Joint Meeting of the United Nations General Assembly Second Committee
and the
Economic and Social Council

"Domestic Resource Mobilization: Where to go after Addis?"

Organized by the Financing for Development Office (FfDO) of the Department of Economic and Social Affairs (DESA)

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Concept Note

Background

Tax issues have featured prominently in international news as of late, ranging from the announcement of the European Commission that some preferential tax rulings constitute state aid and the proposal of new tax rules, developed jointly by the Group of 20 (G20) and the Organisation for Economic Co-operation and Development (OECD), to the deliberations on the institutional arrangements for international tax cooperation, including on strengthening of the UN Committee of Experts on International Cooperation in Tax Matters (the UN Tax Committee), that took place during the negotiations of the Addis Ababa Action Agenda (AAAA).

In September 2015, Member States of the United Nations (UN) adopted the 2030 Agenda for Sustainable Development, including 17 Sustainable Development Goals (SDGs). The 2030 Agenda sets out a universal and transformative vision of a world free from poverty, hunger, disease and want, while protecting the environment. The implementation of the 2030 Agenda will be supported by the Addis Ababa Action Agenda, which was adopted by UN Member States in July 2015 as an integral part of the 2030 Agenda for Sustainable Development. The AAAA provides a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social and environmental priorities.

Domestic resources mobilization is central to sustainable development. Taxes represent a stable source of finance that, complemented by other sources, will be critical in financing development and essential in providing public goods and services, increasing equity, and helping manage macroeconomic stability. The growing recognition of the importance of taxation to achieving sustainable development is underscored by the AAAA, which refers to 'tax issues or matters' 35 times compared to 4 times in the 2002 Monterrey Consensus. In the AAAA, all States made commitments in several areas of tax policy aimed at raising domestic resources and fighting illicit financial flows. These include commitments for domestic efforts, including in the area of tax administration, tax policy, tax incentives, tax evasion and avoidance as well as for increased capacity building and strengthened international cooperation on tax issues.

Key Issue: Tax Administrations Need Adequate Capacity

While many countries have made improvements to their tax administrations in the last two decades, the capacity of tax collection and enforcement remains a concern in many developing countries. Indeed, the average tax-to-GDP ratio for low income countries is estimated to be around half of that of member countries of the Organization for Economic Co-operation and Development (OECD).[1]

Revenue administrations often suffer from under-resourcing, lack of strategic focus, and difficulty in attracting and retaining skilled labor. A number of studies have pointed to the lack of funding for capacity building in the area of tax policy and tax administration in developing countries.[2] To date, technical assistance to the revenue and customs sector has attracted a minimal share of Official Development Assistance (ODA). In 2013, it is estimated that less than $100 million of ODA from donors of the OECD's Development Assistance Committee is targeted directly at domestic resource mobilization and tax administration, less than 0.06% of the total.[3]

Recognizing the centrality of capacity building for domestic resource mobilization, four major initiatives were launched during the third International Conference on Financing for Development:

- In the *Addis Tax Initiative*, more than 30 countries and international organizations have teamed up to enhance the mobilization and effective use of domestic resources and to improve the fairness, transparency, efficiency and effectiveness of tax systems. Donor countries will collectively double their technical cooperation in the area of domestic revenue mobilization and taxation by 2020, while partner countries restated their commitment to stepping up domestic resource mobilization.
- The *Tax Inspectors Without Borders* project, a joint initiative of the OECD and the United Nations Development Programme (UNDP), will facilitate targeted tax audit assistance in developing countries. Tax audit experts will work alongside local officials in developing country tax administrations to help strengthen their tax audit capacities.
- The joint International Monetary Fund/World Bank initiative has two pillars: deepening the dialogue with developing countries on international tax issues, aiming to help increase their voice in the international debate on tax rules and cooperation; and developing improved diagnostic tools to help member countries evaluate and strengthen their tax policies.
- The Member States of the Economic and Social Commission for Asia and the Pacific (UNESCAP) are considering the establishment of an Asia and the Pacific Tax Forum, a

[1] OECD (2014). Revenue Statistics 2013 Edition. Available from http://www.oecd.org/ctp/tax-policy/revenue-statistics-19963726.htm; IMF (2011). Revenue mobilization in developing countries. Available from imf.org/external/np/pp/eng/2011/030811.pdf

[2] For example: OECD (2015). Strengthening Tax Systems to Mobilise Domestic Resources in the Post-2015 Development Agenda. Available from http://www.oecd.org/dac/Post%202015%20Domestic%20Resource%20Mobilisation.pdf

[3] See Development Initiatives (2014). Aid for domestic resource mobilisation: how much is there? At http://devinit.org/wp-content/uploads/2014/02/Aid-for-domestic-resource-mobilisation-%E2%80%93-how-much-is-there.pdf; the updated figures used in this paper will be published shortly

grouping of tax experts to catalyze regional action to raise the region's low tax-to-GDP ratio. This would build on the successes of similar networks in Africa and Latin America.

In addition, the Capacity Development Unit of the UN-DESA Financing for Development Office (FfDO) has developed an extensive portfolio of capacity development tools, activities and other resources in the area of international tax cooperation, as a result of a unique collaborative engagement between government representatives from developing countries and Members of the Committee.

Owing to the fact that FfDO provides Secretariat support to the UN Tax Committee, its capacity development programme draws, to a large extent, on the outputs of the Committee with a view to disseminating and operationalizing them as capacity development tools for the benefit of developing countries. Accordingly, two early areas of focus of the programme have been: (1) Double tax treaties based on the 2011 *United Nations Model Double Taxation Convention between Developed and Developing Countries* (UN Model); and (2) Transfer pricing based on the 2012 *United Nations Practical Manual on Transfer Pricing for Developing Countries* (UN TP Manual).

More recent work focuses on protecting and broadening the tax bases of developing countries. The relevant activities draw upon and contribute to the work of the Committee's Subcommittee on Base Erosion and Profit Shifting (BEPS) Issues for Developing Countries, as well as the OECD's work on BEPS, as appropriate. A first tangible result in this area was the publication of the *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, which was presented as a concrete deliverable in the area of domestic resource mobilization during the Addis Ababa Conference.

Leading Questions for Discussion:

- What are the needs of developing countries for capacity building in tax policy and tax administration?
- Are the new initiatives adequately calibrated to the needs of developing countries?
- How can the international community address these needs effectively and efficiently in a coordinated manner?
- What role can South-South cooperation play?
- How can the Financing for Development follow-up process be used to bring together a range of voices and sharing of experiences?

Key issue: International Tax Cooperation

It is important to recognize that there are certain limits on what individual governments can accomplish in a globalized economy. As value chains have become stratified over many jurisdictions, and in light of increasingly aggressive tax planning by some multinational companies and individuals, tax evasion and avoidance are problematic for all countries. The OECD recently published estimates on the loss in corporate income tax and concluded that between four and ten per cent of global corporate income tax revenues are lost due to base erosion and profit shifting, which translates to US$ 100 to 240 billion annually. Estimates of the impact on developing countries, as a percentage of GDP, are even higher than for developed countries, given their greater reliance on corporate income tax. Tax evasion and avoidance practices have a greater chance of not being detected in countries with overstretched tax administrations, and are more strongly felt in countries where other revenues are lacking, emphasizing the importance of pursuing building domestic capacity. At the same time, as multinational companies are engaging in tax arbitrage, governments can only effectively counter tax evasion and avoidance in a concerted manner through international cooperation.

A number of initiatives from the UN and the OECD have sought to curb tax evasion and avoidance, including tax-related illicit financial flows. The UN Tax Committee has, for example, published the Practical Manual on Transfer Pricing for Developing Countries to provide clear guidance on the policy and administrative aspects of transfer pricing according to the arm's length principle to combat potential profit-shifting between jurisdictions where multinational companies operate. At its eleventh session in October 2015, the Committee approved a new article to be included in the next update to the UN Model Treaty to counter "Fees for Technical Services" being used by multinationals to strip profits from their subsidiaries, thus eroding the host country's tax base. The Committee has also approved guidance on the taxation of the extractive industries, such as on capital gains taxation including indirect sales and on tax treaty issues.

The joint project of the G20 and the OECD on Base Erosion and Profit Shifting (BEPS) was finalized in October 2015 and proposed changes to the OECD Model for double tax treaties, modifications to the OECD's transfer pricing rules and provided guidance on domestic legislation, for example on Controlled Foreign Corporation (CFC) rules. There have also been changes to how tax information will be exchanged, with a new standard for automatic exchange of information (AEOI), i.e. the Common Reporting Standard, being adopted by 94 jurisdictions for implementation in 2017 or 2018.

Despite the fact that both the UN Tax Committee and the OECD propose to use the arm's length principle in valuing the transfer of goods, services, finances and intangibles within an MNE group, there are debates on whether this is the most appropriate mechanism to avoid the shifting of profit. According to the arm's-length principle, transfer prices charged between associated enterprises reflect prices charged between independent entities at arm's length, taking into account circumstances specific to the transaction at hand. However, some academics and non-governmental organizations (NGOs) have pointed to difficulties with this approach, such as the complexity in pricing some items, such as intellectual property, where no clear market price exists. Alternative approaches would treat profit-maximization as occurring at the level of the MNE itself ('unitary taxation'), with mechanisms to allocate group profit to the entities making up the MNE group, according to a fixed formula agreed in advance and intended as a proxy for the level of economic activity in each jurisdiction ('formulary apportionment') [4] In turn, questions have been raised about how effective and beneficial a unitary approach, particularly a global one, would be for developing countries and whether an agreed formula is even possible.[5]

Another area of debate is on the institutional arrangements for international tax cooperation. There are currently over 3,000 bilateral tax treaties and two sets of model treaties. The AAAA

[4] For example: Picciotto, S. (2013) http://www.ictd.ac/sites/default/files/ICTD%20WP13_0.pdf; Independent Commission for the Reform of International Corporate Taxation (2015). http://www.icrict.org/declaration/.

[5] For example: Spencer, D. (2014). Transfer Pricing: Formulary Apportionment is not a panacea, Part 6. *Journal of International Taxation*.

stressed that efforts in international tax cooperation should be universal in scope and approach and should fully take into account the different needs and capacities of all countries. This principle now needs to be translated into practical working arrangements, especially in relation to the UN role.

Leading Questions for Discussion:

- What additional efforts should international organizations take to counter tax evasion and avoidance?
- Are the new rules that are suggested in the OECD/G20 Action Plan on BEPS and on AEOI appropriate for developing countries?
- How can the different international organizations effectively work together to avoid duplication of efforts keeping in mind their respective mandates?
- How can progress be measured in these areas?