

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

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The Committee on Development adopted the own-initiative report drafted by Eva JOLY (Greens/EFA, FR) on Tax and Development – Cooperating with Developing Countries on Promoting Good Governance in Tax Matters.

Recalling that taxation can be a reliable and sustainable source of development finance if there is a progressive taxation regime, an effective and efficient tax administration to promote tax compliance, and transparent and accountable use of public revenue, Members stress that many developing countries do not even attain a minimum tax level which would be necessary to fund public services. The report states that **tax provides a source of income that is potentially more stable and sustainable than aid flows and fosters the ownership of the respective countries in a better way.**

(1) The importance of taxation for meeting the MDGs: Members agree with the Commission that efficient and fair tax systems are crucial for poverty reduction. They welcome the Commission's initiative to strengthen the capacities of good tax governance for development and sees the need for a regulatory framework designed to support international tax cooperation. They regret that too little support has been given so far by donors to tax-related assistance. In this context, they welcome the Commission's proposal to provide enhanced support for assisting developing countries in tax reforms.

Other salient issues include:

- **difficulties encountered by developing countries in raising tax revenues:** Members note with concern that the tax system in many poor countries remains characterised by extremely narrow tax bases, tax exemptions for the elite, corporate tax holidays providing a strong incentive for tax avoidance. Pointing out that efficient, progressive and equitable taxation systems are crucial for development, Members underline that further attention should be paid to difficulties encountered by developing countries in raising domestic revenues in a globalised context. The report stresses that the poorest countries are having difficulties in compensating for the decline in trade taxes resulting from the current global context of trade liberalisation, by replacing them with other types of domestic resources, since at best about 30% of lost trade taxes have been replaced. **Tax revenue must not be regarded as an alternative to foreign aid**, but rather as an integral part of public revenue facilitating these countries' development. Members highlight that tax havens weaken democratic governance, make economic crime more profitable, encourage rent-seeking and increase the inequitable distribution of tax revenues. Therefore, they urge the EU to make the fight against tax havens and corruption a top priority of the agenda in international finance and development institutions.

(2) Supporting effective, efficient, fair and sustainable tax systems: good governance and the quality of institutions represent the most important driver for economic prosperity. Accordingly, Members urge the Commission to assist the tax authorities, the judiciary and the anticorruption agencies in developing countries. The principles of good governance in tax matters should be integrated into the programming, implementation and monitoring of country and regional strategy papers.

The Commission is called upon to include a tax governance clause, including monitoring of its implementation, in relevant agreements between the EU and third countries.

Member States are urged to implement their commitments regarding their aid for tax and to combat bribery committed by companies domiciled in their jurisdictions but which have operations in developing countries.

On the issue of **Economic Partnership Agreements (EPA)**, the report points out that the decline in customs resources brought about in particular by Economic Partnership Agreements with the European Union is having a negative impact on the financial resources immediately available to developing countries. In that context, and to compensate for those losses, it calls on the Commission to encourage developing countries, as part of any assistance given to improve their national tax systems. Furthermore, it calls for the systematic implementation, in the framework of EPAs, of measures to support tax reforms, in the form of both material assistance (IT systems) and organisational assistance (legal and tax training for tax authority staff), if requested by a developing country.

Members reaffirm the need to **enhance the degree of coherence between the European Union's development policy and its trade policy** given that the European Union remains the leading development aid donor, accounting for 56% of the worldwide total, worth €49 billion in 2009. They stress that, in this context, it ought to be a priority for developing countries to put in place an efficient tax system so as to reduce their dependence on foreign aid and other, unpredictable, external financial flows.

Members also call on the development countries to:

- give priority to progressive direct taxes over indirect taxes, particularly those levied on consumption, which, by their nature, hit low-income population groups harder;
- devise alternative sources of revenue collection to encourage innovation, entrepreneurship and the creation of SMEs, strengthening ownership and local development;
- limit administrative costs related to tax;
- tax companies which may account for increased tax revenue (for example those engaged in the extraction of raw materials);
- negotiate with multinational corporations in order to secure an equitable share of corporations' profits;
- favour a system of low-rate taxation of low and medium incomes founded on a broader tax base and excluding all discretionary tax exemptions and preferences, including for the extractive industries;
- concentrate on the principles of neutrality, equality and simplicity with regard to tax systems, which should be achieved by:
 1. a tax that does not take up a greater share of poor people's income but a greater proportion of the taxpayer's income or wealth as it increases;
 2. a tax that does not discriminate on the basis of gender, sexual orientation, type of household, citizenship or civil status;
 3. a clear, simple and transparent tax system which excludes different types of undesirable interpretation of tax laws with the aim of gaining massive tax reductions at the expense of social spending;
 4. identical treatment for tax purposes of true gains and true losses from any given source of income, meaning that the gains are taxable and the losses deductible;
 5. a level of taxation that is robustly linked to different stages of economic development;
 6. the unification of multiple corporate income tax rates by calculating income tax rates on the basis of business volume rather than business sectors.

(3) Working towards a transparent, cooperative and fair international tax environment: Members stress that trade mispricing is one of the most prominent drivers of illicit financial outflows. They call on

the Commission to contribute to enhancing public expertise on such issues in developing countries, and 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. They call for a **review of global tax rules** and urge 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.

Once again, Members call for the **introduction of a tax on financial transactions**, the revenue from which would improve the functioning of the market by reducing speculation and help to finance global public goods such as development and the fight against climate change, and reduce public deficits. Such a tax ought to be as broadly based as possible but, failing that, that the financial transaction tax should be introduced as a first step at the EU level.

Members call for the approach as regards **extractive industries to be reformed**. They urge the development of initiatives to promote greater transparency in natural resource rents. They stress that exploitation of natural resources should be pursued in order to help a country meet its broader social and economic goals. New arrangements in this field should take the form of generalised international standards. The Commission is called upon to step up its development assistance on the formulation of contracts between multinational companies and developing countries on resource exploitation issues.

Lastly, Members call for the **international architecture to combat tax havens to be improved**. They deplore the fact that the G20 has not yet proposed a clear timetable and concrete sanction mechanism to make effective the fight against tax havens. They recall that as much as EUR 800 billion is lost each year from developing countries to tax havens and illicit financial flows. The report 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. It notes that, since the G20 Summit of 2 April 2009, offshore financial centres have committed to OECD standards on transparency and exchange of information. It notes however that the harmful structures of tax havens still prevail and calls once more for action beyond the OECD framework to combat tax havens in view of their various shortcomings. It also 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;
- the EU to adopt measures similar to the US Stop Tax Haven Abuse Act and to consider the possibility of withdrawing banking licences from financial institutions that operate with tax havens;
- international disclosure of the structures of vulture funds to identify them and ban their activities.

The report calls for a clause to be introduced **providing for a mandatory overall review of all EPAs within three to five years** and for the provisions of each agreement to be amended to make them more conducive to poverty eradication, sustainable development and regional integration. A mandatory review of individual countries' progress in implementing tax reforms or efficient tax collection in line with the latest versions of the OECD Model Tax Convention on Income and on Capital is considered necessary.

Lastly, Members consider that the development of an efficient tax system in developing countries must become the backbone of their public finances.