Strengthening Tax Systems to Mobilise Domestic Resources in the Post-2015 Development Agenda

- Strengthening domestic tax collection will be essential to provide governments with sustainable revenue sources to finance the post-2015 Sustainable Development Goals and invest in development, relieve poverty and deliver public services. Effective taxation provides a reliable and sustainable source of revenues that is needed to promote growth and offers an antidote to aid dependence in developing countries.

- The benefits of taxation extend beyond revenue generation as it can increase state capacity, accountability and responsiveness by providing a platform to governments to engage with their citizens. Thus, it strengthens the 'fiscal contract' between the state and its citizens.

- How revenue gets collected is as important as how much gets collected. The objective of tax reform should also be to establish a tax system that is efficient, growth-oriented and equitable. Political commitment to reform is crucial for its success. Experiences of successful reform underline the importance of local leadership, locally developed solutions, and sensitivity of providers of development assistance to local political and social context.

- For developing countries it is even more difficult than for developed countries to deal with weak tax administrations, corruption and poor governance, a low willingness to pay taxes and extensive 'informality'.

- Globalisation poses new tax challenges and opportunities. The OECD launched a major initiative, the **Action Plan on Base Erosion and Profit Shifting,** to revamp the existing international tax standards to address profit shifting by multinational enterprises and stands by developing countries to ensure they share in the benefits.

- Curbing illicit financial flows requires concerted action, through a whole-of-government approach, in both OECD and non-OECD countries. In July 2014 the OECD endorsed a proposal for a new single global standard for Automatic Exchange of Information to fight against tax evasion and illicit financial flows.

- The OECD stands ready, through its **Tax and Development Programme,** to advise and support the international development community in improving the enabling environment for developing countries to collect taxes fairly and effectively.

- With only an estimated 0.1% (USD 118.4 million) of total official development assistance (ODA) dedicated to tax matters in 2012, the international development community needs to do more to improve domestic capacity for tax systems development in developing countries. Cost (ODA) to benefit (additional revenue yielded) ratios of USD 1: USD thousands are not uncommon for tax reform support programmes.

Why focus on taxation as a means to mobilise domestic resources in the post-2015 agenda?

The post-2015 Sustainable Development Goals (SDGs) require adequate funding to be credible and attainable. In addition to official development aid (ODA), many more resources need to be mobilised (see DCR 2014), one of the most important being domestic tax revenues. In 2008 the Doha Declaration on Financing for Development[i] confirmed the need to strengthen efforts to enhance tax collection, investment and other private flows, with a view to supporting sustainable development and inclusive growth. Yet low-income countries mobilise on average only 13% of their GDP, below the minimum level of 20% considered by the UN as necessary to achieve the current Millennium Development Goals (UNDP, 2010).

Taxation provides governments with the funds needed to invest in development, relieve poverty and deliver public services. Effective taxation provides a reliable and sustainable source of revenues that is needed to promote sustainable growth and offers an antidote to dependence of developing countries on external funding. Strengthening domestic tax systems is not just a question of raising revenue: it is also about designing a tax system that promotes inclusiveness, encourages good governance, promotes investments and job creation, matches society's views on appropriate income and wealth inequalities and promotes social justice (IMF et al, 2010).

Taxation is integral to strengthening the effective functioning of the state and to the social contract between governments and citizens. By encouraging dialogue between states and their citizens, the taxation process is central to more effective and accountable states. Reforms which begin in tax administrations may spread to other parts of the public sector (OECD, 2008a).

The UN Open Working Group (OWG) on Sustainable Development Goals considers strengthening domestic resource mobilisation through taxation as a key means of implementation. In its Outcome Document the OWG calls on the donor community to *step up its international support to strengthen domestic resource mobilisation, including through international support to developing countries to improve domestic capacity for tax and other revenue collection* (OWG, 2014). Tax revenues already make up a significant proportion of developing countries' GDP, but have the potential to contribute much more if they are mobilised effectively.

More and better aid to strengthen tax systems is required in the post-2015 framework

Whilst domestic political leadership is the primary driver of capacity development in tax matters, partnerships with international assistance providers can play an important role in strengthening tax collection. Relatively modest international support for a developing country's tax authority can have a dramatic impact on its ability to raise revenues. Advice from the **OECD's Tax and Development Programme on Transfer Pricing**[ii] delivered institutional changes and an additional USD 100 million in collected tax revenues in developing countries[iii]. Cost (ODA) to benefit (additional revenue yielded) ratios of USD 1: USD thousands are not uncommon for tax reforms support programmes:

1. In **Colombia**, revenues increased from USD 3.3M in 2011 to USD 5.83M in 2012 to approximately USD 10M in 2013 and is currently at approximately USD 30M for 2014 and expected to reach USD 50M by the end of 2014 as a result of strengthening their transfer pricing capacity.

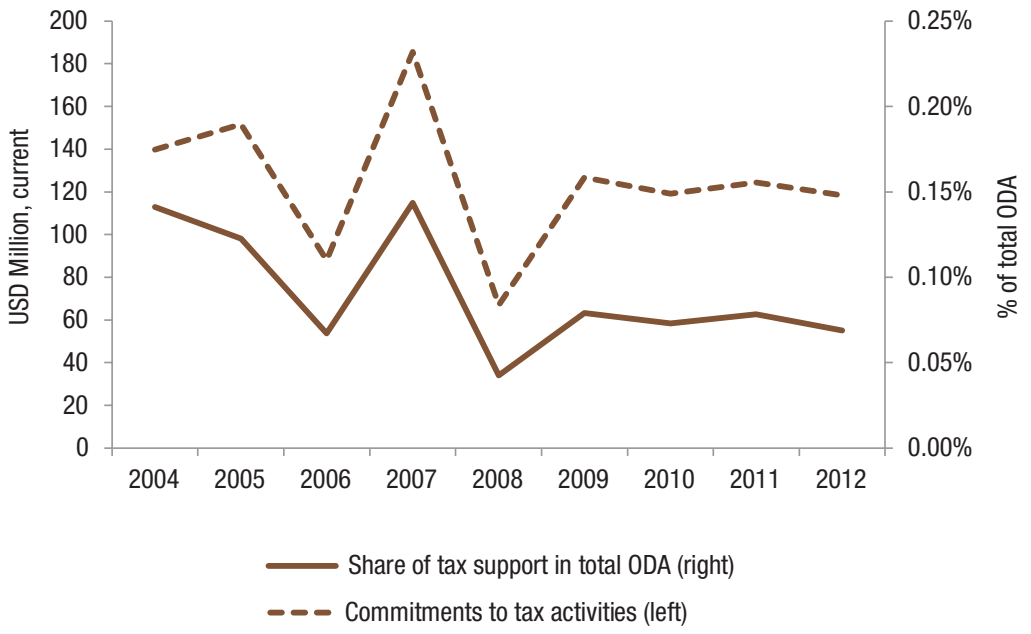
If the evidence of success is compelling, why do tax systems attract so little international assistance?

2. In **Kenya,** revenue collection increased from USD 52M for year ended 30 June 2012 to USD 85M for year ended 30 June 2013 and forecasted to be in excess of USD 100M for year ended 30 June 2014 as a result of targeted transfer pricing support.

3. In **Vietnam,** support to the tax administration strengthened its capacity to enforce its transfer pricing rules. Two recent audits of Multinational Enterprises resulted in increased tax paid of USD 4.5M and USD 3.9M.

Estimates based on OECD data suggests that currently around 0.1% of Official Development Assistance (excluding the IMF) goes to support the development of tax systems in developing countries (Figure 1). This is despite some strong evidence to suggest that international assistance can be a powerful catalyst and lever for domestic resource mobilisation.

Figure 1: Official development assistance for tax-related activities, 2004-12



Source: OECD Creditor Reporting System statistics.
Note: The data do not include figures from the International Monetary Fund.

Challenges in mobilising more domestic resources in the post-2015 framework

Many of the tax challenges[iv] faced by developing countries affect more advanced economies as well, but the specific challenges that loom especially large in developing countries include:

- **Domestic issues:** Weak tax administrations, low taxpayer morale, corruption and the missing reciprocal link between tax and public and social expenditures are challenging developing countries' capacity to raise tax revenue. The vicious circle of low tax morale and compliance — which reduces the lifeblood for funding public services — needs to be broken. Where administrative capacity and incentives to comply are weak, 'hard-to-tax' sectors, including small businesses, small farms, and professionals, become particularly difficult. Structural constraints, including low levels of economic development, large agricultural and informal sectors are common challenges.

- **Globalisation poses new challenges and opportunities in international taxation and the demand for assistance from developing countries is growing:** The G20 has identified base erosion and profit shifting as a serious risk to tax revenues, sovereignty and fair tax systems worldwide. Base erosion and profit shifting is an issue which harms developed and developing countries, arising from deficiencies of current international tax rules and standards. Such deficiencies enable multinational companies to shift profits from countries in which the economic activity and value creation occur to those where they may be subject to low, or no, taxation. For some of the poorest countries, which rely heavily on corporate tax revenue, profit shifting has a particularly significant effect on vital tax revenues. If the largest and most high-profile taxpayers are seen to be avoiding their tax liabilities, confidence in and effectiveness of the tax system is undermined.

- **Natural resource wealth:** Many resource-rich countries still struggle to design and implement fiscal regimes that are not only transparent but also capable of securing a reasonable share — and one reasonably responsive to commodity prices — of resource rents, an issue that recent discoveries are bringing to the fore in more developing countries. Risks of a 'resource curse' impacting on governance and undermining the sustainable management of natural resource revenues need careful consideration. For certain developing countries, natural resource taxation is the single biggest fiscal 'make or break' issue in the next decade and can influence their capacity to reach the SDG's.

Estimates of illicit flows vary, but the illicit outflows from developing countries may well outweigh inflows of ODA and investment.

Box 1. How are OECD countries performing in addressing illicit flows from the developing world?

- Twenty-seven out of 34 OECD countries fail to maintain or require sufficient beneficial ownership information for legal persons, and no country is fully compliant with the beneficial ownership recommendations for legal arrangements (although G8 countries have recently committed to Principles and Action Plans to prevent the misuse of companies and legal arrangements).
- Since 2000, OECD countries have signed roughly 1.300 bilateral exchange of information agreements with developing countries.
- As of 2012, 221 individuals and 90 companies have been sanctioned for foreign bribery, yet around half of all OECD countries have yet to see a single prosecution.
- Between 2010 and 2012, OECD countries have returned USD 147 million and frozen almost USD 1.4 billion of stolen assets.

Source: OECD (2014b), Illicit Financial Flows from Developing Countries: Measuring OECD Responses, OECD Publishing. *http://dx.doi.org/10.1787/9789264203501-en*

- **Illicit financial flows drain development:** This means fewer hospitals and schools, fewer roads and bridges. Tax fraud and evasion deprive governments of essential revenues needed for development and trust in the fairness of the tax system. Corruption deters investment, undermines fair competition, fosters the spread of other criminal activities, destroys public trust and undermines the rule of law. Finally, money laundering is harmful to the financial sector which is important for attracting investors and general economic activity. Developing and developed countries will have to increase their co-operation globally to combat illicit financial flows, recover stolen assets and return them to their countries of origin. It is important that developed countries take measures to avoid becoming safe havens for illicit financial flows from the developing world. (See Box 1)

What role can the OECD play to strengthen tax systems in mobilising domestic resources in the post-2015 development agenda?

The OECD has set up a multi-stakeholder **Task Force on Tax and Development** bringing together OECD member countries; emerging and developing countries; international and regional organisations; civil society and business to take action on improving the enabling environment for developing countries to collect appropriate and adequate tax revenues and to build effective states. (See *http://www.oecd.org/tax/tax-global/taxanddevelopment.htm*).

The Task Force drives much of the international tax agenda at the G20 Development Working Group, the OECD's Tax and Development Programme, the post-2015 process and the Global Partnership for Effective Development Co-operation, ensuring changes take place on the ground. It also monitors progress made by the development community against their voluntary initiatives on domestic resource mobilisation agreed at the 2014 Mexico High Level Meeting of the Global Partnership for Effective Development Co-operation.

The **OECD Tax and Development Programme** underpins the work of the Task Force on Tax and Development on the following issues:

TAX AVOIDANCE

- **Base Erosion and Profit Shifting (BEPS).** The OECD is leading the international tax agenda through its work on international norms, standards and instruments to tackle areas such as double non-taxation and tax avoidance. (See Box 2) Mandated by the G20 in 2013 the OECD launched a major initiative to revamp the existing international tax standards to address profit shifting by multinational enterprises. (OECD, 2013b; and see *http://www.oecd.org/ctp/beps.htm).*

Box 2. OECD support to developing countries in addressing base erosion and profit shifting: The BEPS Action Plan.

The OECD and G20 economies are working together to address BEPS issues, providing consistency for both business and tax sovereignties. In 2013, the OECD launched a 15-point Action Plan to provide governments with the domestic and international tools they need to combat profit shifting (OECD, 2013c). The Action Plan recognises that greater transparency and improved data are needed to evaluate and stop the growing disconnect between where profits are made and where they are reported for tax purposes. In September 2014 the OECD/G20 BEPS Project published the first batch of deliverables, with phase 2 and 3 scheduled to be finalised by September and December 2015 respectively.

Acknowledging that developing countries face specific policy issues and implementation challenges that are not always shared with developed countries, the G20 mandated the OECD to report on the main sources of base erosion and profit shifting for developing countries and set out a new agenda for addressing BEPS issues in developing countries. Based on intensive consultations with developing countries the report highlights the actions developing countries have taken, many with international support, that indicate there are opportunities to raise additional revenues from addressing BEPS issues and to create a more certain and stable investment climate for business. The report sets out how the G20 can assist developing countries address the challenges posed by these BEPS issues and the need for developing countries to have a voice in the process.

Source: OECD (2014a), Part 1 of a report to G20 Development Working Group on the impact of BEPS in low income countries, OECD Publishing. Available at: http://www.oecd.org/tax/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

Note: Part 2 of the report to G20 Development Working Group on the impact of BEPS in low income countries will be made available by the end of 2014.

- **Transfer pricing.** At the request of developing countries, and in partnership with the European Commission and the World Bank Group, the Tax and Development Programme builds capacity to apply the OECD's transfer pricing norms and standards in developing countries. Lessons learned are being fed back into the OECD's standard setting process, to ensure that a developing country perspective is consistently considered in the development of standards and guidance on transfer pricing and other BEPS issues.

- **Tax Inspectors Without Borders (TIWB).** TIWB is an innovative OECD approach to improve audit skills and tackle tax avoidance by offering developing countries assistance to face

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globalisation's new challenges in international taxation, including transfer pricing and tax transparency. TIWB aims to improve the quality and consistency of tax audits, create sustained improvements in tax auditors' skills, and improve voluntary compliance by enhancing taxpayer confidence in the local tax administration.

TIWB facilitates targeted, tax audit assistance programmes, using tax audit experts who work directly with local officials in developing country tax administrations with a specific focus on audit and audit-related issues concerning international tax matters. This new type of direct assistance applies a real-time, "learning by doing" approach to solve current audit issues and transfer knowledge and skills. (OECD, 2014c; and see *http://www.oecd.org/ctp/tax-global/tax-inspectors.htm).*

TAX EVASION

- **Exchange of information.** The OECD supports a fairer and more transparent global tax system. Untaxed economic activity represents an estimated 17% of the total global economy – the amount lost to economies runs into EUR billions. The OECD is helping countries work together to put an end to offshore tax evasion through a secure and cost-effective single global standard for the automatic exchange of financial account information which was launched in 2014. (See Box 3)

Box 3. The OECD supports developing countries in adopting Automatic Exchange of Information (AEOI) for tax purposes

International progress is also being made in the fight against tax evasion. In July 2014 the OECD endorsed a detailed proposal for a new single global standard for AEOI in response to a request by G20 leaders at their summit in September 2013. The standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. This involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (e.g. dividends, interest, royalties, salaries, pensions, etc.).

Developing countries stand to gain from the implementation of this new global standard in their fight against illicit financial flows, by increasing their revenue collection and deterring tax evasion. G20 governments have mandated the OECD-hosted Global Forum on Transparency and Exchange of Information for Tax Purposes, working with the OECD Task Force on Tax and Development, to help developing countries identify their need for technical assistance and capacity building in order to participate in and benefit from AEOI.

In September 2014 the Global Forum presented its roadmap to the G20 spelling out how developing countries can overcome obstacles to participate in the automatic exchange standard and meet its requirements. The roadmap describes a stepped approach for how developing countries can participate in the new standard and includes an outline for pilot projects to be undertaken between developing and developed country partners, working with the Global Forum Secretariat, to address awareness and capacity constraints. It is expected that pilot projects with a number of developing countries will be launched at the beginning of 2015.

Source: OECD (2014d), Automatic Exchange of Financial Account Information, Background Information Brief (updated: July 2014), available at: *http://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf*

- The **Multilateral Convention on Mutual Administrative Assistance in Tax Matters** is a powerful instrument to counteract international tax avoidance and evasion. The Convention provides the ideal instrument to swiftly implement AEOI. The Task Force promotes this important instrument that has been signed by over 60 countries, including Cameroon, Gabon, Ghana, Morocco, Nigeria, South Africa and Tunisia in Africa; Argentina, Colombia and Costa Rica in Latin America; and China, India and Indonesia in Asia. (See http://www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm)

- **Oslo Dialogue on Tax and Crime.** The OECD launched the Oslo Dialogue in 2011 to improve inter-agency co-operation in both developed and developing countries in the fight against financial crime. A key pillar of the Oslo Dialogue is strengthening the capacity of criminal tax investigators to tackle illicit financial flows and the OECD International Academy for Tax Crime Investigation is a critical part of this initiative. The academy provides intensive capacity building for tax investigators, prosecutors, judges and others involved in the fight against financial crime. (See http://www.oecd.org/ctp/crime/tax-crime-academy.htm)

TAX POLICY

- **Curbing wasteful tax incentives.** Under pressure to offer internationally-competitive tax environments, developing countries offer generous tax breaks that undermine their DRM efforts with little demonstrable benefit in terms of increased investment. The OECD provides advice on the policy design of tax incentives for investment, and supports developing countries in improving their governance and transparency.

- **Development and publication of comparative revenue statistics in developing countries.** Revenue statistics underpin all tax policies in all countries and need to be consistently compiled. In collaboration with regional tax organisations the OECD is elaborating disaggregated tax revenue data that allow comparisons of fiscal performance and the mix and fairness of their taxes among non-OECD and OECD countries.

STATE BUILDING, ACCOUNTABILITY AND EFFECTIVE CAPACITY DEVELOPMENT

- **Building tax culture, compliance and citizenship.** The Task Force's work on 'tax morale', measuring what taxpayers think about paying taxes, in developing countries has led to work to share worldwide experience on taxpayer education. The OECD's Global Source Book on Taxpayer Education captures innovative strategies for taxpayer education in 28 countries in order to provide ideas and inspiration to revenue authorities in developing countries for their taxpayer education programmes (See http://www.oecd.org/ctp/tax-global/sourebook-taxpayer-education.pdf).

- **Measuring the quality and quantity of development co-operation for tax matters.** The Task Force gathers evidence of the impact of support to revenue matters and develops knowledge on the interaction between aid and domestic resource mobilisation. Learning from these experiences it has helped to formulate a set of "Principles for International Engagement in Supporting Developing Countries in Revenue Matters" (See Box 4), which offer guidance for development co-operation agencies, revenue authorities, finance departments and developing countries on how to work together to support host country-led domestic resource mobilisation efforts.

Box 4. Principles for International Engagement in Supporting Developing Countries in Revenue Matters (Summary)

1. Follow the leadership of government and co-ordinate at the country level.
2. Do no harm.
3. Take a "whole-of-government" approach to maximise policy coherence and development co-operation effectiveness.
4. Take account of international aspects of taxation.
5. Balance revenue collection imperatives with fairness, equity and governance considerations.
6. Encourage transparency in revenue matters.
7. Strengthen revenue and expenditure linkages.
8. Promote sustainability in revenue collection systems.
9. Encourage broad-based dialogue on revenue matters that includes civil society, business and other stakeholders.
10. Measure progress and build the knowledge base on revenue matters.

Source: OECD (2013a), "Draft Principles for International Engagement in Supporting Developing Countries in Revenue Matters", OECD, Paris, available at: www.oecd.org/ctp/tax-global/Principles_for_international_engagement_May2013.pdf.

END NOTES

i. The Doha Declaration on Financing for Development (2008) reiterates that mobilizing financial resources for development and the effective use of all those resources are central to the global partnership for sustainable development financing.

ii. Transfer pricing refers to the allocation of profits among the different entities within a multinational corporate group for tax and other purposes. More info at *http://www.oecd.org/tax/tax-global/taxanddevelopment.htm*

iii. As reported by the recipient countries to the Task Force plenary Meeting in Korea in October 2013.

iv. Much of this section is drawn from the "Report to the G20 Development Working Group by the IMF, the OECD, UN and World Bank: Supporting the Development of More Effective Tax Systems.", available at *http://www.oecd.org/ctp/48993634.pdf*

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The United Nations (UN) Millennium Development Goals (MDGs) were established in 2000/1 and consist of eight development objectives to be achieved by 2015. It is widely agreed that the MDGs have been effective in mobilising worldwide awareness, leveraging resources, guiding global development efforts and increasing accountability. It is also impressive how close the world will get to most of the MDGs by 2015. There is need, however, for a successor framework once the MDGs expire in 2015 to keep the momentum built to date. The OECD played a pivotal role in defining the MDGs. With two years to go, the OECD is increasing its efforts to support the achievement of the MDGs, and at the same time thinking about how it can help the UN in developing a new agenda and framework post-2015. The OECD has a number of areas of expertise which could play an important role in shaping this post-2015 agenda and framework. In the overview brochure for this series, the OECD proposes eleven areas which would be of particular relevance (Beyond the MDGs: Towards an OECD contribution to the post-2015 agenda). This brochure focuses on one of these – strengthening tax systems to mobilise domestic resources in the post-2015 development agenda.

Element 1:	Measuring what you treasure and keeping poverty at the heart of development
Element 2:	Developing a universal measure of educational success
Element 3:	Achieving gender equality and women's rights
Element 4:	Integrating sustainability into development
Element 5:	Strengthening national statistical systems
Element 6:	Building effective institutions and accountability mechanisms
Element 7:	Developing and promoting peacebuilding and statebuilding goals
Element 8:	Ensuring policy coherence for development
Element 9:	Sharing knowledge and engaging in policy dialogue and mutual learning
Element 10:	Promoting the Global Partnership for Effective Development Co-operation
Element 11:	**Measuring and monitoring development finance**

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MOBILISING DOMESTIC RESOURCES