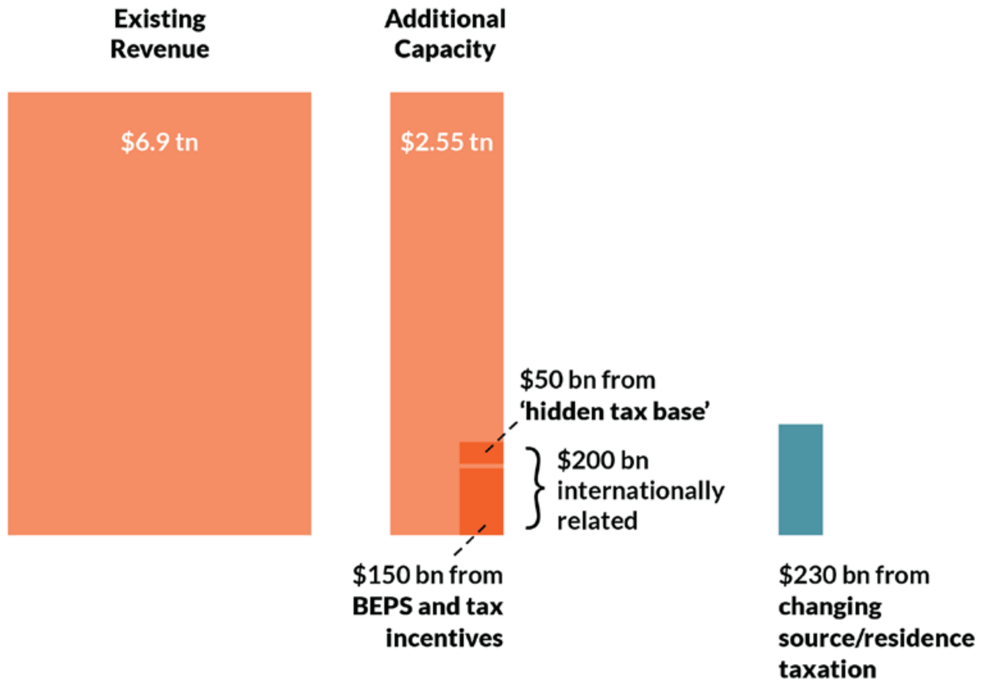
This paper also suggests a second approach to considering how much revenues might be gained if the basis of international taxation were changed to shift the balance between taxation rights of source and residence countries. Very approximately we can think about this in terms of the gap between Gross Domestic Product (GDP) and Gross National Income (GNI). GDP is a measure of a country's overall economic output, including all goods and services produced within the borders of a nation. GNI takes into account income obtained from or remitted to other countries as dividends, interests and the wages earned by temporary migrants (such as cross border commuters). Existing tax treaties tend to result in dividends and interest being taxed in the country where they are received, while reducing (sometimes to zero) the amount of withholding tax levied on them in the source country. Thus the gap between GDP and GNI is a very rough measure (dependent on the quality of these statistics) of how much the apparent economic output of the country in fact relates to foreign owned enterprises—thus 'taxing the gap' provides a very rough measure of the net scale of revenues at stake from shift aligning a country's tax base closer to GDP than GNI by favouring source taxation, and reducing residence taxation.[12] For the 20 countries with a positive gap, the unweighted average revenue associated with 'taxing the gap' was around 0.9 percent of GDP.

While there are not individual country estimates of the **hidden tax base**, Zucman (2015) provides estimates of offshore holdings on a regional basis—which suggest that if 80 percent of returns on offshore investments are going untaxed this could amount to 0.1 percent of GDP in Asia, 0.2 percent in Latin America and 0.3 percent in Africa.

These estimates (while very rough) indicate that measures focused on capturing more revenues from the global tax commons (overlapping and hidden) tax bases can generate significant amounts, they are not huge compared to existing revenues, to broader unused tax potential across the economy as a whole, or to additional absolute revenues which would be generated by sustained economic growth. The figure below illustrates this based on 2012 figures where overall tax revenues for developing and emerging economies were $6.9 trillion.

[12] For example for a country such as Ireland which has attracted a massive scale of international investment compared to its domestic market this difference is very marked—While Ireland's GDP in 2016 stood at €275.6 billion, its modified GNI (excluding the effects of the profits of re-domiciled companies, depreciation of intellectual property products and aircraft leasing companies) was only €189.2 billion in 2016 (Central Statistics Office of Ireland, 2017)

Figure 5: Ballpark estimates of additional potential revenues related to different tax bases for developing and emerging economies (2012 figures)



The following chapter looks in more detail at what some of the opportunities for collecting additional tax could be.

4. "Dangling fruit": Opportunities waiting to be plucked?

Mick Moore and Wilson Prichard (2017) at the International Centre for Tax and Development highlight eight areas of opportunity ("dangling fruit") for low income countries from across the domestic, overlapping and hidden tax bases.

Figure 6: Opportunities for collecting additional revenue

Tax Base	Dangling Fruit
Domestic	VAT
	Property Tax
	Tobacco and alcohol
	Government as a tax citizen
	Tax expenditures
	Personal tax on wealthy individuals
Hidden	
Overlapping	Extractives sector (NB:some of this is in the domestic tax base) Transfer pricing

1. **VAT.** Value added tax (VAT) has been adopted in many low and middle-income countries, often as a replacement for pre-existing sales or turnover taxes, and is now the largest single source of revenue. Collection rates are rising, but VAT 'gaps' are thought to be significant, for example 50–60 percent in Indonesia and Mozambique, for instance, compared to 13 percent in the United Kingdom. (Cotarelli, 2011). VAT systems have the advantage of catalyzing improved tax administration and record keeping by businesses. Collecting more VAT requires improved enforcement but may also involve reviewing systems of reduced rates and exemptions which are not always well targeted (Abramovsky et al. , 2017). VAT refunds for exporters are a necessary part of VAT systems but face problems of fraud and corruption on one hand (e.g.: 'carousel fraud') and denial of legitimate refunds on the other. Such denials happen in part because of fraud controls, but are also because of weak treasury management. Opportunities for improvement include reviewing and simplifying VAT rates and exemptions, and taking a risk-based approach to verifying refunds, giving prompt refunds for firms with good compliance records (Harrison and Krelove, 2005).

2. **Property Taxes.** Despite being widely recognized as an economically efficient, administratively straightforward and progressive way to collect revenue, property taxes are rarely used in low-income countries. In most OECD countries, property taxes account for 1-2 per cent of GDP, while in low income countries where there is data they amount to 0.1-0.2 per cent of GDP. Successful approaches to widening the base of property tax suggest simplifying the assessment of property values and concentrating the institutional responsibility for tax collection in the hands of authorities with strong incentives to collect significant revenue. The barrier to property taxes appears to be largely political; as they tend to tax the very economic and political elites who have the power to their power to prevent them being enacted or enforced (Moore and Prichard, 2017).

3. **Tobacco and Alcohol.** Taxes on products such as tobacco and alcohol serve the dual goals of reducing harmful consumption and raising revenues. It is estimated that taxes on cigarettes in developing countries generated US$ 216 billion in revenues overall or 3.3 percent of government revenues. Raising cigarette excise by US$ 0.25 per pack in all developing countries would decrease smoking by 4 percent and generate an extra US$ 45 billion in revenue (mainly in middle income countries, but with the greatest relative increases in low-income countries) (Goodchild et al., 2017). There are many successful examples of tax policy reform among developing countries, including raising and standardizing excise rates, and controlling Illicit trade through "track-and-trace" systems in the tobacco supply chain, however public policy in small poor countries is especially vulnerable to political influencing activities by the tobacco industry. Regional harmonization in excise tax regimes would reduce the incentives for smuggling.

4. **Tax Expenditures.** Tax credits, exemptions, and rate reductions are a means by which governments give direct subsidies to a subset of taxpayers (including both foreign and domestic investors, as well as consumers). While data is patchy overall they appear to be non-trivial amounts of money, estimated at 2 percent of GDP in Ghana, 2.5 percent of GDP in Kenya and Tanzania, and 5 percent of GDP in Brazil. On tax incentives offered to foreign investors, Martin Hearson (2013) estimates that tax incentives related to corporate income tax averages 0.5-0.6 percent of GDP. Some tax expenditures are a normal part of the tax system (such as capital allowances and import tax refunds for exporters) and in countries with large informal sectors and tax evasion pressures, tax incentives can be a means of preventing firms from shifting into the informal sector or evasion-prone activities (Jun,2017). However tax experts have argued for many years that overall tax exemptions for investment are excessive and ineffective and are often used as a tool to reward political allies, provide leverage over potential opponents, or raise money, both for private and political gain (Moore and Prichard, 2017). Recommendations are that where they are used they should be based on clear criteria, transparently granted and monitored, with a clear time limit.

5. **Government as a tax citizen.** Moore and Prichard (2017) also highlight the importance of cooperation between government agencies in in their roles as direct tax payers, tax collection intermediaries and as clients and procurers.

Problems include long delays in remitting (and sometimes failing to ever remit) VAT, motor vehicle license fees, royalties on natural resource extraction, the PAYE taxes of government employees or withholding taxes on public sector contracts. Public sector agencies may also decline to provide the tax authority with information such as on the non-salary benefits given to public sector employees or of the identity of recipients of major public sector contracts. Another issue which could also be raised here is the insistence by donor countries for special tax treatment of donor-funded projects (including private contractors, local employment taxes etc..). In addition to the revenue implications, in countries with small formal economies where donor-funded activities make up a significant part of the tax base, the incentives to improve tax policy and administration may also be weakened, while capacity is diverted into processing tax exemption claims related to aid funded projects (Brosio et al. 2018).

6. **Personal income tax on the rich.** Personal income taxes amount to an average of about 10 per cent of GDP in wealthy countries, but for only 2 per cent in low income countries. This reflects both that many people are too poor to pay personal income tax, but also that rich people who own property, hotels, schools and other businesses as well as lawyers, private doctors and others in private practice typically pay relatively low taxes on both their assets and their incomes. While offshore tax evasion is not the only route by which elites get away with paying little tax, international exchange of information is a key mechanism to make hiding assets offshore more difficult, and both developing countries and developed country partners should work to ensure that access to automatic exchange of information is expanded, and collaborate to support revenue authorities to use this information. However ultimately the question of how much tax domestic elites pay depends as much on the political settlement mad by elites than on the particular mechanisms of property taxation, banking information or the external data made available internationally.

7. **Extractives sector.** Revenues from oil, gas and mining make a critical contribution to the revenues of resource rich countries, with the bulk of this coming from multinational enterprises. To effectively collect an adequate share of natural resource wealth requires that governments design and implement a fiscal regime that raises revenue without undermining incentives for investment and can cope with price volatility. Options include combinations of royalties and profit taxes, "windfall" taxes, equity participation, export taxes, auctioning of exploitation rights and cash flow taxes. Implementation of transfer pricing, controls on thin capitalization and treatment of capital gains are critical to protect against revenue losses (Daniel et al. 2017) Many developing country governments, together with international organisations and donors are working to strengthen capacity to build and administer tax systems that are robust enough to prevent base erosion and profit shifting in extractives sectors (Readhead, 2017). However in practice rents from natural resources are not only divided between transnational investors and government treasuries, but are often captured through corruption and collusion by political elites.

8. **Transfer pricing.** Developing the capacity for taxing multinationals is crucial for all countries, and most developing countries now have some framework for transfer pricing. However they often but lack strong capacity for audit, enforcement, and dispute resolution. The OECD (2014) notes gaps in developing country tax legislation, together with low audit capacity, are likely to mean that developing countries facing cruder or more aggressive tax avoidance than typically encountered in more advanced economies. This means that there can be good returns from strengthening enforcement. The experience of technical support for transfer pricing audits in low-income countries there can be high returns on public investment Moore and Prichard (2017) report that aid for transfer pricing in Zambia and Tanzania has resulted in returns of 10:1 and 100:1 respectively. Approaches such as safe harbours and simplification measures that target specific transaction types and situations can also be used (Cooper et al. 2017).

Moore and Prichard guesstimate that each of these areas has the potential to raise the tax take by 1-2 percent of GDP over a period of five to ten years.[13] The IMF, highlighting a similar set of areas, suggests that in Sub-Saharan Africa there is potential for many countries to raise tax revenues by about one percent of GDP per year over the next five or so years (Gaspar and Selassie, 2017). As with the broader estimates of the size of the domestic, overlapping and hidden tax bases, the balance of opportunities suggests that while there are revenue gains to be made in relation to cross-border tax issues, they do not make up the bulk of domestic resource mobilisation opportunities.

In most cases the 'tax is political' story seems to offer a better explanation for why particular opportunities are or are not being implemented, rather than 'fix cross border taxation,' or indeed lack of technical capacity or access to capacity building. As Moore and Prichard say "relative to other organisational domains, many potential improvements in tax administration require neither significant financial expenditure nor large improvements in technical expertise. Instead, they demand only a political commitment to improvement strong enough to overcome vested interests among taxpayers, politicians and tax administrators themselves."

[13] However it is worth noting that these areas are not necessarily additive. For resource-rich low-income countries 'the extractive sector,' 'taxing multinationals' and 'tackling tax exemptions' largely focuses on the same part of the tax base. Similarly property taxes and the personal income taxes on the rich are likely to be paid by the same narrow group of people.

5. Why great expectations can be dangerous

Countries should certainly cooperate to close loopholes in the international tax system, and developed countries should use the levers they have to support developing countries on cross-border taxation, going beyond technical assistance to cooperating on exchange of information, and considering alternatives to traditional approaches to transfer pricing. They should also be open to considering whether the global tax framework should have a different source/residence balance than the one we have today.

There are choices to make in sequencing and determining how much limited capacity to invest in domestic and international tax areas. Annet Ogutu argues that "developing countries (such as those in Africa) may not necessarily have the same concerns about BEPS as developed countries" (Ogutu, 2016). Similarly, professor Jeffrey Owens argues that "in a typical developing country, the first priority is to get your tax administration working. Because without that, you can have whatever international arrangements you want, but you're not going to be able to do transfer pricing properly; you're not going to be able to exchange and use information" (Owens and Lennard, 2014). For example receiving automatic information on the offshore holdings of citizens requires significant investment in legislation, administration and hardware to collect, store, and encrypt the data. Implementing these changes competes with other areas of tax administration and should be done on the basis of genuine priority and not inflated expectations of potential yield.

In practice tax which appears to be paid by foreign investors can in fact result in an economic burden falling on local people. Furthermore, as we have seen the absolute amounts of tax at stake from tackling multinational tax avoidance, or even making more significant changes in the source-residence basis of international taxation, are not as large as they have often been perceived.

More fundamentally, it should be recognised that using international agreements to strong-arm taxpayers into paying more tax than has been secured as part of a social contract, or is supported by underlying economic prospects, is likely to be impossible (and undesirable). Closing BEPS loopholes will bring the tax system more up to date but will raise pressure to shift the location of real investment, and therefore also for countries to reduce their tax rate to attract investment (Keen and Konrad, 2012).

There is a danger that an intense focus on the appealing potential of collecting more tax from the overlapping and hidden tax bases could backfire and create negative impacts for development. This danger has two aspects; (1) a negative impact on investment and economic growth and (2) a negative impact on government accountability.

5.1. Deterring investment

Too much tax, and too much uncertainty can negative impact on investment and growth. Many developing countries already set a relatively high level of taxes on business (including profit taxes, employment taxes, important taxes and other fees and levies). The World Bank's Paying Taxes report notes that in sub-Saharan Africa, effective tax rates facing medium-sized companies are 7 percentage points higher than the world average (World Bank/PWC, 2017). These taxes-on-paper may in practice be mitigated by tax exemptions, avoidance or evasion, but these mechanisms themselves create further costs and inefficiencies.

While there is imperfect data on the tax burden experienced by businesses, firms themselves respond to the actual costs they experience, rather than the statistics. Effective tax rates ought to matter: they are factored into the discounted cash-flow analyses that large, formal sector business commonly use for project level investment decision making. Firms consider the projected internal rate of return (IRR) of projects after all taxes and costs are considered.

If taxation is carried out capriciously, with high levels of policy and administrative uncertainty, it is likely to be particularly damaging for the investment environment. A recent OECD survey of senior tax leaders in multinational companies from across the G20 found that they rated corruption as the main factor effecting investment location decisions, followed by political certainty. The tax environment came third, followed by macroeconomic stability (OECD/IMF, 2017). Within taxation the most important factor was not the overall tax rate, but uncertainty.

Tax uncertainty (either because of unstable policy, administrative practices or the political granting and removal of tax incentives) this is likely to lead to the worst of all outcomes—firms discount the value of tax breaks or lower tax rates promised as they do not trust that they will be sustained. This means that each dollar of tax benefit transferred from government to businesses produces a lower effect in terms of investment incentive. Policy instability create a triple-whammy against the effective use of tax incentives. Firstly it translates into immediate business costs such as unreliable electricity supply and lack of infrastructure. Secondly the general perception of country-risk raises the investor's hurdle rate for investment, and thirdly it reduces the trust that companies put in the specific tax incentives. A study by the World Bank (2017) for example finds that the marginal effective tax rate has eight times the impact on investment for countries in the top half of the "Doing Business" index than those in the bottom half.

The danger of raised expectations, and intensive focus on multinational taxation can be seen in the relationship between business and the tax authorities in many countries. Complex businesses require clear rules, carefully applied. Best practice is to move towards "collaborative compliance," where large taxpayers disclose their tax affairs early and discuss issues with tax authorities. But in many countries, businesses and tax authorities have much poorer relationships. Large businesses are frequently targeted by audits driven by revenue targets or by public and political pressure. VAT refunds may be withheld to cover budget shortfalls. Taxpayers see themselves as pressured by an ineffective and unreasonable administration, and move to limit their exposure to weak legal systems, using business models that concentrate activities and asset ownership in core jurisdictions, and adopt pricing approaches that limit income in developing. (MacClean, 2017). Some exploit weaknesses through uncooperative approaches and opaque practices. Politicians, the public and tax administrations see taxpayers acting uncooperatively and there is pressure to redouble efforts to counter this behaviour. They may be stymied in these efforts by a lack of understanding of increasingly complex business models. The OECD (2015) cautions that "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."

Another vicious cycle arises when businesses lobby for tax exemptions. This can be seen in Tanzania, for example, where both domestic and foreign companies lobbied for exemptions to the VAT system, creating complexity that opened up opportunities for abuse and avoidance. Business representatives reflected that in practice tax incentives are not of major importance in their decision whether to invest; instead, they would prefer a simple and predictable tax regime and improved efficiency and transparency in the public administration to reduce corruption. However, in the face of a system where the tax regime is seen as unreliable and incentives are granted to other companies and sectors in a non-transparent way, they remain locked into arguing for tax exemptions to secure their own competiveness whilst undermining the overall investment environment (Fjeldstad, Rakner and Ngowi, 2015).

David Manley (2012) describes the controversy and the history of Zambia's mining taxation regime—the push and pull of secrecy and leaked documents, public pressure and government and industry brinkmanship, and the swinging pendulum of reforms that has resulted. Fiscal policy design in extractives is subject to the "obsolescing bargain" problem, which combined with commodity price volatility and overheated public expectations can lead to a trap of low-performing unstable investment environments. In particular he argues that there is a trade-off between regressive royalty-based regimes and progressive profit-based systems.[14] Royalties deliver earlier public payouts and are less vulnerable to avoidance, but are susceptible to continual renegotiation pressures. Profit-based taxes are responsive to price changes and underlying costs, but depend on the capacity of revenue authorities to administer things like transfer pricing and to secure public confidence in the system. The implication of this trade-off in natural resource taxation is that if perceptions of avoidance are exaggerated, it is likely to drive countries towards less economically beneficial solutions than they could have had, with greater instability and less constructive relationships between industry, government, and citizens. None of this is good for development.

5.2. Undermining accountability

Fiscal policy is critical to economic growth by supporting macroeconomic stability, and through financing infrastructure and public services, but this depends on fiscal discipline, public financial management and effective spending.

Taxation is fundamentally political since it involves transfers from one group to another. Raising more revenues from the 'overlapping tax base' is politically attractive in in both developed and developing countries since it appears to place a tax burden on foreign shareholders, who are both rich and non-voters. It is also a morally attractive proposition for citizens in rich countries concerned with global development as it appears to transfer additional revenues from rich shareholders to poor countries,

[14] 'Regressive' and 'progressive' in relation to fiscal policies in mining, oil and gas relate to the project's earnings rather than the more general use of the terms in relation to the balance across the population. Royalties are 'regressive' because they do not rise with profitability.

without drawing from their own general tax bill in the way that aid does. However if governments and citizens believe that there is a large windfall to come from non-voters, they will be less vigilant in monitoring spending and holding government account for 'taxpayers money.' This effect is part of what is observed as the 'resource curse.' James Cust and David Mihalyi (2017) find evidence for a "Presource Curse" in which oil discoveries lead to elevated expectations, fiscal indiscipline and economic growth disappointments, even before the oil starts flowing.

One area of great hope is the idea of "Open Government" in pursuit of accountability through transparency. The aim is to challenge corruption and build a more effective social contract around taxation and spending, which in turn supports greater tax compliance and transformed governance. The focus on tax justice by international NGOs is often undertaken within this broad frame which links fiscal transparency and citizen participation. It brings together government reformers, civil society organisations and international organisations to ensure the public availability of comprehensive and timely information about natural resource revenues, public budgets and public contracts and concessions (Folscher and de Renzio, 2017). Much effort and resource has been invested in these initiatives (for example 300 people work in the 51 national secretariats of the Extractive Industry Transparency Initiative (EITI), 400 NGOs and are involved and over 1,000 people serve on multi-stakeholder groups with $50 million is spent globally every year to support EITI reporting (GIZ, 2016)). Attention is increasingly turning to the examining evidence of what is working, and how open government initiatives can move beyond a pure focus on 'open data' to enabling real accountability (see Williamson and Eisen, 2016 and Carothers, 2016).

Donors (such as the EU, Norway, Finland, Netherlands and also major foundations) are working to build networks of stakeholders and informed debate on taxation issues domestically as well as interntionally (see, for example, the maketaxfair.net project by Oxfam Novib and Tax Justice Africa, and the approach to supporting citizen engagement on tax taken by Save the Children).

All of these initiatives depend on informed and honest analysis. Inflated expectations undermine this public debate, and allows governments to deflect accountability. The International Budget Partnership notes that "despite the recent [international] attention, a gap remains between the level of engagement in global policy debates and the level of meaningful civil society participation in revenue debates in most countries in the world"(IBP, 2016). If civil society organisations allow themselves to be distracted, and to distract the public with the promise of "Don't Tax You. Don't Tax Me. Tax That Fellow Behind the Tree" they risk undermining the critical process of accountability rather than supporting it.

6. Exploring synergies: A new narrative

"Fix cross-border taxation" and "tax is political" are not two competing teams of adversaries to which supporters are obliged to pick sides. Rather they are descriptions of different aspects of the challenge of taxation for sustainable development. No country can develop its tax system without considering international aspects. But no country can collect a large proportion of GDP as taxation without a large proportion of people in the economy bearing the burden, and for this to support human development requires consent.

Often international debates and action on tax and development, whether focused on domestic or cross-border aspects seem to suggest that countries can 'tax themselves to prosperity' by either adopting the best practice tax systems, or shifting tax revenues directly between the tax base of richer to poorer countries. Both approaches are likely to yield some results, but be limited, on one hand because reforms face institutional or political resistance, and because underlying scale of the overlapping and hidden tax bases is limited.

While it might seem attractive to use the international tax system as a form of off-budget budget support to shift resources to small and poor economies, there is little appetite for this in developed countries. Similarly appeals to morality in taxation seem to be the wrong domain. However there may be more potential synergies between international and domestic action, than are currently being pursued. This requires that we think about tax for development not within the 'financing for development' frame of zero-sum transfers but, within the frame of sustainable economic growth.

6.1. From deals to rules

The pathway from being a poor-low tax country where voters do not expect tax authorities to treat them fairly or government to spend their money accountably, to being a rich country where government is held accountable for tax and spending, is not achieved through a build-up of technical tax reforms, but through the development of a productive economy and a social contract. The capacity to tax is fundamentally linked to establishing law and order within a territory and the interest of economic elites in doing so.

In richer countries, sustained incremental growth has led to diverse economies that rely on complex networks of tacit and distributed knowledge. It is this diversity and interdependency that give rise to strong bargaining power between different groups, enabling support for impersonal rules of governance that support investment, protection of property (which can be taxed), higher wages (which can be taxed), and the responsiveness of governments to the median voter. Thus in rich countries tax collection is largely governed by rules and implemented consensually, and a high proportion of GDP goes to public spending and redistribution. Poorer economies tend to be less diverse, producing fewer and simpler products, in many cases based on a few natural resources. This results in higher levels of inequality and thus concentration of political power (Hartmann et al., 2017). The social contract is not governed by rules but by deals that depend on personal status and informal negotiation. Redistribution does take place, but it is outside of the formal system of government budgets (Kahn, 2010). The constraints to changing the tax system reflects these broader dynamics.

Lant Pritchett and Eric Werker (2012) note that the political economy of the generation of fair, enforced rules—and therefore inclusive growth—is tied to the relationship of the domestic elite to international economic opportunities. More efficient firms tend to do better in investment environments where more of the transfers to and from the business (including taxation) are through official 'rules' based channels, whereas less efficient ones will out-compete them where rents can be earned through informally negotiated 'deals.' They argue that we should stop thinking of the private sector as a homogenous group but look at the microclimates for different kinds of firms, based on the relationship between local elites and international market players, and how these can give rise to constituencies for reform. They offer a useful framework for considering the 'product space' from which rents are derived and distributed (see figure 7) divided into four broad sectors depending on whether the firms are export-oriented or serve domestic markets, and whether they are high-rent or competitive.

Figure 7: The Market Matrix

	High-rent	Competitive
Export oriented	**RENTIERS** Natural resource exporters Agricultural concession exporters	**MAGICIANS** Manufacturing and service exporters Horticultural & other agricultural exporters Tourism
Domestic production & consumption	**POWERBROKERS** Legislative monopolies Natural monopolies Government services Banking & financial services Landlords	**WORKHORSES** Importers Traders & retailers Subsistence farmers Local manufacturers Non-tradable services restaurants, building, healthcare, social care.

Source: based on Prichett and Werker (2012)

For example, Jonathan Said and Khwima Singini (2014) map the product space in Malawi

Figure 8: The product space in Malawi (2012)

	High-rent	Competitive
Export oriented	**RENTIERS** Tobacco (54% of exports) Mining (12% of exports but declining) Tea 6% of exports Tourism (3% of exports Coffee (1% of exports) Cotton (2% of exports)	**MAGICIANS** Beverages (juice—1 company) Some manufacturing Some small tobacco buyers Numerous small tourism players Some exporters of groundnuts, rice etc…
Domestic production & consumption	**POWERBROKERS** Farm inputs (dependent on government procurement Beverages (beer, spirits—1 main company Meat and Dairy—10 main companies Packaging and plastics (5 main companies) Agricultural commodity processing (8 companies s) Electricity (1% of GDP), 1 state company Construction (5% of GDP) Financial services (7% of GDP, (dominated by 3 main banks Telecommunications (4% of GDP) Large retailers (supermarkets) (14% of GDP) Transport and storage services (4% of GDP) Large professional service providers Fuel importation (3 main players) Government services (health, education, justice, water, immigration, etc.) Approximately 120,000 civil servants	**WORKHORSES** Millions of smallholder farmer households—80%+ of population Some small manufacturers Numerous informal retailers and distributors(close to 800,000) Some smaller foreign banks that have entered Malawi in past 10 years—Some small oil seed processors and Numerous smallholder fishermen— Thousands of smallholder energy providers (charcoal)

Each sector can be important for development, and faces a somewhat different taxation environment. *Rentiers* and *powerbroker* sectors tend to generate tend to generate large rents (and therefore taxes) and can sustain a narrow political elite. However *magicians* are often the engine of development through export-oriented industrial upgrading and employment, while *workhorses* provide the vast majority of employment and services to ordinary people. Elites in the rentier and powerbroker sectors can be relatively successful in 'deals' based environment—securing resources and political power, but in the case of powerbrokers passing costs on to domestic consumers in the form of more expensive and poorer services. Magicians generally depend on aspects of a rules based environment in order to thrive and become internationally competitive

Pritchett and Werker argue that three forces are critical in transformations from deals to rules: constituencies for reform, stable coalitions of power and the dynamics between economic performance and constituencies. General reforms that improve the national 'investment climate' are unlikely to work because there is a huge variation for firms within the same country, depending on their sector, their political connections and the degree to which they are willing and able to engage in deal making. Successful policies emerge as the consolidation of emergent practices that muddle or struggle their way into existence in particular sectors, and as a result of particular economic opportunities, rather than as 'big bang' strategic efforts.

This suggests that we should consider not only the economic and legal capacity to extract additional taxes from different areas of the taxbase, but also how international economic players relate to local constituencies for reform.

6.2. The role of MNCs: Beyond making the compliant more compliant

Multinational corporations (particularly large shareholder-owned companies) have an interest in the development of rules-based tax systems. They tend to operate though standardised and formalised operating procedures and codes of conduct as a matter of operational efficiency. They tend to aim to follow the letter of the law, but may lobby for tax incentives and exemptions, and structure their operations 'optimise' their tax bill. Shareholder owned MNCs are unlikely to undertake basic tax evasion such as hiding funds offshore (for example in anonymous shell companies) which would mean employees defrauding shareholders. However the could engage in evasion by creating schemes to create tax losses that relied on a false declaration or deliberately miscategorising expenditure to claim a relief. In general major multinationals tend to be amongst the most tax-compliant entities in developing countries. For example, as ATAF (2014) note the risks associated with the large MNEs are likely to be in the nature of tax avoidance, some of which might be sophisticated—e.g. involving complex but well documented, transfer pricing design. The risk of illegal or fraudulent activity is relatively low. Aggressive or poorly document transfer pricing risks are more often associated with medium or small MNEs and closely held companies where financial flows can be diverted to secretly owned shell companies.

At the same time companies can be involved in grand corruption involving making large side-payments in order to win contracts, license and concessions. Firms are both victims of rent-seeking and corruption as well as, at times, willingly or unwillingly participants. However different multinationals have different levels of appetite for engaging in corrupt practices. One story told by the African Investigative Publishing Collective (2017) about mining companies in Democratic Republic of Congo illustrates the tension between rule-following and corrupt deal-making tendencies and how companies with higher standards can be forced to out in favour of those with fewer scruples: "An account by a former senior engineer of Canadian First Quantum mines illustrates: *'In 2009, when we tried to pay the Direction Generale des Impots (DGI) our due US$ sixty million in tax, one of the directors told us to pay him four million, pay six million to the government and keep the rest, because 'no one here pays tax.' We refused." Months later, First Quantum had its copper mine seized and re-sold to President Kabila's friend, mining tycoon 'Mr Grab' Dan Gertler."*

Little is known about the broader impact of multinational tax practice on the tax policy and administration of host countries. Rather than solely focusing on making the most compliant more compliant, this may be a fruitful area for exploration. Leveraging influence on multinational corporations has often been used as a strategy by governments and civil society organisations seeking to break vicious cycles; political, consumer, and investor pressure has led companies to adopt practices such as carbon emissions accounting and reduction, human rights due diligence, and supply chain labour standards audits. Companies may then become advocates for legal reforms and better enforcement, and for international cooperation.

Multinationals have an interest in securing public confidence in the tax system to prevent toxic uncertainty and risk. However there are notable barriers to private sector involvement in tax system reform, including lack of mutual understanding, miscommunication and real or perceived conflicts of interest There seems to be underexplored potential for improving the state of public and policymaker debate and understanding on taxation, and bringing private sector expertise and resources into collaboration with tax authorities with appropriate safeguards.[15]

Both developed and developing countries could gain from developing medium-term tax strategies—indeed, the Concept Note on the Medium-Term Revenue Strategy (IMF/OECD/UN/WB, 2017) suggests that medium-term tax strategies can be used by all countries. These might start for example as Business Tax Roadmaps aimed at domestic stakeholder engagement and certainty.

6.3. The role of third countries: Can offshore finance be developmental?

International Financial Centres (IFCs) are often highlighted as 'tax havens' and blamed for the ills in the international tax system. However the linkage between IFCs and economic growth and development is largely unexplored, other than through reference to large but unreliable estimates of illicit flows. Is the ability to shop around for legal jurisdictions unfair or valuable, given that governments are not universally competent or benevolent? Within the framework of 'deals and rules' it can be argued that IFCs complement developing country investment environment, enabling international investors to access a more rules based environment than those that are available in the country where they are investing. As Huang (2008) argues, "China's success has less to do with creating efficient institutions and more to do with permitting access to efficient institutions outside of China."

Investors cite simple, flexible, modern, sophisticated, and impartially enforced regulations and laws allowing ease of incorporation, the ability to reduce capital and issue different classes of shares, flexibility of corporate structures and tax neutrality as a reason for using IFCs to structure investment vehicles (Challoner et al, 2011, Aima, 2016). International financial institutions also offer similar rationales to commercial investors

[15] For example see suggestions made by PwC as part of the T20 http://www.g20-insights.org/policy_briefs/tax-collaboration-capacity-building-encouraging-collaboration-private-public-sectors-tax-system-reform/

for using these locations to enable investment (Carter, 2017). IFCs are used as tax-neutral location for combining investment from different locations without adding a layer of taxation between residence and source countries. Similar outcomes could be achieved by structuring funds or joint ventures through locations such as London, but the legal costs would be greater.

Many IFCs argue that they are reorienting themselves and to demonstrate that they not only meet international integrity standards, but that the financial services they offer enable support global.[16] Small states such as Jersey and the British Virgin Islands are increasingly seeking demonstrate that they have strong systems of due diligence and information exchange and contribute to development through their role in facilitating investment, providing the sound and trusted institutions needed to lower transaction costs and facilitate exchange. A key dividing line in debates remains the extent to which those who hold assets through corporate structures should have a right to public privacy about their holdings (i.e. 'compliant confidentiality') as long are they are compliant with tax and other regultions.

All of this suggestions that while International Financial Centres must be held to strong standards of integrity, the idea that they "serve no useful economic purpose" and do not "add to overall global wealth" as 300 economists wrote in 2016, may be ignoring a potentially powerful lever for supporting development.[17]

6.4. Tax treaties, dispute resolution, and other commitment mechanisms

Countries agree tax treaties in order to remove obstacles to the cross-border mobility of people and investment. The aim is to promote the economic development of both countries. Countries can reduce double taxation through domestic legislation, however the advantage of doing it through a tax treaty is that it acts as a commitment device, and an international signal that the country is 'open for business.'

Both the OECD and UN Model Tax Treaties allocate taxing rights to the residence (capital exporting) state and away from the source (capital importing state) as the means to reduce double-taxation. This means that developing countries give up the ability to collect 'Withholding taxes' on interest, royalties or service payments to overseas tax payers. Withholding taxes are simple to enforce, but are economically inefficient as they are gross (turnover) taxes rather than profit or value added taxes . Thus source states elect to lose one form of revenue by design, but seek to make longer term revenue gains by taxing the profits, sales, employment and trade associated with additional inwards investment, which require more sophisticated tax administration.

Many treaties are outdated and show the heavy influence of the former colonial government. Old treaties fail to deal adequately with rapidly-changing business practices while new ones, if care is not taken, can result in unaticipated lost taxing rights, such as

[16] See for example www.cgdev.org/blog/can-swiss-bank-help-deliver-sdgs-podcast-cgds-theo-talbot-and-ubs
[17] Economists call for end of tax havens (May 9 2016) www.ft.com/content/6464c7c0-1525-11e6-b197-a4af20d5575e.)

to income and capital gains in relation to the extractive industries. Tax treaties also open countries up to treaty abuse, although this is now being addressed by the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI). Some have suggested that developing countries could simply terminate existing treaties but that would create uncertainty, potentially harm inward investment, and result in the developing country losing any benefits from the treaty.

One other potential double-edged benefit of tax treaties is dispute resolution through binding arbitration. The MLI encourages countries to commits to resolve disputes through mutual agreement processs (MAP) within two years or go to binding arbitration. This is a commitment device both for tool for building investor trust and confidence in a country's tax system, by providing assurance to investors and encouragement to governments to develop and communicate clear tax laws. However it enhances the negative impact of outdated or poorly negotiated tax treaties whose impact was not anticipated at the time. Many developing countries are wary or opposed to binding arbitration. Furthermore developing countries have little experience of MAP, and building this experience and capacity, and then confidence in arbitration will take some time. Developing countries face challenges such as the high costs of proceedings and lack of capacity. There are particular concerns that arbitrators will be disproportionately from private-sector advisors from developed countries determining how to allocate taxing rights between a developed and a developing country, using their general knowledge, experience, and opinions about the international consensus on various tax matters (Christians, 2012).

It is increasingly argued that low income developing countries should be wary of signing tax treaties, actively reviewing existing tax treaties, and being very careful before signing any new ones. However it may be possible to get beyond this 'all or nothing approach.' Developed countries are called on to undertake 'spillover analysis' of their own tax policies and tax treaties and to ensure their approach to treaty negotiations with low income countries supports development. To date only Ireland has commissioned an independent spillover analysis (IBFD, 2015). The Netherlands commissioned a partial study focused on tax treaties. Both the Irish and the Dutch studies struggled with lack of detailed data to conduct robust econometric analysis. Developing and testing a spillover analysis grounded in available evidence seems worthwhile, as does exploring the potential for an 'MLI for Development'—a way to update treaty networks rapidly to meet the particular concerns of low income countries.

Attention could be given to developing dispute resolution mechanisms that are to be cheaper, simpler and more transparent. Possible solutions are for the costs to be split according to the ability-to-pay principle, or through a trust fund, or by allowing more inexpensive simplified procedures be introduced. Treaty clauses that that create the option of arbitration would also allow developing countries to build experience before deciding whether mandatory and binding arbitration is right for them. Another option that has been suggested is to develop a self-standing arbitration panel under the auspices of the U.N. and OECD. This would allow for standard procedural rules and a panel of arbitrators to be developed. Such a panel could also initiate a training program for future arbitrators from developing countries and address the issue of how to improve the transparency of the process (Kollmann et al., 2015).

7. Eight ideas

Increased public and political engagement, research and civil society attention on taxation is to be welcomed, and offers an opportunity for building momentum and support for reforms to taxation, as well confidence in their stability. However, as we have seen inflated expectations can lead to vicious circles of uncertainty and mistrust. To move beyond antagonism and misunderstandings, policy makers, tax experts, tax payers, tax professionals and advocacy organisations will need to find new ways to engage, debate, collaborate, and learn together, both at an international level and in particular countries.

While there is certainly need for visionary long-term thinking on global tax reform and potential redesign of the tax system, its worth exploring the potential to develop targeted and practical approaches which target taxpayers that are accessible to international policy and influence levers not simply as potential sources of a particular amount of additional revenue, but as potential constituencies for reform in a shift from deals to rules. Here are eight ideas worth testing through engagement with interested parties from government, business, civil society, international organisations and the tax profession:

1. **"An MLI for Development."** The Multilateral Instrument (MLI) has shown how tax treaties can be changed multilaterally. Could an MLI for Development be developed based on a set of minimum treaty provisions which developed & developing countries would agree to collectively, tailored to support the needs of developing countries—for example including minimum withholding tax rates and the treatment of indirect transfers of interest (i.e. capital gains).[18]

2. **Peer review mechanism for responsible tax practice.** Multinational corporations are increasingly publishing tax principles and policies, whether driven by legislation (in the UK), or as a means to take a leadership position and stabilise expectations. However there is no means of assurance. Could companies/ sectors develop a peer review and/or broader assurance process on their practice and performance as responsible tax payers?

3. **Dispute resolution for development.** Dispute resolution and mandatory arbitration provide a means of securing tax certainty, and a commitment mechanism that encourages governments to write clearer laws and to enforce them. What steps should be taken to make dispute resolution mechanisms accessible and useful for low income countries?

4. **Improving the effectiveness of the UN Tax Committee.** The UN Tax Committee plays an important role as a forum for developed and developing countries to address tax issues, beyond and in complement to the OECD processes, however it is constrained by lack of resources and some of its own procedures. How should the UN Tax Committee evolve to make it a more effective forum to serve the needs of developing countries, alongside the OECD and other international bodies?

[18] Thank-you to Heather Self for input on this idea

5. **Business tax roadmaps.** Business tax roadmaps by governments set out plans for business taxes over the medium to give businesses the certainty they need to plan and make the long-term investments, they also provide a focus for broader engagement between stakeholders on the basis and challenges for taxation.

6. **Technology solutions for identity assurance.** The ability to identify the ultimate beneficial owners of accounts and of corporations is crucial to detecting, tracking, and preventing illicit financial flows, and for tax administration. However it does not necessarily follow that all ownership details should be obliged to be publically searchable. Could a blockchain or other technology solution be used to provide a solution for compliant confidentiality, and secure identity and beneficial ownership certification?

7. **Tax simplification for project finance.** Tax uncertainty is a key barrier in developing multi-country investments such as power and infrastructure projects. Bespoke deals often have to be worked out with each country to overcome underlying complexity in the tax system. A model for a simplified system for taxation of project finance could be developed through a multi-sector collaboration involving governments, private sector and DFIs.

8. **A race to the top of International Financial Centres.** Can the characteristics of a responsibly competitive international financial centre be identified and measured? Could there be a Index of responsible competitiveness of financial centres demonstrating integrity and ability to mediate and support investment.

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