# Foreword


## Stephen E. Shay*


The chapters in this volume examine a series of topics relating to the intersection of tax, law and development. The topics examine, among other matters, the relation of tax incentives in developing countries to tax competition, international tax relations, regional integration and traditional tax policy paradigms; tax expenditure reporting and fiscal federalism in emerging economy contexts; a broader and people-focused conception of tax equity; the expanding institutional role of NGOs in tax policy discussions; and how expanding international tax cooperation can benefit developing countries. The issues considered expand the limited scope of legal academy discussions of tax, law and development[1] and challenge us to adopt a more inclusive approach to thinking about how tax systems can be made more effective to improve the lives of global citizens who live in developing countries.[2]

The timeliness of this work is evidenced by the increasing recognition of 'revenue mobilization' as an important factor in sustainable development. At the turn of this century, the nations of the world adopted Millennium Development Goals (MDGs), including trying to eradicate


* Professor of Practice, Harvard Law School


1 Prior contributions are cited in the chapters in this volume.

2 The 2012 World Bank update on poverty in the developing world reports that in 2008 1.29 billion people lived on less than US$1.25 a day and 2.47 billion people lived on less than US$2.00 a day (in 2005 prices). World Bank Development Research Group Briefing Note, 'An update to the World Bank's estimates of consumption poverty in the developing world', at http://siteresources.worldbank.org/INTPOVCALNET/Resources/Global_Poverty_Update_2012_02-29-12.pdf (last accessed 9 July 2012). Anthony Infanti's Chapter 9 reminds us that per capita income is not the only measure of human wellbeing, and points us to other measures that achieve a more people-centered policy focus. Anthony Infanti, *Internation Equity and Human Development*, at p 209 in this volume.

poverty and achieve sustainable and inclusive growth and development.[3] In 2002 representatives from 109 countries assembled under UN auspices in Monterrey, Mexico, to address the challenges of financing achievement of the MDGs adopted just two years before. Acknowledging that there would be a dramatic shortfall in resources required to achieve MDGs, the resulting Monterrey Consensus set out a multi-part plan to address the resource needs, including mobilizing domestic financial resources for development.[4]

Not incidentally, in the face of post-9/11 market declines, Monterrey had the effect of placing a greater burden of meeting MDGs on developing countries. In general terms, it was anticipated that developing countries would have to increase their revenue performance (measured by tax–GDP ratio) by as much as 4 percent of GDP to be able to achieve MDGs.[5] More recently, the United Nations has set an objective that countries mobilize 20 percent of their GDP in tax revenues in order to achieve the MDGs.[6]

The 2008 global financial crisis and associated recession significantly reduced donor country resources for development aid. In its 2010 Seoul, South Korea meeting, the G-20 leaders added a revenue mobilization work stream to the agenda of the G-20 Development Working Group and tasked the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the United Nations and the World Bank with collaborating on a project plan that would identify actions supporting more effective tax systems in developing countries.

The resulting joint report included recommendations on: key capacity constraints faced by developing countries in their tax systems; helping tax multinational enterprises (MNEs) through effective transfer pricing rules; establishing measures to track progress in tax administrations'

---

[3] Millennium Declaration, General Assembly Resolution 55/2 (18 September 2000). The Monterrey Consensus formulation in 2002 states: 'Our goal is to eradicate poverty, achieve sustained economic growth and promote sustainable development as we advance to a fully inclusive and equitable global economic system.' United Nations, *Report of the International Conference on Financing for Development*, A/CONF.198/11, para.1.

[4] *Ibid.* paras 4, 15.

[5] United Nations, *Investing in Development* (New York: United Nations, 2005) 245. The IMF has pared back expectations to a more realistic objective of increasing revenue mobilization by a range of 2 to 4 percent of GDP. IMF Fiscal Affairs Dept, *Revenue Mobilization in Developing Countries* (8 March 2011).

[6] United Nations, *What Will It Take to Achieve the Millennium Development Goals? An International Assessment* (UNDP, June 2010) 26.

capacity improvements; and developing a knowledge management platform to support tax capacity of developing countries.[7] The topics and recommendations in the joint report to the G-20 Development Working Group did not address the impact of developed country tax policies on developing countries' revenue mobilization, such as fostering internation tax competition, continuing residence country revenue bias in international tax treaties and tolerating tax avoidance by MNEs.[8] The developed economies have remained steadfast in supporting national tax sovereignty and maintaining residence country treaty benefits for foreign direct investment (FDI).

The contribution of tax competition between developed countries to developed countries' fiscal shortfalls through erosion of business income taxes has not been fully acknowledged.[9] The pattern in recent years has been for developed countries to support their local champion MNEs by matching other countries' tax incentive mechanisms and shifting the cost to domestic taxpayers. Prime examples are the recent actions of the United Kingdom and Japan to finance lower corporate tax rates in material part with increases in consumption taxes.

Internation corporate tax competition reduces fiscal flexibility to an even greater extent in developing than in developed countries as the corporate tax remains an important component of developing country tax

---

[7] *Supporting the Development of More Effective Tax Systems: A Report by the IMF, OECD, UN and World Bank to the G-20 Development Working Group* (2011), available at www.imf.org/external/np/g20/pdf/110311.pdf (last accessed 9 July 2012).

[8] One sentence in the Report hinted tantalizingly at the issues that plague developed and developing countries alike: 'Perhaps most fundamentally, one theme is that pressures on revenue from trade liberalisation, regional integration and tax competition mean that, *absent greater international policy coordination*, the search for additional revenue will likely focus on relatively immobile bases – most obviously labour, consumption, and real estate' (emphasis in original). *Supporting the Development of More Effective Tax Systems: A Report by the IMF, OECD, UN and World Bank to the G-20 Development Working Group*, *supra* note 7, at 18.

[9] The US Treasury, however, has reported evidence of substantial income shifting to lower tax countries, including evidence from company tax data of operating margin increases correlated inversely with effective tax rates. Testimony of Stephen E. Shay, Deputy Assistant Secretary International Tax Affairs, US Department of Treasury, House Ways and Means Committee, Hearing on Transfer Pricing Issues (22 July 2010), http://democrats.waysandmeans.house.gov/media/pdf/111/2010Jul22_Shay_Testimony.pdf (last accessed 9 July 2012).

revenue. In this volume, Yariv Brauner addresses the pressure on developing countries to provide tax incentives to attract FDI, questioning the benefit of tax incentives for development and growth. He tellingly identifies the linkage of incentives to tax competition.[10] Lisa Phillips examines the use of tax expenditure analysis by India to examine the efficiency of incentives.[11] The chapters in this volume do not prescribe one answer for developing countries, but encourage examination of individual context and circumstances. Developed economies do not provide an unblemished model and their prescriptions require scrutiny.

Notwithstanding the new emphasis on revenue mobilization, there has been little change in the longstanding approach of bilateral income tax treaties, including the United Nations model convention, to require sacrifice of source country taxation in favor of the residence country. There is an important need for rethinking as to whether these treaties make sense for lower- and lower-middle income developing countries.[12] Evidence on whether bilateral tax treaties increase FDI in developing countries is mixed, but an important question for future research is whether treaties in their current form justify the revenue loss.[13] The argument that a double tax treaty provides an important signal to investors that the rule of law and tax system stability will be observed may be addressed by alternative measures that do not sacrifice tax revenue to the same extent. It might be possible, for example, to fashion

---

[10] See Yariv Brauner, Chapter 2.

[11] See Lisa Philipps, Chapter 8.

[12] The World Bank divides countries into low income, US$995 or less; lower middle income, US$996–3,945; upper middle income, US$3,946–12,195; and high income, $12,196 or more (using 2009 gross national income (GNI) per capita). See *Supporting the Development of More Effective Tax Systems: A Report by the IMF, OECD, UN and World Bank to the G-20 Development Working Group* (2011) 52, available at www.imf.org/external/np/g20/pdf/110311.pdf (last accessed 9 July 2012).

[13] See literature summary in Fabian Barthel, Matthias Busse and Eric Neumayer, 'The Impact of Double Taxation Treaties on Foreign Direct Investment: Evidence from Large Dyadic Panel Data' (2010) 28 *Contemporary Economic Policy* 366. From a revenue perspective, it does not make sense for a capital importing developing country to enter into a treaty with a low-tax country that is a mere conduit for investment by a treaty shopping intermediary. As a more subtle example, Tracey Gutuza's Chapter 4 on the South African adoption of a headquarters regime, which is principally a vehicle for treaty shopping using the South African treaty network, poses similar issues. It is questionable whether a headquarters company described in the chapter should be allowed treaty benefits by South Africa's treaty partners.

treaties limited to arm's length transfer pricing, mutual agreement and information exchange provisions.

Developed countries also have turned a blind eye to the publicly reported activities of their own MNEs that use tax havens and low tax treaty countries to strip income from the home country and other taxing countries and thereby earn 'homeless income' (or 'stateless income').[14] The difficulties developed countries have protecting their tax bases are multiplied for developing countries with limited tax administration resources. Revenue mobilization should include work on anti-abuse approaches that can be implemented by developing countries as well as ideas for coordinating tax policies among developed and developing countries to combat homeless income. Transfer pricing is an important cross-border tax issue, but a corporate income tax system should be structured to limit its reliance on transfer pricing to protect its revenue base. The current approaches to transfer pricing are not sufficiently robust to protect a revenue base against the incentives of material rate differentials.

An effective tax system is critical for development. The developed countries, and increasingly the emerging economies as well, are conflicted in assisting developing countries because addressing many of the issues in developing countries' revenue mobilization will result in taxation of local champion MNEs or state-owned enterprises. Not surprisingly, in light of its membership, the G-20 does not probe the linkage between developed countries' tax policies allowing tax competition and their impact on developing countries' ability to mobilize revenue.

There is an important need for independent academic scholarship like that in this volume that takes into account the differing perspectives of developing countries and does not look for 'one size fits all' theories or prescriptions. As Richard Bird has observed:

> What this complex and changing world needs is not some non-existent 'universal fix' but rather a sort of fiscal medicine kit containing a variety of remedies and treatments that may help us cope with the wide variety of fiscal problems and needs that arise at different times and often in different ways in different developing countries.[15]

---

[14] See, e.g., Bret Wells and Cym Lowell, 'Tax Base Erosion and Homeless Income: Collection at Source is the Lynchpin' (forthcoming in *Tax Law Review*); Edward D. Kleinbard, 'Stateless Income' (2011) 11 *Fla. Law Rev.* 699.

[15] Richard M. Bird, *Taxation and Development: What Have We Learned from Fifty Years of Research?*, International Center for Public Policy Working Paper 12-02 (January 2012), available at http://ideas.repec.org/p/ays/ispwps/paper1202.html (last accessed 16 July 2012).

The diverse group of legal scholars from six continents who have contributed to this volume critically address issues from perspectives not restricted to traditional tax policy conceptions and paradigms. As a result, this volume is rich with insights on new and old issues at the intersection of tax, law and development.