OECD Global Forum on **Development**

Hosted by the OECD
Centre for Tax Policy and Administration
Development Co-operation Directorate
Development Centre

Issues Paper

"Domestic Resource Mobilisation for Development: the Taxation Challenge"

OECD Global Forum on Development

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About this paper

1. This OECD Secretariat issues paper is in two parts with annexes. Part 1 sets out why tax matters for development and the current challenges and opportunities facing developing countries. Part 2 sets out a range of action frontiers required to help developing countries address these challenges and take advantage of opportunities the new global tax environment provides. Annexes cover the issues in more detail and include short briefing notes on State Building and Taxation; the International Tax Dialogue; G20; the African Tax Administration Forum; Taxation of Aid Funded Goods and Services; Transfer Pricing and Developing Countries; and Country by Country Reporting.

PART 1: Tax Matters for Development

2. Developing countries have determined that they must build capacity to achieve sustainable growth in their infrastructure, combat corruption, and attract foreign direct investment and develop transparent financial systems. Taxation is central to achieving these interrelated objectives. Taxation provides governments with the funds needed to invest in development and in the longer term, offers an antidote to aid dependence in the poorest countries and a predictable fiscal environment to promote growth. Developing countries also recognise the need to work globally to retain their already scarce resources as an integral part of international efforts to combat illicit financial flows, and especially offshore tax evasion.

3. More broadly, in addition to providing a platform for development, taxation is integral to the 'good governance' agenda. By stimulating the process of negotiation and bargaining between states and their citizens, the taxation process is central to more effective and accountable states. In this regard, *how* taxes are raised matter as much as how much. Recent evidence also indicates that reforms which begin in tax administration may catalyse reforms in other parts of the public sector, rejuvenating reform processes that have stagnated in many developing countries (See Annex 1).

Challenges……..

4. Poor countries often lack the resources and capacity to build effective tax administration and although there have been improvements in revenue raising efforts over the last few years, half of sub Saharan African countries still mobilise less than 17% of their GDP in tax revenues, as against an average of around 35% in OECD countries. Citizens may be unwilling to pay tax, frequently reflecting an often accurate perception that officials themselves may be corrupt, that governments consistently misuse public funds and that expenditure patterns may not reflect their wishes. Elites are equally hard to tax, avoiding, evading or using Non-Cooperative Jurisdictions (NCJs) to take advantage of weak tax enforcement and a lack of adequate international information exchange systems. It is also difficult to collect tax from low income, agrarian economies with large informal sectors and to avoid coercion, particularly at the local level. Moreover, some tax regimes may systematically, even if inadvertently, disadvantage certain groups in society, particularly women. For example, an unintended gender bias may arise from generally accepted tax exemptions made available to owners of businesses or properties—who are more often men than women.

5. The external environment also poses new challenges. The global shift away from tariffs has added to the problems of domestic revenue-raising and striking the right balance between an attractive tax regime for investment and growth, and securing the necessary revenues for public spending, is a key policy dilemma. Globalisation may also exacerbate these fiscal problems, as internationally mobile capital becomes more difficult to tax. Multinationals have increased their bargaining power over poor governments forcing a 'race to the bottom' among developing countries competing to provide the most attractive tax incentives for potential investors. Some Multinationals may take advantage of low or nominal tax jurisdictions to shift out part of their profits. Transparency is a key concern both to provide certainty for investment and to enable tax administrations to counter evasion.

6. These challenges have exposed significant new capacity development needs in developing countries which, as yet, have not been fully recognised by the donor community. Up to now, direct support for revenue and customs sectors has attracted a minimal share of aid (around 0.1% of ODA annually) although the influence of political dialogue on revenue priorities derived from the provision of General Budget Support can also have an impact. At the same time, there are risks that high levels of aid together with the effects of oil and other mineral rents may reduce incentives for developing effective tax systems and tax policies. In addition, some African countries see the extensive pattern of exemptions in the provision of aid funded goods and services as a priority concern. Overall, donors need to see funding of tax systems as an investment in the future of developing countries.

……And opportunities

7. There are, however, many reasons for optimism. First and foremost, governments of developing countries are seeing domestic revenue mobilisation in a new light. The uncertainty created by the global economic crisis has underpinned the realisation that it is primarily fair and efficient taxation that will meet the imperative of predictable revenue mobilisation.

8. At the national level, a shift away from tariffs and customs duties in favour of VAT has made tax more visible and so provides a base for direct interaction between state and small businesses, although the shift is posing a problem for tax administration in some LDCs. Some countries have embarked on simpler, more transparent tax systems and a widening of the tax net which can encourage taxpayer mobilisation. Better tax administration can improve relations with taxpayers, and thus voluntary compliance.

9. These efforts are reinforced by a growing international consensus around these policy themes, backed up by an increasingly powerful and well organised global community of tax professionals. The call for action is increasingly coming from developing countries themselves. In Africa, the creation of the African Tax Administration Forum, driven, managed, and in due course to be operationally funded by Africans, provides a key platform for peer learning, capacity development and dialogue on domestic and international tax issues.

10. In support of these factors, there is compelling evidence to indicate that aid directed at capacity development in the revenue and customs sectors in the developing world has been money well spent—an important result given the mixed record of technical assistance to the poorest countries which has caused considerable donor fatigue. The reasons for this success are complex but relate to the high specificity of the tax and customs functions and, in some cases, the organisational benefits of semi autonomous revenue authorities and departments. The

revenue and customs sectors have provided a conducive environment for external help for successful capacity development, provided interventions from outside are sensitively delivered and respond to clearly articulated needs. There are few quick fixes and sustained results have come from cases where external support has taken a comprehensive institutional approach, delivered over a period of years, if not decades. South-South tax administration cooperation, for example Chile's partnership with Kenya on tax IT systems, is a promising development and demonstrates the truly global nature of the ways in which experiences and ideas are exchanged in the taxation field. In all cases, demand is critical, whether expressed bilaterally or multilaterally, hence the importance of initiatives such as the African Tax Administration Forum.

11. At the international level, in the context of the economic crisis, the G8 and the G20 have made considerable advances with the assistance of the OECD, the IMF, the World Bank and others, towards addressing illicit flows, tax evasion, and NCJs. In particular, more progress has been made in combating bank secrecy as the shield for off shore non compliance in the last year than in the last decade. Over one hundred countries are now committed to transparency and exchange of information standards and are in the process of implementing them. This number will grow quickly as more developing countries become directly involved. A key issue now is how developing countries can best be supported to take advantage of the more transparent international environment, and to strengthen their tax systems. The next step is to agree how the OECD and other international organisations can support and reinforce the Global Forum on Transparency and Exchange of Information, to assist countries to:

- Enter into exchange of information agreements for tax purposes, including working through multilateral mechanisms;
- Create administrative structures to implement exchange of information mechanisms and to protect the confidentiality of information once exchanged;
- Strengthen capacity including audit mechanisms to enable developing countries to request and effectively use information obtained under agreements.

12. Finally, the last few years have seen the creation of several new initiatives to promote collective international action on taxation. These include the International Tax Dialogue (involving the OECD, the IMF, the World Bank, the EU and other development partners, see Annex 2), the German inspired International Tax Compact and the OECD's work on NCJs and tax and development. 2010 will be a key year with the Spanish Presidency of the EU and the G20 prioritising tax and development. The challenge is now how the current mix of international support can best be mobilised to meet the needs of developing countries in the tax area.

PART 2: Action Frontiers

13. A range of actions required to take advantage of these opportunities are explored below.

A. Non-Cooperative Jurisdictions (NCJs) and developing countries

14. NCJs reduce revenue available to developing countries by acting as a destination for income streams and wealth protected by a lack of transparency and refusal or inability to exchange information with revenue authorities who may have taxing rights in respect of that

income or assets. Data on revenues lost by developing countries from offshore non compliance is unreliable and estimates vary greatly. Most estimates, however, exceed by some distance the level of aid received by developing countries—around USD 100 billion annually.

15. The OECD's transparency and information exchange standards in the tax area are now universally endorsed. These standards require the exchange of information on all tax matters between jurisdictions on the basis of international tax agreements.

16. The promotion of information sharing to ensure compliance with tax laws featured prominently in recent G20 Summits. This has led to significant progress towards a more level playing field. All of the remaining jurisdictions which had not yet committed to implementing the agreed standard on exchange of information agreed to do so after the London G20 Summit in April 2009. Since April, over 100 tax information exchange agreements have been signed and over 60 tax treaties negotiated or renegotiated to incorporate the standards. 59 jurisdictions (increased from 40), including all 30 OECD countries, and are now considered as having substantially implemented the standards. 27 additional jurisdictions have committed to the internationally agreed standards and are in the process of implementation (see Annex 3).

17. The OECD has worked with partner countries to create a restructured Global Forum on Transparency and Exchange of Information made up of approximately 90 countries including developing countries participating on an equal footing. The Peer Review Group of the Global Forum is currently developing a peer review process, which will begin in early 2010, to ensure the effective and consistent implementation of these standards.

18. How developing countries can benefit from the more transparent environment, and in particular how they can strengthen their own tax administrations, remains the key issue.

B. The African Tax Administration Forum (ATAF)

19. ATAF was successfully launched in late November 2009 in Kampala by the President of Uganda. This was the culmination of rapid progress since the idea was first discussed at the OECD's Forum on Tax Administration in Cape Town in January 2008. The decision to create an African Forum was made by African Tax Commissioners from 30 countries, who met along with supporting donors and international organizations in Pretoria in August 2008 to discuss Taxation, State Building and Capacity Development. ATAF's goal is to become the platform for African tax administrators and its objectives are to articulate African tax priorities, develop and share best practices in the region and further afield, and build capacity in African tax policy and administration through peer learning and knowledge development (see Annex 4).

20. At its launch, with an initial registered membership of 25 countries, ATAF constituted itself as an independent legal body, elected a Chair (Commissioner Oupa Magashula from the South African Revenue Service), and established a Council (made up of the Tax Commissioners from Botswana, Rwanda, Nigeria, Senegal, Gabon, Ghana, Kenya, Morocco, South Africa and Zimbabwe). The Secretariat will be hosted by South Africa. Recognising the clear need for substantive work, ATAF did not wait for the November launch to deliver a series of technical events on transfer pricing, taxation of mineral resources, and taxation of financial markets for African countries in 2009. These activities are aimed at fulfilling one of ATAF's core objectives of developing capacity. A full programme of capacity development events are planned by ATAF for

2010 together with a flagship initiative on benchmarking progress made in tax administration across the continent.

21. Over the past two years, the CFA, (through the Forum on Tax Administration) and the DAC have supported the development of ATAF, politically, technically and financially. The CFA has provided the expertise for the delivery of technical work in 2009, and at the launch itself, DAC members committed, between them, to support ATAF by meeting the funding gap (approximately USD 2 million) between member's subscriptions, and the institutional and programme costs over the first two years. At the 2009 G8 Summit Heads of Government welcomed this initiative. A critical element of the ATAF proposal is that its membership fees from African countries should enable it to be self-sufficient in respect of operational costs within three years. The next steps are for DAC members to deliver their support to ATAF's pooled fund as soon as possible and to explore how to finance OECD's proposed input into ATAF. More broadly, ATAF seeks to engage donors on a range of issues including the tax treatment of aid funded goods and services (see Annex 5)

C. Strengthening Tax Capacity in Developing Countries: Transfer Pricing and Increased Transparency

a) Transfer Pricing

22. Any enterprise that conducts commercial or financial transactions with an affiliate in another country needs to determine the pricing of those transactions. That pricing, referred to as transfer pricing, will affect the remuneration for tax purposes of each party to such transactions. The problem, for both developing and developed countries, arises where a multinational enterprise (MNE) manipulates its transfer prices in order to artificially shift profits out of a jurisdiction. This is sometimes referred to as "mispricing" and an increasing number of countries have introduced legislation to counter the effects of this mispricing. The international consensus on transfer pricing is based on the arm's length principle, according to which the conditions of the transactions between members of the same multinational group should not differ from the conditions that would have been agreed between independent parties for comparable transactions. The arm's length principle is thus aimed at protecting countries against the artificial shifting of profits out of their jurisdiction. The existence of a broad international consensus on transfer pricing is essential to limit the risks of disputes among countries and of double taxation, which are detrimental to cross-border trade and investment. Such international consensus is developed by the OECD (Working Party No. 6 of the CFA) and set out in its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* which will form the basis for national legislation in countries as diverse as China, Russia, South Africa, Argentina and Kenya.

23. Although the arm's length principle represents the international consensus position on transfer pricing, many countries—developed and developing—experience difficulties in applying and implementing it, either because the domestic legal basis for their implementation is inadequate or, because they lack the administrative capacity to apply the relevant international guidelines and domestic legislation. It is important to now intensify the engagement with developing countries to (i) ensure that they be given the opportunity to protect their tax base using, to the extent possible, the framework developed by the OECD and (ii) develop capacity in this area to ensure that developing countries can effectively apply the arm's length principle in a way that achieves the twin aims of protecting their tax bases and avoiding double taxation.

Annex 6 provides details of a current CTPA initiative to develop guidance on transfer pricing that is relevant and accessible to developing countries.

b) Increased Transparency

24. To improve tax transparency and compliance in developing countries, NGO's have proposed that multinational enterprises (MNEs) report on a country-by-country basis in annual financial statements. Detailed reporting would cover, for instance, a disclosure of the countries in which the MNE operates and financial performance in each country, identifying both third party and intra-group trade (sales, purchases), labour related information (costs, employee numbers) and pre-tax profit (see Annex 7 for details).

25. Proponents of country by country reporting suggest that this would discourage profit shifting between countries, through, for example, transfer pricing (due to the disclosure of profits derived and taxes paid by MNEs), reduce corruption (by making governments more accountable to their citizens in terms of how they use the revenues raised), increase corporate social responsibility (by enhancing the relationship between a company and its host community, e.g. due to the disclosure of labour conditions) and facilitate corporate governance (by exposing the risks inherent to an MNE's activity, highlighting MNE operations in fragile countries, NCJs and other sensitive areas). Overall, it is argued that the degree of transparency achieved as a result of country by country reporting could lead to a significant increase in the revenue collected by developing countries.

26. On the other hand, critics of the proposal point to the potentially heavy compliance burden and increased costs of both auditing and reporting which would be incurred by MNEs. They also note that while information arising from country-by-country reporting may appear to demonstrate profit shifting, it is very far from conclusive and can be no more than a tentative and preliminary observation. To establish if profit shifting has occurred, it is necessary to carry out significant additional factual and legal analysis. Without this context there are strong possibilities for misuse or misinterpretation of data derived from country-by-country reporting.

27. The OECD has already carried out significant work towards increasing disclosure and tax transparency. This could be explored in more detail in the context of the OECD's Guidelines for Multinational Enterprises, which requires that enterprises should comply with the tax laws and regulations in every country in which they operate, including providing all information necessary for the correct determination of taxes to the relevant authorities. Transparency issues could also be examined in the context of the OECD's Principles of Corporate Governance which helps improve public understanding of the structure and activities of enterprises, corporate policies and performance. The OECD could take a lead role in evaluating the potential benefits of developing an international framework to increase transparency in developing countries, taking into consideration the sensitive issues at stake.

D. Illicit Flows.

28. Whilst the process of liberalisation and integration of financial markets has brought economic benefits, lowering the cost of capital and encouraging greater competition, there have been downsides. For OECD countries the scope for financial crime has widened. Money laundering, misuse of corporate vehicles, terrorist financing, tax crimes, have all changed in both

nature and dimension. Transnational organised crime generates vast illegal gains estimated between USD 1.5tn and USD 2.0tn per year.

29. For the poorest countries, the downsides are if anything more serious. Billions of USD are lost to the developing world in the form of capital flight, with drug trafficking as the largest single source of illegal profits world-wide (the drug economy represents half of Afghanistan's economy). Violent insurrections have used the illegal exploitation of natural resources, often with links to markets in OECD countries, to finance their campaigns (e.g. diamonds for Sierra Leone's Revolutionary United Front and Angola's UNITA). Leaders who have driven violence between their own people have stolen huge sums too, the returns from which have in turn financed further conflict, again with links to OECD economies. (E.g. Indonesia's Suharto: 35 USD billion stolen).

30. Tax administration provides one entry point for addressing the problem of illicit flows, and strengthens the case for more concerted assistance for tax administration per se. Better capacity within tax administrations in the developing world increases the chances of identifying economic crime. OECD countries have found that tax is a critical starting point for addressing the financial networks which launder, protect and convert the proceeds of crime into legitimate resources.

31. Work is already underway internationally and across the OECD to address these problems including promoting good corporate governance and good practice for multinational enterprises; countering the misuse of corporate vehicles and trusts; fighting money laundering and bribery; promoting integrity. Action to address the interconnected issues of crime, violent conflict and security and tracking illegally held assets in OECD countries originating from the developing world is also being taken.

32. Significant challenges remain, however. OECD governments operate a range of institutions, agencies, legal procedures and rules to work on these complex issues. Reformers from developing countries intent on addressing illicit flows struggle with legal and procedural complexities and may not have access to the relevant institutions in OECD countries. In developing countries, the links between organised crime, corruption, violent conflict and outward illicit flows are poorly understood—hindering action by donors to lend effective support.

ANNEX 1

TAXATION, STATE BUILDING AND AID

Factsheet – Update December 2009

The link between taxation and governance is not immediately apparent, but in fact one is vital for the other. Taxation can stimulate a process of negotiation and bargaining between states and their citizens. Recent work[1] by the OECD/DAC GOVNET[2] demonstrates how taxation can contribute to more effective and accountable states. Donors can take practical steps to support tax reforms that strengthen better governance.

WHY DOES TAXATION MATTER FOR GOVERNANCE?

Historically, bargaining between governments and taxpayers has played a central role in state building and the emergence of democratic governance. Box 1 identifies how a social contract can be established around tax. More recently, tax relationships have also helped to underpin broad-based growth and state efficiency in some East Asian developmental states.

Box 1: Taxation can increase state capacity, accountability and responsiveness

When governments depend on a large number of taxpayers for revenue they have incentives to promote broad prosperity, and to develop bureaucracies capable of collecting and administering taxes effectively. This makes governments more responsive to their citizens and helps build state *capacity*.

Bargaining with citizens over tax makes governments more *accountable*, as taxpayers mobilise to resist or negotiate tax demands, monitor how tax is collected and used, and insist on having a greater say in public policy in exchange for compliance with tax demands. As tax compliance increases, state *capacity* improves and the taxation process becomes more efficient and predictable. Better public policy results from debate and negotiation with citizens.

Today the circumstances facing developing countries are different, so the historical experience of tax bargaining as the basis for state building does not automatically follow. But the lessons are the same. Lack of dependence on citizens for revenue is a major cause of weak, unresponsive governance in many poor countries. In addition, domestic resource mobilisation often relies heavily on large tax payers, including multinationals, which makes it inherently difficult to create a valid social contract with the poor.

The malign effect of the "resource curse" is well documented: states that earn large surpluses from oil and minerals exports are not dependent on their citizens for revenue. Consequently, they have few incentives to promote broad economic development, or to be responsive to their citizens. Moreover, extractive industries are often in the hands of multinationals which exploit the international tax system to avoid their fiscal responsibilities. This undermines the fiscal contract even further. Making governments more responsive and accountable to their own citizens is a global priority. Taxation can help to do this.

1. Governance, Taxation and Accountability: Issues and Practice
2. Network on Governance, *www.oecd.org/dac/governance*.

CAN AID UNDERMINE TAX RELATIONSHIPS?

This question has become more urgent in the light of donor commitments to scale up assistance to aid-dependent countries, especially in Africa. Here, many aid-dependent countries are generating increasing revenue from natural resource exports, fuelled by growing demands from developed and transitional economies.

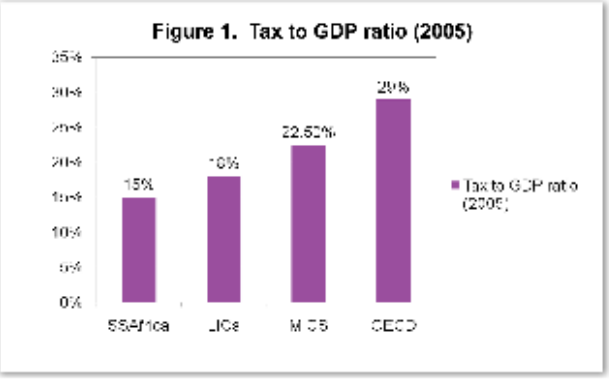
Aid has arguably a less damaging effect on governance than natural resource rents and there is no conclusive evidence that it actually depresses domestic revenue mobilisation. Nevertheless, donors should be alert to the risk that long-term aid dependency can further weaken the need for partner governments to be accountable to their own citizens. A renewed focus on enhancing domestic revenues through broadly-based taxation is therefore needed, alongside higher aid flows. Increased revenue can also help guard against unpredictable aid flows, ensure that aid-funded investments are sustainable, and prepare for an orderly exit from aid in the long term.

WHAT CAN DEVELOPING COUNTRIES DO?

How tax is raised matters, not just how much. Governments need to tax a larger number of citizens and enterprises more consensually. This is very challenging in many poor countries.

Poor countries often lack the resources and capacity to build effective tax collection systems. Citizens may be unwilling to pay tax, frequently reflecting an often accurate perception that governments consistently misuse public funds. It is also difficult to collect tax from low income, agrarian economies with large informal sectors, and to avoid coercion, especially at local level. Moreover, the poorest already pay an equivalent of tax in the form of bribes and informal fees. The global shift away from trade taxes has added to the problems of domestic revenue-raising in poor countries. They often lack the resources and capacity to build effective tax collection systems.

Although there have been improvements in revenue raising efforts over the last few years, half of sub-Saharan African countries still mobilise less than 15% of their GDP in tax revenues (*Figure 1*).



However, there are also reasons for optimism. Global programmes of tax reform, although focused on fiscal objectives, have the potential to improve governance. A shift away from indirect trade taxes in favour of VAT has made tax more visible, especially to small businesses. Simpler, more transparent tax systems and a widening of the tax net can encourage taxpayer mobilisation. Better tax administration can improve relations with taxpayers, and thus voluntary compliance. Small, practical changes to tax design and improvements in tax administration can encourage taxpayers to engage in constructive bargaining with government.

At the international level significant progress was made in 2009 by the OECD in tackling tax havens – with strong political support from the G20. The G20 and the OECD are working with the Global Forum on Transparency and Exchange of Information to enable developing countries to benefit directly from the increasingly transparent international tax environment.

Box 2. Tax Compliance Certificates in Malawi

In 2004, the Malawi Revenue Authority decided to reward tax compliant businesses by giving them tax compliance certificates on an annual basis. Local banks have unilaterally started using such certificates as a requirement for businesses seeking loans, as an index of overall credit worthiness.

This has led to an increase in tax compliance for large and medium taxpayers, and there has been a motivational effect on other smaller taxpayers, who are keen to qualify for the certificates.

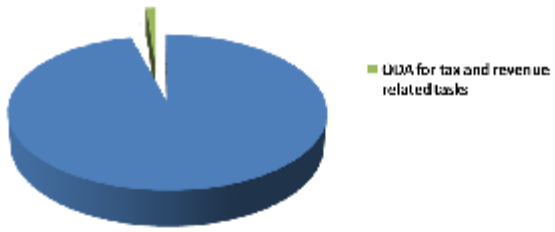
Source: adapted from Government of Malawi, 2007.

Taxing the informal sector remains a challenge, although experience, for example from the road transport sector in Ghana, suggests that innovative approaches can work. There is also potential for reform at sub-national levels, for example, through the introduction of an urban property tax. Effective communication by local authorities to show people how their tax is contributing to specific public programmes can help improve compliance.

HOW CAN DONORS HELP?

Donors can do more to support revenue raising efforts in partner countries in ways that are likely to improve governance. In 2007, only 0.15%[3] (USD 185.6 million) of official development assistance (ODA) was dedicated to tax and revenue related tasks (*Figure 2*).

Figure 2. Tax related assistance as a proportion of total Official Development Assistance (ODA) in 2007



There are successful examples to build on *(Box 3)*; and also lessons to learn from past tax assistance. Political commitment to reform is crucial, and more important than the formal status of revenue authorities. Experience underlines the importance of local leadership, locally developed solutions, and donor sensitivity to local political and social context. A good entry point is provided by tax officials from developing countries, who increasingly participate in organised global networks of tax professionals and contribute to an emerging consensus about tax reform.

Box 3. Tax reform: The governance dimension in Rwanda

DFID's support to the Rwandan Revenue Authority (RRA) has resulted in a significant increase in domestic revenue (from 9% of GDP in 1998 to 14.7% in 2005). Costs of collection have also been reduced. This success is the result of strengthening internal organisational structures and processes and of building accountable relationships with external partners, such as central and local government, a growing tax profession and taxpayers themselves. The RRA now plays an important role in strengthening relationships between citizens and the state, helping to build a "social contract" based on trust and co-operation.

Source: DFID, 2007.

3. Excludes IMF.

OECD member countries and donors can also do more to influence the enabling environment for improved revenue generation by:

- Constructing a compact between developed and aid-dependent countries in which more - and more predictable - aid is provided in the short term, in return for enhanced domestic resource mobilisation.
- Helping to ensure that multinational enterprises pay a fair share of taxes.
- Facilitating dialogue with international tax specialists on how they can help to improve governance through taxation.
- Giving special priority to regional initiatives and South-South learning on tax reform for improved governance.
- Providing more collective and harmonised support to tax reform, and tax and customs administration.
- Continue to ensure developing countries have the capacity and voice to take advantage of the more transparent international tax environment.

ANNEX 2

International Tax Dialogue

Background

The International Tax Dialogue (ITD) is a collaborative project of the European Commission (EC), Inter-American Development Bank (IDB), International Monetary Fund (IMF), Organisation for Economic Cooperation and Development (OECD), United Kingdom Department for International Development (UK-DFID) and World Bank Group to better discharge each institution's own mandate by facilitating increased cooperation on tax matters among governments, international organisations and other key stakeholders.

Objectives

The main objectives of the ITD initiative are to:

- Promote effective international dialogue between participating organisations and governments on both tax policy and tax administration;
- Identify and share good practices;
- Provide an improved focus for technical assistance on tax matters; and
- Avoid duplication of efforts in respect of existing activities on tax matters.

Activities

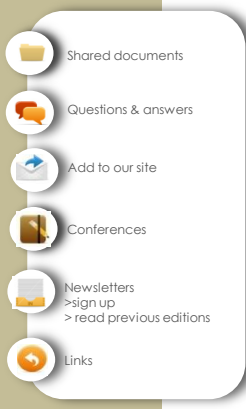
Activities to date include creating an online knowledge sharing facility, global and regional conferences, a newsletter service, a shared database of technical assistance activities and studies of issues of global interest. The ITD partners also meet regularly to facilitate increased co-operation.

www.itdweb.org

Are you interested in tax administration and policy developments in other countries and international organisations?

www.itdweb.org provides an opportunity for tax administrations, ministries of finance, and international and regional organisations to share experiences and knowledge with peers on a global basis. Over 3000 documents are currently online with new documents added daily. The site is available in eight languages and includes an extensive range of links to resources in over 180 countries, a tax reform questions area, a one-click search over more than 300 ministry of finance and administration sites globally, a newsletter service and a directory of technical assistance activities delivered by key international and regional organisations.

All countries are invited to contribute documents and links.



International Tax Dialogue

Activities…..

Global and regional conferences

ITD global conferences bring together leading experts and practitioners to share developments and consider key challenges and solutions.

Three global conferences have been held to date, all attended by senior officials from approximately 100 countries. The 2005 conference considered value added taxes (VAT) now found in more than 140 countries. The 2007 conference addressed taxation of small and medium enterprises (SMEs), focussing on identifying good practice in ensuring compliance whilst minimising compliance burden and providing the best environment for growth. The 2009 conference provided a unique and timely opportunity to consider 'Financial Institutions and Instruments – Tax Challenges and Solutions'. The next global conference will be held in 2011 in Egypt.

The first regional conference was held in April 2009 for Africa, hosted by the Rwanda Revenue Authority. The conference continued the discussion on SMEs with a focus on issues and challenges particularly relevant in the region. An Asia event will be held in March 2010 in Manila, Philippines.

New initiatives to further support developing countries

The ITD has recently launched two new initiatives to further support developing countries, initially focussed on the Africa region:

- Development of comparative analysis of tax administrations. A pilot study of approximately 22 countries is underway. The pilot will be assessed and a full study launched in mid 2010.
- A tailor made knowledge sharing internet site, to be developed in partnership with the African Tax Administration Forum. The site will enable Africa countries to share documents, links, contacts, etc across the continent.

More information

For more information on the ITD initiative visit www.itdweb.org or contact the ITD Project Manager, Ms. Rebecca Breach, at rebecca.breach@oecd.org.

www.itdweb.org

ANNEX 3

Taking Forward the London G20 Summit Tax Transparency Agenda

A Report by the OECD Secretariat

G20 Finance Ministers – 7-8 November 2009

The era of bank secrecy is coming to an end

In London the G20 announced the end of bank secrecy. Since then there has been unprecedented action to implement the OECD initiated and now globally endorsed standards of transparency and exchange of information in tax matters:

- Since April over 100 tax information exchange agreements (TIEAs) have been signed and over 60 tax treaties negotiated or renegotiated to incorporate the standards;
- All major on and offshore centres have now endorsed the standards and those which had impediments to implementing them are in the process of removing them.
- A further thirteen jurisdictions have now substantially implemented their commitments and four jurisdictions that were uncommitted have now committed.

I am pleased to report that all 30 OECD countries have now substantially implemented their commitments.

But the work is far from finished. More than twenty-five jurisdictions have not yet substantially implemented the exchange of information standard. There are still some jurisdictions that committed long ago to implement the standards but have not delivered (Belize, Montserrat, Nauru, Panama, Vanuatu still have no agreements to the standards). Some jurisdictions are negotiating TIEAs with parties with whom they have little or no economic ties; this issue will be addressed in the context of the Global Forum's peer review and monitoring process.

Moving forward on the London Summit mandates

- Strengthening the Global Forum: Membership has been expanded, a Global Forum Secretariat created, a more transparent governance and financing structure has been put in place, with 10 of the 15 members of the Steering Group coming from G20 countries. The restructured Global Forum is chaired by Australia with China, Bermuda and Germany as Vice-Chairs.
- A Peer Review Group has been established under the Chairmanship of France, with Vice-Chairs from India, Japan, Jersey and Singapore. A first meeting was held on 14-16 October. The second meeting will be held in early December.

- A Multilateral Tax Information Exchange Agreement has been designed by OECD and preparations are advancing to update and extend the membership of the joint OECD/Council of Europe Multilateral Convention for Administrative Assistance in Tax Matters. Both measures will open up the process to developing countries and speed up the negotiating process.
- The OECD's Development Assistance Committee and Committee on Fiscal Affairs have initiated work to build up capacity in tax administrations in developing countries so that they can benefit from this new open environment.
- G20 leaders identified in London three categories of countermeasures: domestic tax measures; tax treaty measures; non-tax measures.

These decisions translate the G20 political support into actions which if effectively and speedily implemented could have far reaching consequences for tax compliance around the world.

The real challenges are just beginning

Whilst unprecedented progress has been made since April, the challenging stage of achieving an effective implementation will now start. The top priority is to advance quickly on the peer reviews and the monitoring of agreements. First results will be available in Spring 2010. Work on countermeasures will continue focusing on how they can be made more effective. The updated OECD/Council of Europe Multilateral Convention should be completed by March 2010. In January 2010 the OECD will host a high level meeting between tax and aid officials to identify the ways that developing countries can benefit from the more transparent environment, including the use of multilateral instruments.

ANNEX 4

AFRICAN TAX ADMINISTRATION FORUM: INAUGURAL CONFERENCE

KAMPALA COMMUNIQUÉ

We, the Heads and senior officials of 31 African Tax Administrations, met in Kampala, Uganda from 18 to 20 November 2009. There, 25 African Tax Administrations signed an Agreement, formally establishing the African Tax Administration Forum. We set out on this journey with representatives of 9 development partner countries and 18 development partner organizations. This marks a crucial milestone in the realization of our dream of creating a platform to promote and facilitate mutual cooperation among tax administrations in Africa, and between Africa and the rest of the world.

The Forum was officially launched by the President of the Republic of Uganda, His Excellency President Yoweri Museveni, and was given further impetus by the support of the Ugandan Minister of Finance, Planning and Economic Development, the Honourable Mrs Syda Bumba, and the Ugandan State Minister for Finance (Investment), Mr Aston Kajara and the Ugandan State Minister for Finance (Micro Finance), Mrs Ruth Nankabirwa.

Our shared experiences over the three days once again demonstrated that efficient and effective tax administration is key to building capable states. The establishment of ATAF will directly contribute to economic development and good governance on the African continent.

ATAF is African led, managed and supported primarily through the expertise, resources and financial contributions of its Members. As an African initiative, it will work towards achieving increased financial independence for African countries.

To make ATAF a functioning entity, we elected South Africa as the Chair of the ATAF Council; and Botswana, Gabon, Ghana, Kenya, Nigeria, Rwanda, Senegal and Zimbabwe as Council members. The North African countries of Mauritania, Morocco and Sudan have recommended that Morocco joins the Council as their representative. The Council will submit this recommendation to the presiding electoral officer of PWC for endorsement and will inform the members of the North African region of the outcome. We also unanimously agreed that South Africa will host the ATAF Secretariat.

In order to enable the ATAF Council to discharge its functions, we passed necessary resolutions regarding the ATAF Agreement, procedures, transitional arrangements, staffing, and the budget and work programme for 2010.

As a result of our dialogue with development partners, we recognize the significance of their support as they accompany us on the road to turning our ATAF vision into a reality. In this regard, our proposal for cooperation establishes a strong relationship and we acknowledge their support through financial assistance and the sharing of technical expertise.

The establishment of ATAF is but the beginning. While our work programme is already underway, the journey in pursuit of our objectives will be a long one as we, together with our development partners, actively promote improvements in tax administration through sharing experiences, benchmarking, and peer reviewing best practices. Together we will develop our database of African tax systems and methodologies, and deliver capacity development events on international and domestic policy and administration issues. In order to facilitate our work programme in the longer term, we resolved to establish an African Tax Centre.

Above all, our mission is to mobilize domestic resources more effectively and increase the accountability of our states to our citizens. We resolved that the next meeting of the ATAF Council will be held in March 2010, where a date for the first General Assembly will be decided.

We take pride in ATAF's achievements so far, particularly the foundation already developed which this conference is built on, as well as the technical events delivered with the assistance of development partners.

We wish to express our deep appreciation for the insight and leadership of the ATAF Steering Group, for the commitment by the members of the Technical Task Team and the skills and efforts of the Interim Secretariat based at the South African Revenue Service for having brought us this far. We are humbled by the commitment and enthusiasm shown by all delegates at the conference.

Finally, we wish to express our appreciation to the Commissioner General of the Ugandan Revenue Authority, her staff and the Ugandan Government for their gracious hospitality, excellent organization and hard work in ensuring the success of this conference.

Kampala, Uganda
20 November 2009

Appendix

ATAF MEMBER STATES:

Botswana, Chad, Egypt, Eritrea, Gabon, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritania, Mauritius, Morocco, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Africa, Sudan, Uganda, Zambia and Zimbabwe.

PARTICIPATING AFRICAN TAX ADMINISTRATIONS:

Benin, Cameroon, Congo (Democratic Republic), Mozambique, Swaziland and Tanzania.

PARTICIPATING DEVELOPMENT PARTNER COUNTRIES:

France, Germany, Ireland, Japan, Netherlands, Norway, Sweden, Switzerland and the United Kingdom.

DEVELOPMENT PARTNER ORGANIZATIONS:

ADB, ATI, CERDI, CMI / ISS, DFID, EU - RT VAT, GTZ, IMF, IDS, IRISH AID, JICA, KFW, NORAD, OECD, SADC, SAICA, SDC and USAID.

ANNEX 5

TAXATION OF AID-FUNDED GOODS AND SERVICES

What is the issue?

Donors frequently secure tax exemptions from developing countries on aid inputs. The exemptions typically include income taxes on aid workers' salaries, goods and services and value-added taxes on local purchases, and customs duties and excise taxes on imports. Tax officials in recipient countries consider that such special exemptions weaken their tax systems, cause considerable cost and complication and provide opportunities for corruption.

Have any donors taken action on this issue?

Yes, mainly the multilaterals, although France has taken action in some areas. The World Bank, for example, typically rolls the relevant duties into the total loan (and later debt), allowing them to be met from within the loan amount. This is implemented in different ways, often by setting a government project 'share' or matching payment at the assumed minimum level of taxes. Practical problems include that Ministries of Finance require the duties upfront, say on importing vehicles, yet project entities are not given counterpart funds sufficient to offset the cost. This can result in cars sitting idle in bonded warehouses for months.

Why is this an issue for developing countries' tax systems?

This is an issue of both principle and practice. In principle, exemptions should be removed for reasons of economic efficiency and consistency and to help strengthen tax systems. In practice, it is argued that the exemptions:

(i) cause economic distortions (e.g. goods and services imported from donor countries may receive preferential tax treatment over domestically-produced goods and services);

(ii) provide opportunities for corruption, particularly tax fraud and tax avoidance schemes, both of which have to be policed by tax administrations, straining their scarce resources;

(iii) fuel a tax exemption culture which affects overall governance;

and (iv) impose significant transaction costs because of the large number of individually negotiated agreements with each donor country.

The total costs are unknown but country-level evidence suggests tax exemptions for aid-assisted projects represent a significant budgetary issue for recipient countries. In Niger, for example, tax expenditures on vouchers—one method by which exemptions may be implemented—amounted in 2002 to about 18 percent of project financing, and 10 percent of all tax revenue. In Tanzania, customs exemptions for donors accounted for around 17 percent of the gross value of imports in 2005. These figures suggest a significant loss to treasuries, without counting the costs of potential corruption and of transferring resources to police it. Thus developing countries argue that removing the exemptions would widen the tax base, boost the credibility of both the revenue administration and the donors, simplify tax systems and encourage voluntary compliance by local and multinational taxpayers.

And from a donor perspective?

From a donor perspective, there are both political and practical arguments for maintaining the present system. At the political level, it is hard to persuade taxpayers in OECD countries that taxes on aid funded goods and services collected by governments often perceived as corrupt, will be put to good use. At a practical level, the process of unravelling the current range of exemptions would be complex and it is argued that the benefits would be uncertain. Among the bilateral donors, only the UK's DFID has indicated an interest in debating this topic. Donors are unlikely to accept the argument that developing countries forgo revenue by accepting aid from outside, and would point out that paying taxes on aid inputs reduces the resources available for other projects. And there is understandable scepticism as to whether removing exemptions on aid inputs would lead to general abolition of exemptions, including on developing countries' own purchases.

But don't donors already transfer resources directly into government budgets in developing countries?

Yes, many do and those in favour of removing exemptions agree that the starting point is in countries where donors have empirically-based confidence in local public financial management arrangements and systems. This, however, is not a straightforward recommendation because there is no consistent pattern in donors' use of local systems—local systems may be used by donors when they are not sound but not used when they are thought to be sound. In addition, whilst there may be confidence in local revenue systems, there may be less confidence in the capacity of government to convert revenues into effective expenditures.

Is it logical and consistent to change the current regime without changing other similar anomalies and distortions inherent in the international system?

It is true that a complex set of international rules provide for various exemptions. But there is no inherent reason why the current tax arrangements concerning aid funded goods and services cannot be debated and if necessary tackled as a discrete package. Other exemptions will need to be examined on a case-by-case basis by the parties concerned.

Where does the international debate take place on this issue?

The issue of tax exemptions for international assistance projects has been on the agenda of the United Nations Committee of Experts on International Cooperation in Tax Matters for the last few years. In 2006, the Committee discussed draft guidelines prepared by the secretariats of member organisations of the International Tax Dialogue (ITD). However, the UN Committee comprises only tax experts from developed and developing countries. The UN Committee has acknowledged the debate will not advance without the donor agency staff who include the exemptions in memoranda of understanding governing aid contributions.

Next Steps?

The debate has been given new impetus by the Africa Tax Administration Forum which wishes to engage donors on this topic.

OECD Secretariat, January 2010

ANNEX 6

Transfer Pricing and Developing Countries

Introduction

This Annex provides background on the issues raised by the adoption of transfer pricing rules by developing countries and describes the strengthening dialogue with non-OECD economies in developing guidance and approaches tailored to their needs and priorities.

Why is it in the interests of developing countries to implement the arm's length principle in domestic legislation?

The challenge for developing countries in the development of transfer pricing legislation is in essence the same as for OECD countries: protecting their tax base while not creating double taxation or uncertainties that could hamper foreign direct investment and cross-border trade. The adoption of transfer pricing legislation embodying the arm's length principle can be instrumental in achieving this dual objective.

The arm's length principle is found in Articles 9 of the OECD Model Tax Convention on Income and on Capital and of the United Nations Model Double Taxation Convention between Developed and Developing Countries, and is elaborated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Transfer Pricing Guidelines"). Dozens of countries around the world have implemented transfer pricing laws, and all of them are based on the arm's length principle. It should be noted that the Commentary on Article 9 of the United Nations Model Convention states that:

> "… the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommends that the Guidelines should be followed for the application of the arm's length principle which underlies the article."

Alignment of domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Transfer Pricing Guidelines can:

- Provide countries with the tools they need to fight artificial shifting of profits out of their jurisdiction by multinational enterprises ("MNEs");
- Provide MNEs with some certainty of treatment in the country concerned, thus encouraging international trade and investment;
- Reduce the risk of economic double taxation, removing disincentives to international trade and investment;
- Provide a level playing field between countries; and
- Provide a level playing field between MNEs and independent enterprises doing business within a country.

Is the arm's length principle more favourable to developed economies than to developing l countries?

The arm's length principle simply states that transactions between associated enterprises should not be distorted by the special relationship that exists between the parties. As such, the arm's length principle is neutral.

Transfer pricing is not in practice about a tension between developed and developing countries, but rather about a tension between high tax and low tax jurisdictions. Developed and developing countries suffer in the same way from the artificial shifting of profits to low tax jurisdictions. The arm's length principle and the Transfer Pricing Guidelines were developed to establish a principle which could be implemented to resolve disputes that arise among OECD countries related to the allocation of taxing rights over MNE profits. Developing economies that are faced with the challenge of measuring the profits from MNEs that should be taxable in their own jurisdictions can benefit from the arm's length principle and Transfer Pricing Guidelines in the same way as OECD countries.

The dual objectives of the arm's length principle (protecting a country's tax base while limiting risks of double taxation) are shared by OECD and non-OECD countries. For the latter as well as for the former, being part of the international consensus is the most effective method of achieving these objectives.

Is the arm's length principle too complex for developing economies to administer?

It is true that implementing the arm's length principle can be complex and resource-intensive. Most OECD countries, however, started this implementation process modestly, built their transfer pricing legislation and practices progressively and are still in the process of improving them. One key element is the necessity to tailor legislative measures and the deployment of administrative capacities based on the strategic needs and resources of each particular country. This typically means prioritising transfer pricing enforcement activities in accordance with the circumstances of each particular economy; setting enforcement objectives that are realistic given the administration's capacities; and designing compliance requirements that are reasonable for taxpayers given the size of the cross-border trade.

The OECD's dialogue with developing countries on transfer pricing

A significant part of the OECD's activities in the transfer pricing area consists in developing a strong dialogue with non-OECD economies to share practical experience on the implementation and application of transfer pricing rules. Under the auspices of the CFA's Global Relations programme, the OECD holds about 25 multilateral and bilateral events per year on transfer pricing issues, as well as providing bilateral dialogue on country-specific issues and developments. In addition, the OECD hosts an annual meeting of an Advisory Group which provides a structured forum for non-OECD economies to input their views into the development of the OECD's approach to transfer pricing and other technical tax work and their priorities for the shape of the ongoing Global Relations programme. This dialogue is demand driven – addressing issues identified as high priority by non-OECD economies. It is also two way. The OECD recognises that its approaches must have the same relevance and applicability to non-OECD economies as they do for OECD member counties. Multilateral and bilateral dialogue provides forums in which non-OECD economies can feed their views and perspectives into the

development of OECD approaches and guidance. This ongoing dialogue is enhanced by current ongoing initiatives:

- The development of guidance on the adoption and application of transfer pricing rules - targeted in particular towards developing countries and developed in collaboration with them. This guidance takes the form of a suggested approach to transfer pricing legislation (including a template framework for domestic transfer pricing legislation), together with a "Transfer Pricing Manual" consisting of a number of papers on the practical implementation of transfer pricing rules and the application of the arm's length principle.

- Complementing this guidance is the development of an additional event within the OECD's Global Relations programme, targeted in particular towards developing countries in the early stages of developing transfer pricing capacity, addressing the regulatory and administrative framework that such countries identify as of high priority and relevance to them.

ANNEX 7

COUNTRY-BY-COUNTRY REPORTING

Following the British-French Summit on 6th July 2009 and the call by British Prime Minister Brown and French President Sarkozy for the OECD to examine Country-by-Country Reporting and the benefits of this for tax transparency and reducing tax avoidance, this note provides a brief description of Country-by-Country reporting (CbC) and its objectives, together with a discussion of the arguments for and against CbC and the extractive sector's experience with the Extractive Industries Transparency Initiative (EITI). This note is intended to serve as a background briefing for discussions on the 27 and 28 January 2010.

What is Country-by-Country reporting?

CbC is a proposed system of reporting for multinational enterprises (MNEs) that would require an MNE to report in its annual financial statements:

1. The name of each country in which it operates;

2. The names of all members of the MNE group trading in each country in which the MNE operates;

3. Its financial performance in every country in which it operates, including:
    - Third party and intra-group sales;
    - Third party and intra-group purchases;
    - Labour costs and employee numbers;
    - Financing costs (paid to third parties and to other members of the MNE group); and
    - Pre-tax profit.

4. Tax information including:
    - The tax charge included in its accounts for the country in question (split between current and deferred tax);
    - Actual tax payments to the government of the country in the period;
    - Liabilities for tax and equivalent charges at the beginning and end of each accounting period; and
    - Deferred tax liabilities for the country at the beginning and end of each accounting period.

5. Details of the cost and net book value of physical assets located in each country; and

6. Details of the MNE's net and gross assets in total for each country in which it operates.

CbC is promoted by the Task Force on Financial Integrity & Economic Development[1] (the Task Force) and its constituent civil society organisations (Global Financial Integrity, Tax Justice Network, Christian Aid, Global Witness and Transparency International). Publish What You Pay (PWYP), a "global civil society

[1] *See* Task Force on Financial Integrity & Economic Development (June 2009), *Country-by-Country Reporting: Holding multinational corporations to account wherever they are*, *http://www.financialtaskforce.org/wp-content/uploads/2009/06/Final_CbyC_Report_Published.pdf* (authored by Richard Murphy, Tax Research LLP). The Task Force describes itself as a consortium of governments and NGOs.

coalition", promotes CbC in the extractives sector as part of the Extractive Industries Transparency Initiative.[2] In September 2008, the European Parliament adopted a resolution[3] on overseas development assistance that encouraged EU Member States to be fully involved in the EITI (and to call for it to be strengthened) and called on the European Commission "to ask the International Accounting Standards Board (IASB) to include among these international standards a country-by-country reporting requirement on the activities of multinationals in all sectors".

Why a CbC initiative?

One of the main goals of the CbC initiative is to discourage illegitimate shifting of profits between countries through transfer pricing manipulation – *i.e.* the improper setting of prices in transactions between members of the MNE group at other than arm's length prices. Proponents of CbC argue that manipulation of transfer pricing is facilitated by a lack of transparency in the way MNEs report. At present, group accounts do not report intra-group transactions, and there is no requirement for MNEs to publish information on a country-by-country basis. CbC would disclose the profits that an MNE records in each country in which it operates and the taxes paid to those countries, which proponents of CbyC have suggested would discourage transfer pricing manipulation and permit the MNEs and relevant tax authority to be held accountable for the taxes paid.

The arm's length principle, as embodied in Article 9 (Associated Enterprises) of both the United Nations Model Double Tax Convention and the OECD Model Tax Convention, is the internationally accepted standard for the allocation of income where transactions have been entered into between associated enterprises (parent and subsidiary companies and companies under common control – *i.e.* members of an MNE group). The arm's length principle is thus the standard used by MNE groups to determine appropriate transfer prices for intra-group transactions. The application of the arm's length principle may be complicated, however, by the evolution and complexity of international intra-group trade[4] and, proponents of CbC argue, the lack of transparency with respect to MNEs' activities.

In general, tax authorities can thus face two major problems in their approach to MNEs:

1. Determining which MNE groups to challenge on transfer pricing issues; and

2. Determining where, if at all, transfer pricing abuses are most likely to take place within an MNE group.

Proponents of CbC argue that the additional data CbC would provide would allow tax authorities to more effectively tackle these problems. For example, they could incorporate CbC information into their risk assessment processes and thereby make the most effective use of scarce resources. The Tax Justice Network states that up to USD 1 trillion of trade mispriced deals may take place annually to achieve tax savings and, accordingly, that the losses to tax avoidance are significantly greater than estimates of the

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2 *See* http://www.eitransparency.org. The EITI is described in detail below.

3 European Parliament resolution of 23 September 2008 on the follow-up to the Monterrey Conference of 2002 on Financing for Development (2008/2050(INI)), http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0420+0+DOC+XML+V0//EN.

4 The Task Force and the Tax Justice Network cite an OECD estimate that 60% of all world trade is undertaken on an intra-group basis (and thus susceptible to transfer mispricing). *See*, *e.g.*, Task Force on Financial Integrity & Economic Development, *supra* note 1, at p. 16.

amount needed to fund the Millennium Development Goals.[5] It should be noted, however, that the Oxford University Centre for Business Taxation has commented that, "Some of the existing estimates of tax revenue losses due to tax avoidance and evasion by firms systematically overestimate the losses. … *Overall, it is fair to conclude that most existing estimates of tax revenue losses in developing countries due to evasion and avoidance are not based on reliable methods and data*."[6]

The information reported in CbC would not be available solely to tax authorities. The information would be publicly available and subject to the scrutiny of academics, non-governmental organisations and other components of civil society. This greater scrutiny is expected by advocates of CbC to change more than simply MNE manipulation of transfer prices. Further objectives said to be achieved by CbC are to **tackle corruption, increase corporate social responsibility and accelerate economic and social development in developing countries**. Proponents say publishing the tax revenues raised by governments will in theory make government officials more accountable to citizens in terms of how they use such revenues, helping to cut corruption. They believe CbC should enhance the relationship between a company and its host community, making the company more accountable to that community and, for example, providing information on labour conditions (number of employees, remuneration) in the community. The transparency provided by CbC with respect to local economic activity of MNEs should also in their view result in accountability for taxes paid (or not paid) and contribute to breaking the cycle of aid dependency in developing countries. They believe all of these goals should help to create fully independent, accountable governments capable of raising their own tax revenues.

A final goal of CbC is to **facilitate corporate governance** by helping capital providers and commercial investors to understand the risks inherent to an MNE's activity, highlighting MNE operations in politically unstable regimes, tax havens and other sensitive areas.

Where is the debate?

Before considering the particular arguments against CbyC, it is important to recognise that reporting demands on MNEs have increased significantly over recent decades to the point where there are serious concerns about the ability of users of reports to see the wood for the trees. If anything, work is needed to try to reduce complexity and simplify reporting rather than adding more information; and that in doing so the needs of capital providers must be given priority (see the UK Financial Council's recent discussion paper "Louder than Words").

One of the main arguments against CbC is that it will impose large **administrative burdens and costs** on MNEs.[7] Proponents of CbC say MNEs already have much of the information that would be required to be

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5 *See* Tax Justice Network (March 2008), *Country-by-Country Reporting: How to Make Multinational Companies More Transparent*, *http://www.taxjustice.net/cms/upload/pdf/Country-by-country_reporting_-_080322.pdf.*, at p. 2.

6 *See* Oxford University Centre for Business Taxation (19 June 2009), *Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature*, *http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/TaxEvasionReportDFIDFINAL1906.pdf*, at p. VI (report prepared for the U.K. Department for International Development) (emphasis in original).

7 *See*, *e.g.*, Ernst & Young (July 2009), *Tax policy and controversy briefing*, *http://www.ey.com/Publication/vwLUAssets/TPCBriefingJuly2009/$FILE/TPCBriefingJuly2009.pdf*, at p. 13 ("… there is a broad consensus in the business community that [CbC] would create an additional, expensive compliance burden.").

reported, which they may use, for example, to prepare tax returns in jurisdictions where they do business. It is argued by others, however, that the sheer volume of the required information, especially for larger MNEs, would make CbC unfeasible. Moreover, because any accounting information reported in the annual group accounts prepared under International Financial Accounting Standards would be audited by an MNE's independent auditor before it was published, critics say CbC could greatly increase audit costs. The Task Force itself admits that CbC "will make the audit of some multinational companies more complex and more expensive."[8]

Another argument against CbC is the **potential for misuse of the information disclosed**. To the extent there are circumstances where the information provided by CbC may appear to suggest that transfer pricing abuses or other forms of improper income shifting may have occurred, it is necessary to apply existing tools (*e.g.* Articles 7 (Business Profits) and 9 (Associated Enterprises) of the OECD Model Tax Convention) to determine whether transfer prices have been appropriately determined or income has been appropriately attributed to a permanent establishment. In other words, critics argue that the information provided by CbC must be complemented by a robust legal analysis before it can serve as the basis for initiating an audit leading potentially to a tax adjustment. They say the potential for misunderstanding or misinterpretation of complex financial information reported without any context or explanation would appear to be substantial. In addition, in their view it is not always clear what CbC reporting will add to the analysis, given that tax authorities with jurisdiction to tax an entity will generally already obtain (or have the power to obtain) the information required to properly tax the transactions and dealings of that entity.

Other arguments against CbC include its **anti-competitive effects**, **questions regarding the appropriateness of using accounting standards to tackle tax avoidance** and the **lack of clarity as to the information that should be presented and how it should be presented**.

The potential for success of CbC appears to be based on its adoption worldwide within International Financial Reporting Standards (IFRS). Although IFRS apply in more than 100 countries, it has been argued that significant gaps in their coverage could work to the competitive advantage of those companies not subject to CbC. In addition, given that the purposes of accounting rules and tax rules are not the same, questions have been raised as to whether accounting rules are the appropriate mechanism to combat perceived tax avoidance. Given both of these considerations, it can be expected that business will lobby strongly against integrating CbC into IFRS.

The Task Force proposal provides a detailed description of the types of information to be reported in CbC. At the same time, additional clarity is required (*e.g.* which taxes or revenue streams), given that a lack of agreement on standardised reporting could make the information reported less useful. It has been argued that a better approach would be for MNEs to report on all the taxes that they pay and generate in a country through their operations, and that this could extend to other aspects of the economic value that the add through employment, the local supply chain, infrastructure and community investment. Finally, there does not appear to be universal agreement whether CbC should be presented in annual financial reports or through non-financial reports such as annual sustainability or corporate responsibility reports, but clearly this choice would be influenced by whether any reporting requirements are voluntary or part of IFRS.

[8] Task Force on Financial Integrity & Economic Development, *supra* note 1, at p. 41.

The Extractive Activities' Experience

The voluntary disclosure of information regarding transactions within international extractive companies has become an internationally accepted goal through PWYP's Extractive Industries Transparency Initiative (EITI). The EITI looks to tackle the natural resource-related corruption that exists in many of the poorest resource-rich developing countries. The initiative is based on the premise that transparency with respect to payments made by extractive companies to these countries helps citizens to hold their governments accountable for how the resource-related funds are managed and distributed. Because EITI does not focus on the transfer pricing issues that are the one of the main targets of CbC, the extractive activities' experience is not necessarily comparable, although it does provide some useful indications.

EITI is a global standard with a methodology for monitoring and reconciling company payments and government revenues at the country level. Implementation of EITI is the responsibility of individual countries – once a country becomes "EITI-compliant", all the companies operating in the relevant sectors in the country have the obligation to disclose payments made to the government.[9] The EITI approach, which is overseen by p from the government, companies and national civil society, incorporates the following elements to achieve compliance:

- Regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner;

- Where such audits do not already exist, payments and revenues are the subject of a credible, independent audit, applying international auditing standards;

- Payments and revenues are reconciled by a credible, independent administrator, applying international auditing standards and with publication of the administrator's opinion regarding that reconciliation, including discrepancies (should any be identified);

- The approach is extended to all extractive sector companies, including state-owned enterprises;

- Civil society is actively engaged as a participant in the design, monitoring and evaluation of this process, and contributes towards public debate;

- A public, financially sustainable work plan for the operation of the EITI is developed by the host government, with assistance from international financial institutions where required, including measurable targets, a timetable for implementation and an assessment of potential capacity constraints.

The issue of whether an aggregated or disaggregated (company-by-company) approach to disclosure should be adopted in countries implementing the EITI has been a contentious question since the inception of the initiative at both the international and EITI countries level.

[9] To date, only one country, Azerbaijan, has achieved EITI compliance, but 28 other countries are currently candidates working towards compliance.

The International Accounting Standards Board (IASB) was asked to develop an International Financial Reporting Standard (IFRS) on accounting for extractive activities and is currently conducting a research project. The primary focus of the project is to consider financial reporting issues associated with reserves and resources (including their exploration) – in particular whether and how to define, recognise, measure and disclose reserves and resources. The disclosure of payments to governments as part of such an IFRS is still being reviewed. For the moment, research shows that such disclosure would provide information that could be used by at least some capital providers in making their investment decisions (risk assessment) but that significant cost would be associated with it. Further study is required to conclude whether the country-by-country disclosure of payments to governments would be justifiable on cost-benefit grounds.[10] This issue will be studied by the IASB as part of a consultation process to be launched during the first quarter of 2010, which will assess the implications of the disclosure of all payments to governments or, alternatively, the disclosure of those types of payments to governments that are both significant and readily observable from the entity's financial records.

How can the OECD approach the issue?

The CbC is largely about increasing disclosure, tax transparency and the relationship between the MNE and the host government. The OECD has already done much work in this area, notably in the context of the work on the "enhanced relationship" between taxpayers and revenue bodies described in the 2008 Report, *Study into the Role of Tax Intermediaries*. The OECD could take a lead role in evaluating the potential benefits of developing an international framework to increase transparency in developing countries, taking into consideration the sensitive issues at stake, in particular as regards OECD work on transfer pricing. The determination whether to pursue such an approach will require governments to begin to discuss these issues, certain of which have not been addressed in detail. An outline of these issues is attached to this note as Annex 1.

One possible way that could be explored is in the context of the *OECD Guidelines for Multinational Enterprises*[11](the OECD MNE Guidelines). In this regard, the Taxation Chapter (X)[12] provides the following:

> It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with the tax laws and regulations in all countries in which they operate and should exert every effort to act in accordance with both the letter and spirit of those laws and regulations. This would include such measures as providing to the relevant authorities the information necessary for

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10 International Accounting Standards Board, Extractive Activities Research Project (10 August 2009), *Draft Discussion Paper: Extractive Industries*, *http://www.iasb.org/NR/rdonlyres/23F1424B-05E4-4BD1-AFD8-382125765D8E/0/ExtractivesDPworkingdraft10August2009.pdf*, at p. 159.

11 http://www.oecd.org/dataoecd/56/36/1922428.pdf.

12 It should also be noted that paragraph 60 of the Commentary on the Taxation Chapter states the following:

> Corporate citizenship in the area of taxation implies that enterprises should comply with the taxation laws and regulations in all countries in which they operate, co-operate with authorities and make certain kinds of information available to them. However, this commitment to provide information is not without limitation. In particular, the *Guidelines* make a link between the information that should be provided and its relevance to the enforcement of applicable tax laws. This recognises the need to balance the burden on business in complying with applicable tax laws and the need for tax authorities to have the complete, timely and accurate information to enable them to enforce their tax laws.

the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.

The Disclosure Chapter (III) of the OECD MNE Guidelines also provides generally: "Enterprises should ensure that timely, regular, reliable and relevant information is disclosed regarding their activities, structure, financial situation and performance. This information should be disclosed for the enterprise as a whole and, where appropriate, along business lines or geographic areas."

CbC could also be explored in the context of the OECD *Principles of Corporate Governance*[13], which recognise that disclosure "helps improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate" and make express reference to the *OECD Guidelines for Multinational Enterprises*.

Any such evaluation would be done on a cross-disciplinary basis and would take into account the stated objectives of CbC reporting, the extent to which the proposed reporting would further those objectives, technical issues relating to implementation of the proposals, and some assessment of the relative merits of CbC reporting versus possible alternatives.

In conclusion, taking this work forward would be a joint exercise of CTPA and the Directorate for Financial and Enterprise Affairs. Based on the outcomes of the discussion of CbC at the CFA-DAC Joint Meeting and the OECD Global Forum on Development in January 2010, it will be possible to further assess how to take the work forward.

[13] www.oecd.org/daf/corporateaffairs/principles/text. Principle V (Disclosure and Transparency) provides, "The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."

APPENDIX 1

Separate Country Reporting
Outline of Issues

I. Summary of The Existing Proposals for Separate Country Reporting

- Listing of public proposals and the proponents
- Core Proposal – Require public companies to report certain financial data on a country-by-country basis in their annual public financial statements
- Implement the proposal through changes in IASB accounting standards
- Data required to be reported on a country-by-country basis would include:
  - List of all countries in which members of the MNE Group operate
  - Names of all members of the MNE group trading in each country
  - Total Annual Sales
    - Third party
    - Intra-group
  - Total Annual Purchases
    - Third party
    - Intra-group
  - Number of employees
  - Total Annual Labor costs
  - Total Financing costs
    - Paid to unrelated parties
    - Paid to related parties
  - Income before tax
  - Tax information
    - Cash tax paid
    - Financial statement tax charge
      - -- Current
      - -- Deferred
    - Total balance sheet liability for tax at beginning and end of period
    - Total deferred tax liability at beginning and end of period
  - Information regarding assets in the territory
    - Cost and net book value of physical assets in the territory
    - Gross and net total assets in the territory

II. Proponents' Stated Objectives

- Help combat tax avoidance through "transfer mispricing"
  - Assist tax administrations in identifying which companies to challenge under transfer pricing and anti-avoidance rules
  - Help deter transfer pricing abuse by disclosing level of corporate income diversion to low tax jurisdictions / tax havens
- Help address the problem of corruption in developing countries
- Improve corporate social responsibility
- Accelerate economic development in developing countries

III. Baseline Summary of the Nature and Extent of Current Geographic Segment Financial Reporting Rules

- IASB
- FASB
- Other
- Include some description of how current geographic reporting rules address questions of source of revenue and allocation of income
- Separate country reporting in the extraction industries

IV. Issues Related to Technical Details of the Proposal

- What is the source of a sale or purchase for purposes of the proposal?
  - Location of the customer
  - Place of delivery
  - Location of seller / supplier / buyer
- Should source rules consider rules relating to taxing jurisdiction over export or import sales revenue for purposes of the proposal
- What taxes are covered by the proposal? Income tax? Employment taxes, social taxes, property taxes, local (non-national) tax, sales and use tax, VAT, payments of royalties and concessions for mineral rights, franchise and other payments for rights to engage in business etc. etc. – Note: scope of transfer pricing is normally limited to national level income tax
- How does one allocate deferred tax on a country-by-country basis?
- Etc. Etc. Etc. – Probably many more

V. Issues Related to Whether the Proponents' Transfer Pricing Concerns are Justified

- How large is the problem of transfer pricing non-compliance?
  - Summary of proponents' estimates
  - Summary of other literature on the topic including Oxford etc.
- How much of the transfer pricing non-compliance problem is related to MNE dealings in developing countries?
- Is the availability of or access to country-by-country financial data of the type required by the proposal a problem for tax administration enforcement of transfer pricing rules?
  - Relevance of country-by-country aggregate data to transfer pricing determinations, transactional nature of pricing determinations, etc.
  - Usefulness of country-by-country data in tax administration risk assessment
  - Nature and adequacy of existing transfer pricing documentation requirements
  - Limitations on tax authority access to transfer pricing relevant financial data located outside the country – information exchange, practical impediments

VI. Issues Related to Whether the Proposal Would Address the Proponents' Stated Tax Compliance Objectives

- Would public disclosure of country-by-country financial data limit company willingness to take aggressive transfer pricing positions?
- How often would aggregate country-by-country financial data be relevant to resolution of particular transfer pricing issues with local tax authorities?
  - Generally a transactional undertaking
  - Under most transfer pricing methods aggregate financial data is not directly relevant

- Could aggregate country-by-country financial data lead uninformed users to unwarranted conclusions about a company's transfer pricing compliance practices?
  - Correspondence between financial report data allocated to a country and local country jurisdiction to tax such income
  - Importance (or lack thereof) of balance sheet asset values to transfer pricing determinations / particularly internally developed intangible assets
- Could local country tax authorities utilize country-by-country data in allocating scarce tax enforcement resources?
- Would material portions of any tax enforcement benefits of the proposal accrue to developing countries?

VII. Issues Related to Proponents' Concerns Other Than Tax Compliance

- Corruption
- Corporate social responsibility in developing economies
- Other
- What are the unintended consequences of greater disclosure

VIII. Issues Related to Whether the Additional Burdens on Business are Justified

- Nature of the additional data collection and reporting burdens placed on business by the proposal
  - Availability of data in the form suggested, e.g. does an MNE always know the location of the customer? – internet sales, etc. – reference VAT discussions
  - Practicality of consolidation of separate company results country-by-country
- Consequences for timeliness of financial reporting
- Possibility that the proposal would undermine the primary purpose of public company financial reporting – providing relevant timely data to investors and other capital markets participants regarding corporate performance
- Cost burdens on MNEs related to enlarged scope of financial audits
- Question of whether certain financial statement items are calculated on a country-by-country basis at all, e.g. tax reserves; other reserve accounts; etc.
- Question of whether IASB rules would be the correct place to implement the proposals.
  - Lack of universal application
  - Uneven playing field
  - Effects of enhanced reporting rules on small / start up public companies
  - Deterrent effect on public offerings and forced reliance on private equity markets

IX. Issues Related to Whether Alternative Approaches Could Address the Proponents' Objectives

- Publication of Unaudited Data in Corporate Social Policy Discussions
- Publication of Selected Separate Company Financial Data – Audited or Unaudited – showing company's place of organization and countries in which it does business but not necessarily allocating income by country
- Enhancement of Transfer Pricing Documentation Requirements to include non-transactional summary financial data