
**Committee of Experts on International
Cooperation in Tax Matters
Seventeenth session**

Geneva, 16-19 October 2018

Item 3 (c) (ix) of the provisional agenda

Taxation of development projects

Tax Treatment of ODA Projects

Note by the Secretariat

Summary

This note is presented FOR DECISION at the meeting of the Committee to be held in Geneva on 16-19 October 2018.

The note provides a short background on the work done on the tax treatment of ODA projects. It indicates that, through written procedure, the Committee decided, on 10 September 2018, to continue its work on this topic.

The Committee is now invited to decide whether a subcommittee on the tax treatment of ODA projects should be set up to carry forward the work on this issue and, if it decides to establish such a subcommittee, to select a coordinator and agree on the mandate of the subcommittee.

Background

1. At the fifteenth session of the Committee (Geneva, 17-20 October 2017), a number of members and observers stressed the importance of addressing the issue of the tax treatment of ODA projects and the Committee decided that the next step would be to have a paper prepared for discussion at the sixteenth session of the Committee.

2. That paper, note E/C.18/2018/CRP.5, included an annotated version of the 2007 draft guidelines that had been first discussed at an informal meeting that took place on 12 February 2018 in the margins of the first global conference of the Platform for Collaboration on Tax on “Taxation and the Sustainable Development Goals” (held at the UN headquarters in New York on 14-16 February 2018). The issue of the tax treatment of ODA projects was also raised during that conference itself and the Platform Partners’ Statement that was released at the closing of the conference indicated that the Platform’s Partners (i.e. the International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations and World Bank) intended to “review current practice, and provide guidance and recommendations, on the tax treatment of ODA funded goods and services.”

3. At the sixteenth session of the Committee (New York, 14-17 May 2018), the Secretariat introduced note E/C.18/2018/CRP.5 by reminding the Committee that the issue of the tax treatment of ODA projects had been on the agenda of the Committee since the first session in 2005. It described the work previously done and observed that the issue of the tax treatment of ODA projects was now attracting more attention in the context of efforts to increase domestic resource mobilization in order to achieve the SDGs.

4. The following summarizes the interventions that were made during the discussion of the note by the Committee:

- One member observed that the present membership of the Committee had not yet taken a decision as to whether this issue should be addressed and that one approach could be to simply leave the issue to the Platform for Collaboration on Tax, which is doing its own work on this topic.
- Other members stressed the importance of the issue but requested more time to examine the annotated version of the 2007 draft guidelines before considering possible next steps.
- A representative from the Overseas Development Institute noted that the tax treatment of ODA projects was an important issue for developing countries. He indicated that the Institute had just released a paper on this issue and suggested that the Development Assistance Committee of the OECD could also play a useful role in this area.
- One member expressed concerns about the part of the 2007 draft guidelines dealing with the income taxation of services performed in a partner country, suggesting that if work was carried out in a country, the remuneration of that work should be taxed in that country. Another member supported that view. It was noted, however, that the main object of the guidelines was to reflect internationally-agreed standards concerning residence-source taxing rights and that in some limited cases, such as when services are performed by employees of a foreign State, it was generally agreed that the remuneration should not be taxed in the State where the services are performed.

- A question was also asked concerning the World Bank Group’s practice in this area and the observer from the WBG agreed to try to get more information on this.

5. At the end of the discussion, the Chair invited all interested parties to send written comments on the annotated version of the Draft Guidelines and on the issue of whether the Committee should continue its work in this area. One member then asked what follow-up should be given to the proposal, made by some members at the October 2017 meeting of the Committee, that a subcommittee be set up to carry on follow-up work in this area. The Chair responded that before discussing whether a subcommittee should be set up, the Committee needed to endorse the proposal to continue the work on the revision of the 2007 Draft Guidelines. Stressing again the importance of the issue for developing countries, the same member expressed the wish that a subcommittee on the tax treatment of ODA projects could be set up at the October 2018 meeting of the Committee.

6. The issue of the tax treatment of ODA projects was also discussed at the one-day Special Meeting of ECOSOC on International Cooperation in Tax Matters which was held immediately after the Committee’s sixteenth session. A report on the discussion of the topic during that meeting is included in the Annex.

Follow-up

7. The main issue that needed to be addressed after the May meeting of the Committee was whether or not the Committee should continue its work on the topic of the tax treatment of ODA projects.

8. The Committee members were asked for their views on this question. Since six of the eight Committee members who responded supported the continuation of the work, the Co-Chairs of the Committee wrote to all Committee members seeking approval, through written procedure, of their recommendation that the Committee continue its work on the tax treatment of ODA projects. On 10 September 2018, the Committee endorsed that recommendation.

9. The next step for the Committee is to address the suggestion that a Subcommittee on the tax treatment of ODA projects be set up (see paragraph 5 above).

10. Only two Committee members sent written comments on the 2007 Draft Guidelines after the May meeting of the Committee. Some of these comments raised substantive issues that should be discussed by other members. Also many Committee members from developing countries have previously dealt with issues related to the drafting and application of special exemptions for ODA projects and could help to improve the 2007 Draft Guidelines. It would also be important to ensure that work in this area benefits from the input of various other stakeholders. For these reasons, setting up such a subcommittee would appear to be an efficient way of moving forward on this topic.

11. If the Committee decides to establish a Subcommittee on the tax treatment of ODA projects, it will need to select a coordinator and agree on the mandate of the Subcommittee. That mandate could be drafted along the following lines:

The Subcommittee is mandated to update and finalize the 2007 Draft Guidelines on the Tax Treatment of ODA projects that were attached to note E/C.18/2018/CRP.5, taking into account, among other things, the annotations included in that document and the written comments sent by Committee members. In carrying on that work, the Subcommittee shall

- Pay special attention to the experience of developing countries and of governmental and inter-governmental donor agencies.
- Ensure that its work draws upon and feeds into, as appropriate, the relevant work on the issue done in other fora, especially the Platform for Collaboration on Tax.

The aim of the Subcommittee shall be to present to the Committee a revised version of the 2007 Draft Guidelines for consideration with a view to their adoption at the first meeting of the Committee in 2020. Updates on the progress of the work shall be provided to the Committee at each preceding session. The Subcommittee may request the Secretariat to develop necessary inputs and provide necessary support within its resources.

ANNEX

Summary of the Panel on Taxation of ODA projects at the 2018 ECOSOC Special Meeting on International Cooperation in Tax Matters

1. The panel session on “Taxation of ODA Projects” was moderated by Mr. Jacques Sasseville from the Secretariat and featured presentations by Mr. Abdoufatah Moussa Arreh, Head, Tax Policy Unit, Ministry of Economy and Finance, Djibouti (delivered by Mr. Sasseville in the absence of Mr. Moussa Arreh); Ms. Titia Stolte-Detring, Deputy Head of Division, International Tax Section, Federal Ministry of Finance, Germany; Ms. Elfrieda Stewart Tamba, Commissioner General, Liberia Revenue Authority, and Mr. Christophe Waerzeggers, Senior Counsel, International Monetary Fund. The panel also featured interventions by the following speakers from the floor: H.E. Mr. Marc Pecsteen de Buytswerve, Permanent Representative of Belgium to the United Nations; Mr. Dang Ngoc Minh, Deputy Director General, General Department of Taxation (GDT), Ministry of Finance, Viet Nam, and Ms. Natalia Aristizabal Mora, Vice-Chairperson, Committee of Experts on International Cooperation in Tax Matters.
2. The moderator introduced the session by noting the commitment, included in the Addis Ababa Action Agenda, to “consider not requesting tax exemptions on goods and services delivered as government-to-government aid, beginning with renouncing repayments of value-added taxes and import levies.”
3. Mr. Sasseville presented the slides prepared by Mr. Moussa Arreh, which first described the importance of foreign-funded development projects in the economy of Djibouti, where the amounts spent on such projects are almost equivalent to the State’s entire budget. It was estimated that in recent years, the wide range of tax exemptions (from both direct and indirect taxes) granted to donors with respect to these projects resulted in a loss of tax revenues corresponding to between 10% and 15% of the total tax revenues of Djibouti. Administering these exemptions, which are incorporated in different provisions included in bilateral agreements with donors, raises a number of difficulties for the tax administration. For these reasons, requesting such exemptions was difficult to reconcile with efforts to increase domestic resource mobilization in Djibouti.
4. Ms. Stolte-Detring provided an overview on some common reasons why donors request tax exemptions for ODA projects. She argued that such exemptions reduce the compliance costs for donors, who have to deal with a wide range of tax systems and legal requirements in the different countries where they provide ODA. She remarked that it is easier to get political support in donor countries for targeted assistance projects than for providing budgetary support to a partner country through the payment of taxes. She also referred to concerns that taxes paid to a partner country by a donor might be misused because of weaknesses in the partner country’s institutions or might be used for purposes that would be contrary to public policy (*ordre public*) in the donor country. She observed that tax costs reduce the amount of funding that is directly used for a development purposes. Finally, she mentioned the difficulties that would arise, if these exemptions were to be removed, from the need to renegotiate the large number of bilateral development cooperation treaties that include such exemptions.
5. Ms. Stewart Tamba began her presentation by expressing her country’s gratitude to donor countries that provide development assistance to Liberia, a country experiencing a

significant funding gap representing more than 20% of its national budget. She observed that the need for such development assistance put Liberia in a difficult position when negotiating development assistance contracts with donor countries, which explains why it has granted a wide range of tax exemptions to these donors. She referred to the costs associated with the administration of these exemptions and to the economic distortions and risks of tax avoidance that they create. These exemptions affect the effectiveness and fairness of the tax system and the uniform application of tax law, thereby undermining the integrity of the tax system. Ms. Stewart Tamba suggested to limit exemptions to capital taxes, thereby allowing the collection of income taxes and custom duties, in particular as regards natural resources. She also suggested that donor agencies should accept to withhold and remit taxes and facilitate compliance through administrative measures such as requiring tax identification numbers when making payments to service providers.

6. Mr. Waerzeggers observed the lack of significant progress in defining a consistent approach at the international level on exemptions for development projects, however noted the relevance of the issue for developing countries. He remarked in particular the significant administrative difficulties at the domestic level, deriving from multiplicity of exemption systems, which also undermined international efforts in promoting consistency and certainty for both taxpayers and tax administrations, including by the Platform for Cooperation on Tax. Mr. Waerzeggers also noted that such exemptions posed transparency and governance issues, as provisions would often be found in a range of non-public agreements, negotiated by different government actors than the ones who would be tasked with their implementation.

7. Mr. Sasseville remarked that guidelines on the taxation of official development projects were drafted in 2007 by the United Nations Committee of Experts on International Cooperation in Tax Matters, and that the issue was still on the agenda. He highlighted that such guidelines recognized the significant administrative and governance issues generated by tax exemptions, and stressed the importance of involving tax authorities in the negotiation of such exemptions, which would significantly affect the amount of tax collected.

8. H.E. Mr. Pecsteen de Buytswerve shared the experience of Belgium in changing policies towards the suspension of requests for tax exemptions on development projects. He remarked that such decision resulted from considerations on the problems generated by exemptions, in particular by undermining efforts in domestic resource mobilization, critical for funding the Sustainable Development Goals; by burdening tax administrations; and by increasing the risk of tax evasion and fraud. Within this context, Mr. Pecsteen de Buytswerve recalled the commitments contained in the Addis Ababa Action Agenda, and noted that Belgium decided, in line with other donor countries, to suspend their requests for exemptions on development funding on both new and existing projects, and to advocate with the European Union to encourage the global adoption of similar policies. He also reported that such suspensions would be conditional on criteria related to the status and ongoing reform of the tax system of the recipient country, and would be limited to a period of 5 years, following which an independent evaluation would assess the continuation of the policy. Finally, H.E. noted that suspending tax exemptions might result in tax payments up to 10% of the budget for Belgium development cooperation programmes, and up to 15% on infrastructure projects.

9. Mr. Minh reported that development assistance accounted for a significant share of the national budget of Vietnam, and as a consequence, broad tax exemptions were granted over time. Although the overall impact of foreign aid was beneficial in creating infrastructure and generating economic development, he noted the distortionary effects of widespread exemptions, including unfair competition, tax avoidance and abuse, corruption, and

inconsistency in the tax system. In light of the efforts of Vietnam in increasing the mobilization of domestic resources, Mr. Minh welcomed the work in this area by the United Nations Committee of Experts on International Cooperation in Tax Matters, in particular with respect to the elimination of tax exemptions on goods and services delivered as government-to-government aid. He highlighted that consistent guidelines would support developing countries in the negotiation of development project frameworks, to ensure increased policy consistency, reduced tax avoidance and abuse, and lowered administrative costs.

10. Ms. Aristizabal shared the experience of Colombia in introducing a law addressing the tax treatment of development projects funded by foreign aid. Such law established that projects would be exempt from all taxes, provided that the funding was provided under the framework of a cooperation agreement, and that the project could be considered “for the common good or utility” as defined by the tax authority, and as certified by the government entity in charge of overseeing the project. She highlighted that such process ensured that exemptions would be applied to relevant and appropriate projects. Finally, Ms. Aristizabal noted the potential distortionary effects of exemptions on indirect taxation and financial transactions taxation, and called for caution in this respect.

11. During the brief ensuing interactive discussion, the representative from Zambia further remarked the economic distortions and administrative burdens which might be caused by broad tax exemptions on development projects, and called for the advancement of work in this area by the United Nations Committee of Experts on International Cooperation in Tax Matters. The representative from the Overseas Development Institute welcomed the decision by several donor countries to suspend requests for tax exemptions, and noted the relevance of the issue for the advancement of the Sustainable Development Goals.

12. Panelists concluded by remarking the importance for consistent approaches in tackling issues related to requesting tax exemptions on development assistance projects, and called for the international community to further the analysis and discussion of the issue.