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Why should business be interested in tax and development?

A successful tax administration in developing countries will ultimately determine the quality of the investment climate, Pascal Saint-Aman asserts

Even the most casual reader of daily newspapers will have noticed that the column inches devoted to tax matters is expanding by the day, particularly since the onset of the financial crisis. Much of the attention concerns big business and high profile individuals and issues of fairness or even injustice over taxation. From much of the coverage, the reader is left with the impression that the battle lines are uncompromisingly drawn between big business on one side and the campaigning NGOs on the other, fighting out whether corporations are paying their fair share of taxes in developing countries.

Yet there is far more common ground between the two sides than one might expect. I witnessed this first hand at the latest meeting of the OECD's Task Force on Tax and Development held in Cape Town in May. The Task Force brings together representatives from the tax and aid communities from OECD and developing countries, business, international organisations and NGOs. This unique alliance aims to improve the climate in which developing countries can collect taxes fairly and effectively.

The different stakeholders in the Task Force agree on the fundamental challenges facing low income countries. Half of sub-Saharan African countries still mobilise less than 17% of their GDP in tax revenues, below the minimum level of 20% considered by the UN as necessary to achieve the Millennium Development Goals. Several Latin American countries fare little better. Moreover, regressive tax structures, the result of low direct and high indirect taxes plus tax evasion, weaken the legitimacy and credibility of tax systems and states more generally.

The shift away from tariffs and customs duties in favour of VAT is a difficult transition for developing countries to manage. Moving towards simpler, more equitable and more transparent tax systems and a broadening of the tax base is not easy, but would reap benefits over time. Perceptions of corruption and weak capacity means that progress will be incremental. The reciprocal link with public expenditures is critical and the vicious circle of low tax morale leading to poor compliance needs to be broken.

The external environment poses new challenges, too. Competition between developing countries for investors can trigger a race to the bottom. Globalisation may also exacerbate these fiscal problems, as internationally mobile income and capital becomes more difficult to tax. Developing countries face challenges in designing and implementing effective transfer pricing and information exchange regimes and more generally in improving transparency.

In the Task Force both the NGOs and the business community have set out their concerns. NGOs are concerned that there is abusive exploitation of gaps in both domestic and international tax law by multinational enterprises,

investors are looking for certainty and predictability in tax matters and this means they have a clear interest in helping build the capacity of tax administrations in the developing world leading to profits being shifted out of developing countries to low tax territories, which erodes the tax base of developing countries. NGOs are equally concerned that many developing country tax administrations do not have the capacity to address such abuse.

Businesses who are investors in developing countries care greatly about tax policy and administration. They need to know that they will not be treated in an arbitrary way or that corruption will threaten their investments and operations. More broadly, they have longer-term interests that depend on revenues being successfully converted into development outcomes - infrastructure, health and education, the factors which ultimately determine the quality of the investment climate.

Fundamentally, investors are looking for certainty and predictability in tax matters and this means they have a clear interest in helping build the capacity of tax administrations in the developing world. I often hear from businesses that they much prefer to deal with knowledgeable tax auditors, who apply relevant domestic and international tax principles in a consistent and fair manner. So the building of capacity is a shared priority for all stakeholders.

In international tax matters, business can help. In the work that the OECD has begun in partnership with the World Bank and European Commission to build effective transfer pricing regimes in Rwanda and Colombia, business is playing a role by providing industry specific briefings to help tax administrations understand how the supply chains and costs structures operate in the mining industry for example. This basic industry knowledge underpins the tax administration's approach to understanding transfer pricing risks.

Business can also help in the area of tax incentives offered by developing countries to investors. Many countries, developed and developing alike, offer various incentives in the hope of attracting investors and fostering growth. Yet there is strong evidence that calls into question the effectiveness of some tax incentives, particularly tax holidays.

Although business must maximize profits and minimize costs they should refrain from seeking or accepting exemptions not contemplated in the statutory or regulatory framework related to taxation, financial incentives, or other issues, as set out in the OECD Guidelines for Multinational Enterprises.

Even in controversial areas where business and civil society are unlikely to agree, on proposals put forward for country by country reporting, (for example, the proposals call for multinational enterprises to be required to report sales, profits and taxes paid in their audited annual reports and tax returns for each jurisdiction in which where they operate), business can engage positively. Some businesses are taking unilateral decisions to increase transparency. In 2011 Rio Tinto, for example, won PricewaterhouseCooper's Building Public Trust award for reporting taxes transparently.

There is clearly much more all stakeholders - government, business and civil society - can do to help developing countries. But there are grounds for optimism. Several countries, including Rwanda, El Salvador and Tanzania, have made significant advances, often in the most challenging governance environments. Of most importance, the call for action is increasingly coming from developing countries themselves. In Africa, the creation of the African Tax Administration Forum, driven, managed, and in due course to be operationally funded by Africans, is providing a key platform for peer learning, capacity development and dialogue on domestic and international tax issues. In the Americas, the Centro Interamericano de Administraciones Tributarias is a well established platform for regional action.

At the international level, the G20 is helping to focus external support for domestic resource mobilisation, helping to reverse an era of relative neglect of tax as a development priority. Under G-20 political leadership, the OECD hosted Global Forum on Transparency and Exchange of Information for Tax Purposes is making significant progress in addressing offshore non-compliance and the Task Force on Tax and Development can help with a broader range of capacity building concerns. ■

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