Center for Global Development

CGD BRIEF
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Tax and Development:
New Frontiers of Research and Action

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KEY TAKEAWAYS

- Both international and domestic action are important for mobilising domestic resources through taxation.
- Expectations of the revenue at stake from international tax issues are often inflated, with hopes of massive increases in health and education budgets from taxes on multinational corporations and offshore wealth.
- Domestic measures have greater potential for raising tax yields over time. Rough estimates indicate that there may be $9 of additional tax capacity from domestic policy measures for every $1 from international action. The main enabler is political commitment.
- This is a dilemma for international players concerned with domestic resource mobilization; international tax issues are salient, accessible, and morally attractive, but can distract government and civil society from how tax revenues within a country are collected and spent.
- Taxpayers accessible to international rules and influence should be viewed not only as potential sources of incremental tax revenues, but as potential players in constituencies for reform in a transition from “deals to rules” in productive economies.

TAXES ARE FUNDAMENTAL TO DEVELOPMENT

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 (for example, tax certainty, rule of law, ease of compliance); and enabling accountability to citizens over tax policy and public spending.

However, debates among those seeking to invest and grow businesses and to improve investment environ-

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ments, and those seeking to secure public revenues and accountability through domestic resource mobilisation have often been fractious, disconnected or 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. (See box on page 4 for further discussion of inflated expectations of tax revenue.)

POLITICAL COMMITMENT IS USUALLY KEY TO INCREASING TAX REVENUES

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 the potential gain from improving taxation of multinationals and offshore wealth approach 1 percent of GDP, overall estimates of the potential to collect additional tax from across the wide 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 is political commitment strong enough to overcome vested interests among taxpayers, politicians, and tax administrators themselves.

The way we think about tax and the SDGs cannot be simply as a target for incremental revenues. National development involves a shift 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 players from all sides in debates and action on tax and development.

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. They 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 rules rather than the other 9 percent of domestic tax policy while reforms in areas such as property tax and reducing tax exemptions have often proved resistant to technical assistance and advice. 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.

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 in 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.

A PATH FORWARD ON TAXATION AND DEVELOPMENT

To move beyond antagonism and misunderstandings, policymakers, tax experts, tax payers, tax professionals, and advocacy organisations will need to find new ways to engage, debate, collaborate, and learn together. We need a new narrative 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 to leverage the interest of taxpayers as advocates and supporters of reform. There is underexplored potential for approaching taxpayers that are accessible through international levers, such as 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 PRACTICAL IDEAS FOR FINDING A PATHWAY FROM DEALS TO RULES ON TAX

Interested parties from government, business, civil society, international organisations, and the tax profession should consider the following eight ideas for reform in a shift from deals to rules:

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 and 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 both 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-term to give businesses the certainty they need to plan and make 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 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 required to be publicly 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 multisector collaboration involving governments, private sector, and development finance institutions.

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 an index of responsible competitiveness of financial centres demonstrating integrity and ability to mediate and support investment?

BEWARE OF GREAT EXPECTATIONS!

OECD estimates that base erosion and profit shifting by multinational corporations results in global revenue losses in the region of US$100-240 billion. UNCTAD estimate that one form of profit shifting—thin capitalisation—results in a revenue loss of around $100 billion in emerging and developing economies, while the IMF estimate that base erosion and profit shifting cost non-OECD countries around $200 billion a year. All of these are tentative estimates based on statistical observations, and they are not measures of potential revenues that could be recoverable by particular policies.

While these sums of money are clearly significant, often estimates are presented in ways that make them appear larger than they really are:

- *Wrong countries.* Estimates of revenue losses attributed to "Non-OECD" countries mainly relate to major emerging economies such as Russia, Brazil, Mexico, China, Saudi Arabia and South Africa. They are often misinterpreted to relate to low-income countries, and compared with aid or with health or education budgets.

- *Wrong numbers.* Another fertile source of misunderstandings are the annual estimates of illicit financial flows through invoice fraud, produced by the Washington based NGO Global Financial Integrity. These figures (US$1 trillion a year) do not represent a direct revenue loss but are often misunderstood as an estimate of multinational tax avoidance.

- *Wrong taxpayers.* Estimates relating to one category of taxpayer behavior are easy to confuse with others. For example a much-quoted figure is that developing countries lose three times more to the tax avoidance by multinational companies than they receive in aid. The original source for this is single sentence in a newspaper article, by the OECD's Angel Gurria in 2008. In fact, Gurria was not offering an estimate of tax loss, or even talking about multinational corporations at all, but giving an estimate of the amount of capital held offshore by citizens of developing countries—gross amounts whose interest might be taxed.

- *Wrong time period.* Sometimes estimates are aggregated over multi-year time periods to produce large numbers, which are harder to contextualize than annual figures. In some cases these multi-year estimates are then compared to annual spending, such as doctors, teachers or nurses salaries.

Auditing multinational companies can result in the recovery of significant tax revenues. However the results will not live up to these heightened popular expectations. For example, early results from the "Tax Inspectors Without Borders" programme include increasing revenue from transfer pricing audits in Colombia from $6 million in 2012 to $33 million in 2014, in Kenya from $52 million in 2012 to $107 million, and in Vietnam from $3.9 million in 2013 to $40 million in 2014.

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