Tax and development - Cooperating with developing countries on promoting good governance in tax matters

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PURPOSE: Commission Communication on cooperating with developing countries on promoting good governance in tax matters.

CONTEXT: this Communication aims to improve synergies between tax and development polices by suggesting ways in which the EU could assist developing countries in building efficient, fair and sustainable tax systems and administrations with a view to enhancing domestic resource mobilisation in a changing international environment. The European Parliament has expressed strong support in this regard. In many developing countries, the sustainable provision of public services that is necessary to achieve and maintain the Millennium Development Goals (MDG) requires an increase in domestic revenue. Their tax-to-GDP ratio ranges between 10 to 20% as opposed to 25 to 40% in developed countries. Increasing domestic revenue not only creates additional space for supporting MDG-related spending, it also allows a country to assume ownership for its policy choices.

The paper sets out the difficulties encountered by developing countries when attempting to increase their domestic tax revenues, including the structure of their economies with large informal sectors, and the predominance of agriculture over industry and services, The increasing integration of international markets and the economic globalisation also affects the effectiveness of national tax systems. Implementation of domestic tax rules becomes difficult in a world with an increasing geographical mobility of taxpayers, the volume of trade and capital flows and the use of new technologies.

The Commission believes the donor community can do more and make better use of the existing funds and instruments by setting up **a more consistent approach in this area**. It highlights the importance of assistance, including technical cooperation, in designing developing countries' tax systems and implementing the principles of good governance in the tax area. For example, in 2009 the Commission has disbursed EUR 117 million on ongoing activities and committed an additional EUR 49 million in new projects to support public financial management, including tax policy and administration, in developing countries.

CONTENT: this Communication aims to improve synergies between tax and development polices by suggesting ways in which the EU could assist developing countries in building efficient, fair and sustainable tax systems and administrations with a view to **enhancing domestic resource mobilisation in a changing international environment**. The European Parliament has expressed strong support in this regard. In many developing countries, the sustainable provision of public services that is necessary to achieve and maintain the Millennium Development Goals (MDG) requires an increase in domestic revenue. Their tax-to-GDP ratio ranges between 10 to 20% as opposed to 25 to 40% in developed countries. Increasing domestic revenue not only creates additional space for supporting MDG-related spending, it also allows a country to assume ownership for its policy choices.

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The Commission proposes to:

1)strengthen support to domestic revenue mobilisation in developing countries, in the context of its broader efforts to strengthen good governance and public finance management in these countries, by:

- increasing the effectiveness of the support to developing countries' capacities to raise domestic revenues in line with the principles of good governance in the tax area. This will be done in particular through a more comprehensive approach in support of tax reforms and administration, increased support to demand-driven regional and international capacity development initiatives, including EITI and IMF initiatives, and better donor coordination at EU and international levels;
- making best use of relevant dialogue and assessment tools, e.g. governance criteria, profiles, action plans, for ensuring an effective monitoring of domestic revenue issues and good governance commitments in the tax area;
- better integrating tax issues when assessing budget support eligibility and supporting Public Financial Management reforms;
- strengthening monitoring capacities in developing countries in the fight against illicit financial flows, including through support to non-state actors;
- supporting regional institutions and countries engaged in economic regional integration and trade liberalisation, and strengthening their capacity to improve domestic tax revenue mobilisation.

2) promote the principles of good governance in tax matters, and support developing countries to fight against tax evasion and other harmful tax practices, by:

- encouraging and supporting closer cooperation between relevant OECD and UN bodies when developing international standards of tax cooperation, taking into account the specific needs and capacities of developing countries;
- including, as appropriate, a specific reference to strengthening tax systems and to the principles of good governance in the tax area in all development cooperation agreements with third parties;
- providing technical cooperation to developing countries committed to the principles of good governance in the tax area to enable them to conclude and implement TIEA and, where appropriate, DTC;
- supporting the adoption and implementation of the OECD transfer pricing guidelines in developing countries;
- supporting ongoing research on a country-by-country reporting requirement as part of a reporting standard for multinational corporations, notably in the extractive industry.