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DRAFT REPORT

on Tax and Development – Cooperating with Developing Countries on Promoting Good Governance in Tax Matters
(2010/2101(INI))

Committee on Development

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PR_INI

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on Tax and Development – Cooperating with Developing Countries on Promoting Good Governance in Tax Matters
(2010/2101(INI))

The European Parliament,

– having regard to its resolution of 10 February 2010 on Promoting Good Governance in Tax Matters[1],

– having regard to the Communication from the Commission on Tax and Development - Cooperating with Developing Countries on Promoting Good Governance in Tax Matters (COM(2010)0163),

– having regard to the Declaration of Monterrey (2002), the Conference on Financing for Development in Doha (2008), the Paris Declaration (2005) and the Accra Agenda for Action (2008) whereby capital flights and illicit financial flows were explicitly identified as a major obstacle to mobilization of domestic revenue for development,

– having regard to the initiative to strengthen international cooperation with developing countries to fight tax evasion and avoidance, launched by the German Ministry for Economic Cooperation and Development, referred to as the 'International Tax Compact' (ITC),

– having regard to the conclusions of the International Conference on Taxation in Pretoria on 29 August 2008,

– having regard to the conclusions on the London G20 Summit of 2-3 April 2009,

– having regard to the Leaders' Statement issued following the Pittsburgh G20 Summit of 24 and 25 September 2009 and its resolution of 8 October 2009 thereon2,

– having regard to its resolution of 24 April 2009 on the London G20 Summit of 2 April 20093,

– having regard to the resolution of 14 November 2007 on the draft Commission regulation amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard (IFRS) 8, concerning disclosure of operating segments4,

– having regard to the Norwegian Government Commission Report 'Tax Havens and Development', June 2009,

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[1] Texts adopted, P7_TA(2010)0020.
[2] Texts adopted, P7_TA(2009)0028.
[3] Texts adopted, P6_TA(2009)0330.
[4] Texts adopted, P6_TA(2007)0526.

– having regard to Rule 48 of its Rules of Procedure,

– having regard to the report of the Committee on Development and the opinions of the Committee on Economic and Monetary Affairs and the Committee on International Trade (A7-0000/2010),

A. whereas the strengthening of the tax system is one of the principle challenges faced by developing countries to achieve MDGs,

B. whereas developing countries face important challenges in raising tax revenues due to insufficient human and financial resources to collect taxes, weak administrative capacity, corruption, lack of legitimacy of the political system and unequal distribution of revenues,

C. whereas the major forms of illicit financial flows and capital flight include transfer mispricing, round-tripping, tax incentives and tax competition between countries to attract FDI, and opaque and disadvantageous investment protocols,

D. whereas the possibility of enhancing domestic resource mobilisation is further weakened by the global context, characterised by customs tariff liberalisation,

I. The importance of taxation for meeting the MDGs

1. Agrees with the Commission that efficient and fair tax systems are crucial for poverty reduction, good governance and state-building;

2. Welcomes the Commission's proposal to provide enhanced support for assisting developing countries in tax reforms and strengthening tax administrations regarding EDF for ACP States, the Development Cooperation Instrument and the ENP and Partnership Instrument, and support for national supervisory bodies, parliaments and non-state actors;

Difficulties encountered by developing countries in raising tax revenues

3. Notes with concern that the tax system in many poor countries remains characterised by extremely narrow tax bases, tax exemptions for the elite, massive revenues from natural resources going unaccounted for, and high illicit capital flows related to massive tax evasion;

4. Deplores that tax havens weaken democratic governance, make economic crime more profitable, encourage rent-seeking, and increase the inequitable distribution of tax revenues; urges the EU to make the fight against tax havens and corruption a top priority of the agenda in international finance and development institutions;

5. Underlines that globalisation exacerbates the fiscal problems of developing countries;

6. Stresses that the decline in trade taxes, resulting from WTO obligations and regional trade agreements, has posed acute problems for the poorest countries that have at best replaced about 30% of their lost trade taxes;

II. Supporting effective, efficient, fair and sustainable tax systems

7. Urges the Commission to upgrade its assistance to strengthen the judiciary and anti-corruption agencies in developing countries, to effectively integrate the principles of good governance in tax matters into the programming, implementation and monitoring of country and regional strategy papers, and to systematically include clauses on good governance in future trade agreements;

8. Recalls that the main challenge for poor countries is to broaden the tax base; points out that the decline in trade taxes has led to the introduction of consumption taxes (VAT or energy taxes); considers that even if VAT can enable the widening of the tax base in economies with large informal sectors, it is not an ideal instrument as it hits poor people the hardest; believes that EU assistance for tax reform should be geared to developing direct taxation;

9. Recalls that tax competition affects the way the tax burden is distributed between owners of capital and wage earners; underlines that the costs of tax competition are higher for developing countries since they derive a larger part of their tax revenues from capital and have little possibility to collect alternative taxes; considers that multinational enterprises should pay a fair share of taxes, while developing countries should have policy space to impose capital controls;

III. Working towards a transparent, cooperative and fair international tax environment

Trade mispricing

10. Stresses that trade mispricing is one of the most prominent drivers of illicit financial outflows; calls on the EU to work upon concrete proposals to ensure that the G20, the OECD, the UN and the WTO consider a broader set of indicators and methods for tackling trade mispricing, among which are the US ‘comparable profit methods’ that have shown promise in determining the incorrect pricing of transactions;

11. Urges the EU to defend within the G20 and OECD the principle of the automatic exchange of information on tax matters along the lines of the EU savings tax directive, as a way to curb illicit financial flows in secrecy jurisdictions;

Extractive industries

12. Urges the development of initiatives to promote greater transparency in natural resource rents, inter alia through the OECD Anti-Bribery Convention and the Extractive Industries Transparency Initiative; welcomes the adoption of the new US ‘Conflict Minerals’ Law and asks the Commission to propose a legislative initiative along this line;

13. Recalls that the quality of financial reporting is crucial to combat tax evasion effectively; insists that the IASB includes within its International Financial Reporting Standard a requirement that all multinational corporations report their income and tax paid on a country-by-country basis;

Improving donor coordination

14. Takes note of the findings of the ITC 'Mapping Survey', whereby further donor coordination in the area of taxation and development is needed; encourages the Commission to take initiatives along this line and to step up its support for multilateral and regional initiatives, such as the African Tax Administration Forum and the Inter-American Centre of Tax Administrations;

Improving the international architecture to combat tax havens

15. Stresses that conventional ODA will fail to eradicate global poverty if no ambitious measures are taken within the G20, the OECD and the EU to clamp down on tax havens and harmful tax structures;

16. Notes that since the G20 Summit of 2 April 2009, offshore financial centres have committed to OECD standards on transparency and exchange of information; notes however that the harmful structures of tax havens still prevail; calls once more for action beyond the OECD framework to combat tax havens in view of their various shortcomings;

17. Expresses its concern about the unfortunate effect of tax treaties on the distribution of tax revenues; notes that the method of assigning the right to tax based on the domicile principle rather than the source country helps to make tax havens a more favourable location; deems that tax treaties should be reviewed for fairness, which implies the possibility of granting the primary right to tax in the source country where real activities are pursued;

18. Calls for the adoption of an international convention with the purpose of eliminating harmful tax structures that would include sanctions both for non-cooperative jurisdictions and for financial institutions that operate with tax havens; urges the EU to adopt measures similar to the US Stop Tax Havens Abuse Act;

19. Instructs its President to forward this resolution to the Council, the Commission and the governments and parliaments of the Member States.

EXPLANATORY STATEMENT

Background

In April 2009, the European Commission issued a Communication on "Good Governance in Tax Matters", with the intention to launch a debate about concrete actions that could be taken to better promote the principles of good governance in the tax area (transparency, exchange of information and fair tax competition). Additionally the Commission issued a working paper "Tax and Development-Cooperating with Developing Countries on Promoting Good Governance in Tax Matters."

The aim of the Commission document is to improve synergies between tax and development policies, to make them more effective, identifying difficulties encountered by developing countries in the mobilisation of revenue through taxation, including domestic and international factors, suggesting some ways in which the EU can do more and make better use of its existing funds and instruments.

Moreover, in February 2010, the European Parliament approved a resolution on the same topic.

1. Comments on the Commission document

Positive aspects:

The achievement of MDGs and tax governance
The Commission clearly recognizes the link between the achievement of MDGs & tax governance. Taxation is essential to provide the basis for an accountable and responsive democratic system.

Principle of ownership of development strategies
The EU is committed to the principle of ownership of development strategies, and acknowledges the prime responsibility of developing countries themselves to improve their revenue systems, according to their own economic and political circumstances and choices.

Engagement for the support of developing countries tax systems
The Commission aims to engage the EU instruments in providing enhanced support in designing developing countries' tax systems and implementing the principles of good governance in the tax area, i.e. by paying more attention to effectively integrating the principles of good governance in tax matters into the programming, implementation and monitoring of country and regional strategy papers.

Country-by-country financial reporting standard
The Commission supports country-by-country financial reporting standard for multinationals

as a tool to detect international tax avoidance and evasion practice. It is also important to underline the fact that a Communication on Corporate Social Responsibility will consider how to develop a system for mandatory disclosure of governance information in the annual accounting;

International dialogue and cooperation in tax matter
The Commission aims to step up the process of international dialogue and cooperation in tax matters, notably by enhancing the participation of developing countries in relevant international *fora*.

Tax Information Exchange Agreements (TIEA)
The Commission insists on the need to conclude and implement Tax Information Exchange Agreements (TIEA), including through multilateral mechanism, by referring to the model of the EU Savings Taxation Directive, based on the automatic exchange of information.

Negative aspects:

Customs revenue
This document does not address the negative impact on low-income countries of trade liberalisation in terms of customs revenue. While reasserting the need to shift the resource base from external common tariffs towards other types of taxation, it advocates the deepening of regional integration, through further trade liberalisation. In this way, the Commission completely denies the difficulties raised by the erosion of customs revenues especially for poor countries, that according to IMF studies, have at best replaced 30% of lost trade taxes. There is also an absence of proposals to expand the tax base, with the view to ensure a fair and progressive tax system.

Current flaws of the OECD
The Commission aims to encourage and support developing countries to adopt and implement international standards in the tax area, without making critics or observations about their current flaws in the context of the OECD. In this regard, it should be recalled that OECD Code of Conduct allows governments to escape its blacklist merely by promising to adhere to the information exchange principles, turning it down into a mere "Declaration of Principles", rather than being effectively implemented.

Adoption and Implementation of the OECD transfer pricing guidelines
While supporting the adoption and implementation of the OECD transfer pricing guidelines in developing countries, the Commission mentions the need to investigate the application of the arm's-length principle, not proposing other methodology.

Erosion of Tax revenues
Unfortunately, there is no reference to the erosion of tax revenues arising from tax competition between countries in a globalised economy.

Some necessary steps

A. Combating tax havens

1. **Combating tax havens** is a key priority for achieving the MDGs. Indeed, tax havens contribute to weakening the quality of institutions and the political system in developing countries. They make economic crime more profitable, encourage rent-seeking and increase the inequitable distribution of tax revenues.

i) The secrecy practised in tax havens creates information asymmetry between investors, and consequently reduces the efficiency of international financial markets. This situation leads to higher risk premiums and thereby increases borrowing costs for both rich and poor countries.

ii) Tax treaties help to make tax havens a more favourable location. A large network of bilateral tax treaties seeks to overcome the potential problem of double taxation resulting from the principle that under international tax law, both the country where an owner is domiciled or registered (domiciliary principle) and the country where the income is earned (source state principle) have the right to tax capital gains. In case of tax havens, where legal entities merely register in a jurisdiction for tax facilities, the implementation of the domiciliary principle engenders an unequal division of tax revenues, since very little of the economic activity actually takes place in the tax haven. In such circumstances, principles of fairness suggest that the right to tax should lie with the source country.

iii) While many tax treaties between OECD members and developing countries have taken account of the effect of the domiciliary principle on the distribution of taxes by giving the source country the right to impose a withholding tax up to a specified amount (this system ensures therefore that the source country also receives a share of the tax revenues), tax treaties established between tax havens and other developing countries make no provision for such a withholding tax.

iv) Tax treaties between tax havens and developing countries often contribute to a significant reduction in the tax base of the latter, while weak public finances are one of the principal challenges in a number of developing countries. Furthermore, tax treaties will not affect the harmful structures that exist in tax havens (such as the use of secrecy rules and fictional domiciles). Therefore, it is important to ensure that tax treaties will not constrain further action against tax havens and should be revised accordingly.

B. Trade mispricing

Incorrect pricing of intra-group transactions with the aim of transferring profits from a high-tax to low-tax jurisdictions, is one of the most prominent drivers of illicit financial outflows. It constitutes a major problem for both rich and poor countries: it leads to extensive competitive distortions between national and multinational companies, and can cause a substantial loss of tax revenues. Although OECD guidelines on transfer pricing by multinational enterprises exist, there is space to improve them.

C. Weaknesses of the international architecture to combat tax havens

While a number of international organisations work on issues related to the harmful effects of tax havens (OECD, IMF, FATF, FSF, UN), none of these organisations have a mandate directed specifically at tax havens. International collaboration in this area is aimed primarily at money laundering and at establishing tax treaties that include the right to obtain information from other states on specific tax matters. Moreover, the international framework

suffers from several fundamental weaknesses:

- developing countries are excluded from a number of initiatives (as in the case of the OECD and FATF);
- none of the initiatives are suited to overcoming the principal problems related to illicit financial flows, among which the lack of automatic exchange of information on ownership and insight into transfer pricing within companies;
- full participation in the various fora and initiatives often call for a level of expertise and capacity which many developing countries do not possess.

D. The "natural resource curse"

A wide range of countries that can be dubbed "rentier" states (they benefit from abundant natural resource rents, particularly those from oil and minerals) which do not need to tax their citizens tend to:

- be independent of citizen-taxpayers, and therefore unresponsive to them;
- have few incentives to promote broad economic development;
- use oil revenues to buy off opposition, and to fund repressive internal security;
- have few incentives to establish effective bureaucracies to raise and manage taxes.

Initiatives have been taken to promote greater transparency in regard to the spending of natural resource rents, including innovative ventures such as the Extractive Industries Transparency Initiative (EITI). Such initiatives need to be supported, while transnational corporate companies need to disclose profits and taxes paid on a "country-by-country" basis so as to make it possible to compare what they pay in every developing country where they operate. Country-by-country reporting goes hand-in-hand with the support of multinational companies for corporate social responsibility.

E. Globalisation and fiscal problems
Globalisation exacerbates fiscal problems, as internationally mobile capital becomes more difficult to tax. This problem relates particularly to taxation of capital gains by companies registered in tax havens. Developing countries should have the necessary policy space to impose capital controls and other measures to deflect speculation and ensure financial stability.

Widening the tax base
Widening the base is a key priority to enable poor countries to achieve the MDGs[1]. Over the last twenty years, tax reforms worldwide have seen a shift away from reliance on trade taxes, and the introduction of broad-based consumption taxes (VAT). One problem to address is the relative decline of trade taxes (as a result of tariff liberalisation) and the introduction of consumption taxes such as VAT or energy taxes. Although indirect taxation is a practical way forward to widen the tax base in economies with large informal sector, VAT is not an ideal

[1] Where personal income tax generates around 7% of GDP in developed countries - and is paid by about 45% of the population, the corresponding number for developing countries is only 2% of GDP - paid by less than 5% of the population.

instrument since it consists of a regressive system of taxation. Moreover, VAT has the disadvantage of being harder to collect than the trade taxes it has replaced. Tax reform should be geared to developing direct taxation, while ensuring that multinational enterprises pay a fair share of taxes.

"Ownership" of taxation strategy

Taxation is not just a technical issue which can be transferred from one context to another without taking account of local authorities. Donor's approach must be sensitive to each country's specific socio-economic environment.

Better coordination between donors

Donors can do more to support revenue-raising efforts in partner countries in ways that are likely to improve governance. A study led by the IMF in 2005 shows that of the USD 7.1 billion spent in 2005 on bilateral aid for government administration, economic policy and public sector financial management, only 1.7% went on tax related assistance. The figures for 2004, 2003 and 2002 were 2.7%, 2.2% and 3.5% respectively[1]. In addition, there is a need to better reflect the impact of different aid modalities on domestic accountability and tax.

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[1] Sources: "Governance, Taxation and Accountability: issues and practices", OECD 2008.