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ACRONYMS

ASEAN	Association of Southeast Asian Nations
ATAF	African Tax Administration Forum
BEPS	Base erosion and profit shifting process
CEPAL	Economic Commission for Latin America and the Caribbean
CEQ	Commitment to Equity
CGT	Capital Gains Tax
CIAT	Inter-American Center of Tax Administrations
CIT	Corporate Income Tax
CSO	Civil society organizations
DRM	Domestic resources mobilization
EAC	East African Community
HIC	High-income country
HNWI	High net worth individuals
IADB	Inter-American Development Bank
ICRICT	Independent Commission on the Reform of International Corporate Taxation
IEO	Independent Evaluation Office
IFC	International Finance Corporation
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
LIC	Low-income country
LMIC	Lower-middle income country
LTU	Large Taxpayer Unit
MDB	Multilateral development bank
MIC	Middle-income country
PIT	Personal Income Tax
PRGT	Poverty Reduction and Growth Trust
PSIA	Poverty and social impact analysis
SDGs	Sustainable Development Goals
SSA	Sub-Saharan Africa
TA	Technical assistance
UEMOA	West African Economic and Monetary Union
VAT	Value Added Tax

EXECUTIVE SUMMARY

'From our work at the IMF, we know that the fiscal system can help to reduce inequality through careful design of tax and spending policies. Think about making taxation more progressive, improving access to health and education, and putting in place effective and targeted social programs. Yet these policies are hard to design and – because they create winners and losers – they create resistance and require courage. Nevertheless, we need to get to grips with it, and make sure that “inclusion” is given as much weight as “growth” in the design of policies. Yes, we need inclusive growth.'

IMF Managing Director Christine Lagarde in the Richard Dimbleby Lecture, London, 3 February 2014.

Oxfam believes that all individuals and companies should be taxed according to their means, in order to finance essential public services, end extreme poverty and reduce inequality. Yet in many countries, the wealthy and the largest corporations pay lower actual tax rates, due to unprogressive tax systems, exemptions, avoidance and evasion.

The International Monetary Fund (IMF) exercises a central influence on tax policies in low- and lower-middle income countries, through advice and conditionality, technical assistance (TA), and by setting global standards and analyzing global trends. In recent years, its research and leaders' speeches have advocated progressive taxation and a strong fight against evasion. This paper assesses whether IMF advice and TA are living up to these statements, based on five country case studies (Ghana, Mozambique, Nicaragua, Peru and Senegal) covering 2000–15, and supported by a desk review of public IMF documents covering all Poverty Reduction and Growth Trust (PRGT) countries' programs during 2013–14.

Key findings

The desk study and case studies confirm that IMF advice and TA in almost all countries have focused on increasing tax collection and efficiency, rather than on progressivity. The case studies show that this has been successful in increasing tax collection – with an average rise of 5% in revenue/GDP (between 0% and 13%) between 2005 and 2012 – but this rise has stalled more recently.

Since 2012, there has been increased focus by the IMF and governments on combating inequality, leading to more emphasis on tax progressivity by three case-study governments. Yet the IMF has contributed little to these discussions. For example, since 2005 it has conducted no systematic monitoring of tax progressivity through proxies such as indirect/direct tax ratios, incidence analysis of tax effects on income distribution, or poverty and social impact analysis (PSIA) of proposed tax policies.

Tax policy advice and TA from the IMF have rarely focused explicitly on progressivity, and this focus has not increased significantly in recent years. Other studies using incidence and other econometric analysis have assessed that three of the case studies have clearly regressive tax systems, and that it is likely the other two are also regressive – due partly to less progressive design of individual taxes, and partly to failure to collect more progressive direct taxes.

Insufficient focus on progressivity emerges clearly in the **design of individual taxes**.

Personal Income Tax (PIT). All case studies except Ghana have top rates above global averages, having resisted a 'race to the bottom' since 1980, and reasonable differentials (>20%) between top and bottom rates. Yet there is no evidence that the IMF has had a consistent policy on desirable PIT levels, beyond opposing extremely high or low rates: it has endorsed top rates of between 25% and 40%, and not made consistent recommendations to increase minimum thresholds below which poorer citizens pay no PIT.

Social security and pension contributions are among the most regressive taxes, though they generally apply to only middle and high incomes. They can be made less regressive by shifting the burden to employers, or by requiring higher-income earners to pay on all their income. There is no evidence from the case studies that the IMF has had a consistent policy on the progressivity of these taxes, as well as focusing on the long-term financial viability of social security and pension funds.

Taxes on capital gains, property and wealth are crucial to make tax progressive, because these are much more unequal than income. Four of five countries (except Ghana) tax capital gains at the same rate as income, and three collect some revenue up front using withholding taxes. Four countries have property taxes, which are set very low and generate little income. All five have taxes on wealth flows (two on financial transactions, and five on property sales/rental income, inheritances and gifts). The IMF has helped two countries to introduce taxes based on wealth (but only as withholding taxes on CIT). It seems to have opposed financial transaction taxes, or suggested their reduction to tiny amounts, and its attitude to inheritance and donation taxes is unclear.

The range of **Corporate Income Tax (CIT)** rates across the case study countries is much narrower than that of PIT (25–32%). There is strong evidence of a race to the bottom in the 1990s, and Nicaragua and Peru are currently planning rate cuts, though Senegal has recently raised its rate. The IMF does not seem to have had a consistent policy on rates, having advised Peru to cut to 25% in 2002, but Senegal to increase to 30% in 2015. However, it has recently strongly suggested that PIT and CIT rates should be similar, to cut scope for avoidance. It has also provided TA in four countries to eliminate lower rates or reduce exemptions for some types or sizes of enterprises, and helped them to establish Large Taxpayer Units (LTUs) to collect more from largest taxpayers, which has increased progressive tax revenues considerably.

Value Added Tax (VAT) has been found to be regressive in tax literature and three of the case studies. The IMF played a major role in designing VAT in all countries, and in recommending rate increases in Ghana and Peru, as a key way to increase revenue and reduce budget deficits. However, it did not analyze the impact of these measures on poverty or inequality (except in Nicaragua). As for measures which could make VAT progressive, it appears to have opposed multiple rates on the grounds that they might be ineffective; accepted only a very limited number of exemptions for basic goods; and not pushed consistently for higher minimum registration thresholds to exempt small traders. However, it is important to realize that some of its advice to reduce VAT exemptions has been progressive, because they exist for reasons (promoting sectors, exports, etc.) which have nothing to do with fighting inequality, or are not well targeted (e.g. it helped Senegal to end VAT exemption on a basic tranche of water and electricity for wealthier citizens).

Excise taxes are even more regressive than VAT, unless they are structured to rise sharply for luxury goods. In general, the IMF has favored them in order to raise revenue rapidly, and provided advice on how to adjust them automatically with product prices, and to rationalize excessively complex multiple rates (though it did not publicly advise reduction of Mozambique's higher rates on luxuries). However, after the global 2008 rises in petroleum prices, it did advise many countries (including Peru) on how to reduce fuel excise duties.

Trade taxes have a mixed impact on progressivity, depending on who consumes imports or produces exports. Since the 1990s, their share of revenue in developing countries has fallen sharply due to global and regional trade liberalization. The IMF has played only a marginal role in import taxes, but pre-2000 it advised countries to abolish or reduce export taxes, on the grounds that they discouraged exports.

The IMF has shown consistency in opposing excessive corporate tax exemptions, and corporate and individual avoidance and evasion. Strong action in this area could dramatically increase collection of more progressive income taxes.

However, **tax exemptions** – also known as ‘tax expenditures’ – are large in all five case study countries, at 2–7.5% of GDP, and 10–33% of revenues. The IMF has strongly encouraged countries nationally, regionally and globally to publish reports on tax expenditures. However, many countries still do not do this, or publish reports which do not cover all exemptions, or do not provide enough detail of beneficiary sectors or enterprises. At country level, the IMF has had mixed success in getting its advice to reduce exemptions implemented. It has recently developed methodology to help countries assess the costs and benefits of tax incentives, which should help in this effort, but this does not include any analysis of their impact on equity and progressivity. The IMF has often not expressed publicly enough its support for government policy on these issues.

The IMF has repeatedly highlighted in its global and regional analysis the pernicious effects of **harmful global tax competition** – the ‘race to the bottom’ in tax rates, as well as the proliferation of exemptions. It provided key analysis resisting this in the West African Economic and Monetary Union (UEMOA) region, but there is much less evidence of it playing an active role in other regions. Indeed, to the degree that it bases recommendations for tax rates on comparisons with falling rates in other neighboring countries, it may inadvertently be encouraging the competition.

On **tax evasion and avoidance**, the IMF has provided TA in many countries to establish and support LTUs, to ‘audit’ economy-wide compliance with taxes (especially VAT), and sometimes to help countries assess risks of likely avoidance/evasion and to identify the most risky sectors and types of enterprises. However, to combat evasion and avoidance by specific enterprises and individuals, through audits and other measures, it has tended to suggest other sources of TA, rather than providing direct support itself.

The IMF has encouraged all countries to establish or reinforce teams specializing in **transfer pricing**, provided documentation to support their assessments of whether prices are distorted, and referred countries to other institutions’ training courses. However, there is no evidence that it has encouraged more proactive measures by governments such as setting their own fixed prices for different goods/services to pre-empt transfer prices. It has been involved in the **Base erosion and profit shifting process (BEPS)**, but has not allocated major new TA resources to this given the involvement of many other organizations, preferring to focus its TA on its other comparative advantages.

The IMF has not engaged extensively with discussions on **unitary global taxation of countries and formulary apportionment of resulting revenues**, including the 2015 suggestions of the Independent Commission on the Reform of International Corporate Taxation (ICRICT).

The IMF has also not engaged extensively with **individual tax evasion and illicit financial flows**, except in encouraging tax information sharing and efforts against money laundering and terrorist financing.

All case study countries have signed **tax treaties** or other agreements (from three in Nicaragua to 20 in Senegal) which could be losing them revenues of 3% of GDP. The IMF has played no systematic role in advising countries on the costs and benefits of treaties, or encouraging them to use more advantageous treaty models, such as those of the UN. However, when consulted it has provided some ad hoc advice against signing treaties with tax havens.

Recommendations

To fund the ambitious post-2015 agenda of the Sustainable Development Goals (SDGs), countries will need to increase revenues dramatically. To ensure this happens, the Fund will need to **analyze systematically for each country, in program documents, how progressive tax measures can increase revenues much more rapidly to levels that can fund the SDGs, and help countries to design multi-year plans to achieve this.**

The IMF is uniquely placed among international organizations, through its in-country work, to conduct global analysis of tax policy trends. It should therefore ***produce an annual report on global progress in progressive domestic resources mobilization (DRM) to fund the SDGs.***

The IMF and World Bank are currently finalizing a tax policy diagnostic tool for developing countries. This tool must contain a strong pillar assessing tax progressivity and equity, with clear impact on IMF policy and TA recommendations.

Many other organizations are already conducting analysis of tax progressivity and incidence in developing countries. The IMF should take full account of this analysis in its policy and TA recommendations, develop simple tools to conduct its own analysis where needed, and devote a major proportion of its future tax TA to building country capacity to analyze progressivity.

In terms of the design of individual taxes, the IMF should:

- develop and publish policy guidelines for recommending more consistent and progressive PIT rates and thresholds, to encourage greater progressivity, and combat any harmful competition among countries;
- adopt a policy to maximize progressivity of social security and pension systems, building on findings of the Independent Evaluation Office (IEO) review of the IMF and social protection;
- place much more emphasis on capital gains, property and wealth taxes in its policy advice and TA, as key means to raise progressive revenue;
- adopt and publish more consistent policies on CIT rates, designed to maximize collection of this progressive tax, minimize 'harmful tax competition' among countries, and continue to emphasize TA to reinforce LTUs;
- recommend VAT policies supporting exemptions or zero ratings for basic goods, and setting minimum registration thresholds which exclude small traders;
- adopt clear guidelines for recommendations to make excise duties less regressive;
- recommend greater progressivity on import duties based on incidence analysis.

The IMF should also continue to scale up its support to help countries fight excessive corporate tax exemptions, and corporate and individual tax avoidance and evasion, by:

- scaling up its assistance to countries to publish comprehensive annual reports on tax exemptions, including analysis of their negative impact on tax progressivity;
- making its own opposition to excessive tax exemptions more public at country level;
- taking a much more active role in analyzing and opposing 'harmful tax competition' and the race to the bottom in all its global, regional and national reports;
- helping all countries to conduct systematic assessments of risks of tax evasion and avoidance, and encouraging them more actively to audit high-risk taxpayers;
- emphasizing to donors the need to ramp up funding for TA to make tax systems more progressive by reducing exemptions, avoidance and evasion;
- conducting more detailed analysis of the potential impact of unitary global taxation and formulary apportionment, based on increasing tax revenues in countries that are the sources of raw materials from which enterprises make profits;
- making stronger recommendations for tax havens to end bank secrecy, and making public all information on beneficial ownership of corporations and trusts;
- providing extensive assistance to developing countries in analyzing information supplied from tax havens, and on enforcing resulting tax collection demands;
- systematically helping countries to review tax treaties, advising on how to change them, and leading a global debate on this to enhance DRM in developing countries.

Finally, the IMF could contribute much to global transparency in two main ways. First, as examined in the New Rules background study, there is only very limited publication of IMF TA reports, including on tax, because the country has to specifically request publication. As a result, it has been very complicated for this study to establish the nature of advice the IMF gives to countries. ***The IMF should apply to TA reports the same Transparency Policy it has for other country documents – of publication unless the government requests otherwise, in order to make more transparent what it is recommending to governments.***

Second, there is no single global database that includes figures on tax/GDP ratios, tax composition, rates and thresholds across different types of taxes, exemptions and estimates of avoidance and evasion. The IMF publishes tax data for various countries, but it is dispersed across multiple databases and documents with different formats. Such a database is essential to help governments and other analysts judge relative performance, and assess progressivity, harmful competition and other trends. ***The IMF should create such a database, to support country policy choices.***

The above suggestions for changes in IMF practice would do much to ensure that the institution is living up to its own policy announcements and research findings, focusing on reducing inequality and accelerating growth in developing countries. To make national tax systems more progressive, developing and OECD countries will also need to take strong measures:

- Developing countries will need to demand that IMF assistance analyzes issues of equity and progressivity, and makes such analysis public;
- Parliaments and civil society in developing countries will need to demand strong policy measures to make tax systems more progressive;
- OECD and G20 countries will need to introduce changes in global tax rules to discourage excessive tax exemptions, redesign treaties to favor paying more tax in developing countries, and fight tax evasion and illicit flows more effectively.

However, the IMF should not wait for others to lead. As the key global source of country-specific tax advice to developing countries, the IMF should play a clear lead role itself, to ensure that countries mobilize the progressive domestic resources which will be essential to finance the SDGs.

1 INTRODUCTION AND METHODOLOGY

One of the main pillars of Oxfam's campaign against inequality is to ensure greater equity and justice in tax policies. There is global consensus that progressive taxation and public services are key policy levers to end extreme poverty, reduce inequality and ensure fairer and more sustainable growth. Taxation and spending are also at the heart of the social contract and accountability discussions between citizens and government. Oxfam believes everyone (individuals and companies) should be taxed according to their means: progressive tax systems both generate resources to finance essential public services, and reduce inequality by ensuring everyone pays a fair share according to their wealth.

However, in many developed and developing countries, tax regimes are not progressive enough – relying mainly on consumption taxes, where poorer citizens bear a heavier burden because they consume a higher share of their incomes. Recent years have also seen cuts in many countries' more progressive personal and corporate income taxes.

In addition, in many countries, tax collection is way below potential levels, due partly to poor tax administration, but especially to very high tax avoidance by corporations and wealthy individuals, which is often made legal by bilateral tax treaties, or tax exemptions signed by developing country governments. As the wealthy have greatest capacity to use these channels, tax systems become even less progressive in practice.

The IMF exercises central influence on tax policy in low-income countries (LICs) and middle-income countries (MICs), in four ways:

1. by providing TA on tax policy to countries;
2. by setting policy conditions on tax in IMF-approved economic programs;
3. by setting global standards on tax policy practices, which influence all countries;
4. by analyzing global tax policy trends, and making recommendations to the G20.

In recent years, IMF tax policy thinking at headquarters, as expressed in multiple studies, has seemed to become more progressive, and opposed to tax avoidance and evasion.¹ In addition, IMF Managing Director Christine Lagarde has made several speeches supporting progressive taxation.² However, it is vital to assess whether the IMF is providing systematic policy and TA support to countries to make their tax systems more progressive and combat evasion. Oxfam International therefore commissioned this study from **Development Finance International**, to assess whether IMF tax policy advice and TA is living up to expectations.

To assess IMF policy advice and TA, the study uses two methods:

- a desk-based review of public IMF documents for all PRGT-eligible countries in 2013–14³ that was conducted by **New Rules for Global Finance**; and
- five case studies of Ghana, Mozambique, Nicaragua, Peru and Senegal since 2000.

The case studies in this report were chosen from among a broader group of countries where Oxfam country teams expressed a wish to analyze tax policies and IMF advice. The choice was based on a preliminary analysis of tax trends in all developing countries, to represent varying income levels and regional groupings, different experiences of increases in or progressivity of tax collection, and different IMF histories.

CASE STUDIES

Country	Income level	Tax/GDP (2000–14)	Tax progressivity	IMF relations
Ghana	LIC→LMIC	13 to 18	Medium	2000–2006 2009–2012 2015–
Mozambique	LIC	19 to 31	High	2000–2014
Nicaragua	LIC→LMIC	Stagnant at 23	Medium	2000–2011
Peru	LMIC	19 to 22	Medium	2000–2008
Senegal	LIC→LMIC	19 to 24	Low	2000–2014

Notes: Income level: LIC = low-income country; LMIC = lower-middle income country.

Tax progressivity: judged very simplistically by the ratio of direct to indirect taxes. If this is less than 1, progressivity is low; if it is between 1 and 1.3 it is medium; and if it is over 1.3, it is high. For more detailed analysis of how to assess progressivity, see Box 1.

IMF relations: dates are the period when each country had programs with the IMF.

The countries have differing experiences of relations with the IMF. Mozambique and Senegal have had IMF programs throughout the period, albeit moving from formal programs funded by loans, to Policy Support Instrument agreements.⁴ On the other hand, Peru has had no IMF program since 2008, and neither has Nicaragua since 2011. Ghana has had an on-off IMF relationship, with breaks in 2007–08 and 2013–14.

What do these factors mean for the impact of IMF advice? As the case studies show:

- the impact of IMF analysis or TA is usually much lower when there is no formal IMF program. Technical assistance tends to be most intensive and to have the most impact when linked to a formal IMF program;
- the impact of IMF advice and TA tends to be stronger when a country is lower-income, given that it is usually linked to broader public financial management reform programs, supported by many donors who rely on IMF approval of policy.

To assess the content and impact of IMF support, the study looks in turn at advice on:

- overall tax revenue collection/efficiency, productivity and progressivity as assessed by the composition of revenue in terms of different taxes;
- the design and structure of individual taxes (including indirect taxes such as VAT, excise and trade taxes; direct taxes on corporate and individual income and capital gains; and other taxes including on property and wealth; and
- combating tax exemptions and holidays, and tax avoidance and evasion.

Sections 2–4 of this paper examine each of these sets of issues, and section 5 concludes with main findings and recommendations.

Box 1: How can we assess whether tax systems are progressive?

This study uses two methods to judge progressivity of national tax systems:

The composition of tax revenues, split among different types of taxes: This method has often been a fallback proxy for progressivity used by civil society organizations (CSOs) and governments. However, it is somewhat unreliable: while it is usually true that indirect taxes are more regressive, and direct taxes more progressive, the degree to which this is the case depends on exactly how they are designed and enforced.

The progressivity of individual types of tax, as judged by the thresholds, percentage tax rates, and exemptions applied to them. This is a much more accurate way of judging tax policy progressivity, and there is a wealth of academic literature identifying weightings to apply to different issues to assess overall progressivity.

By combining these two methods – i.e., judging the progressivity of each individual type of tax, and then weighting them by the overall proportion of that in tax revenues – it is possible to arrive at a reasonable overall judgment. Of course, there are no ‘ideal’ benchmarks for progressivity, so any judgment rests on comparison with other countries, notably those commonly considered to have progressive systems, adjusted for different income levels or economic characteristics. **It should be a priority for the IMF to establish such benchmarks for different country groupings, as a basis for judgements on where countries could make more efforts to enhance progressivity.**

However, both of these methods assess *intended* progressivity. Many countries have tax systems which look progressive on paper, but are in reality much less progressive. An often-cited example of this dichotomy is the US, which has a tax code that looks relatively progressive (higher tax rates for wealthier corporates and individuals) but, due to a combination of loopholes/exemptions and avoidance/evasion, is actually much less progressive. The Nicaragua and Peru case studies also emphasize that effective tax rates for wealthier citizens are much lower, and the Ghana and Senegal studies show that individuals pay higher shares of tax than much wealthier corporates. CIT and PIT are also much less effectively collected than VAT in all the case study countries, with CIT productivity especially low in Ghana, Nicaragua and Senegal, and PIT productivity low in Ghana, Peru and Senegal.

The most reliable way to judge **actual progressivity** of tax systems is to look at the incidence of different taxes on different income deciles, by analyzing household surveys. It is striking that the IMF very rarely conducts incidence analysis, except if a country requests this as a major focus of TA (e.g. Iceland) – in contrast to many other organizations such as the Asian Development Bank, CEQ and UN CEPAL.

The IMF should conduct systematic analysis of progressivity/incidence of taxes in all countries, and publish such analysis in program and Article IV documents.⁵

2 TAX REVENUE LEVELS AND COLLECTION 'EFFORT'

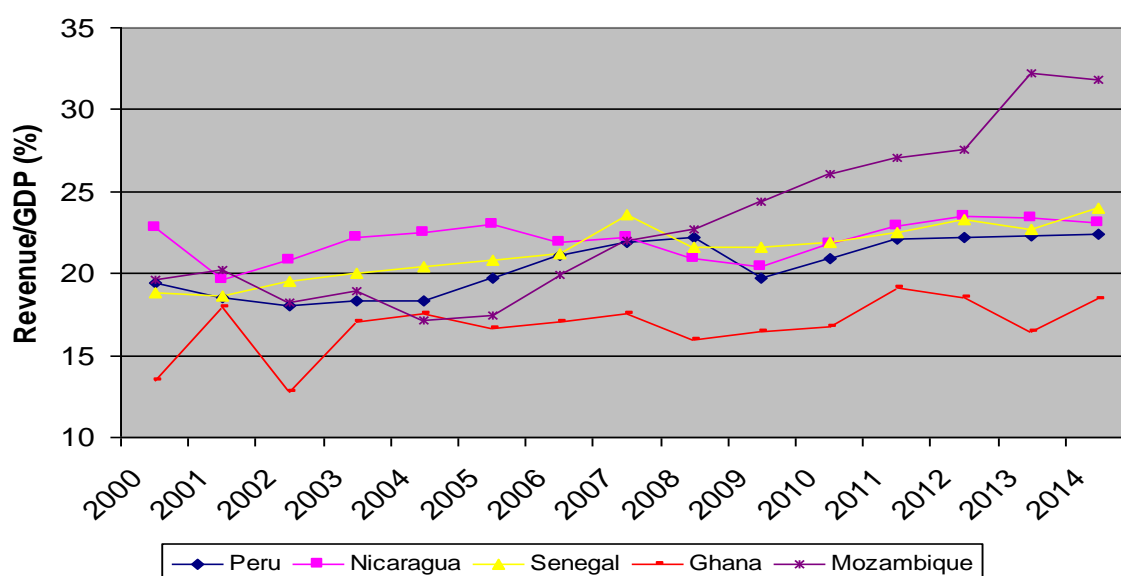
2.1 How much tax are countries collecting?⁶

The desk study and case studies confirm that IMF advice and TA in most countries have focused mainly on increasing tax revenue/GDP ratios (i.e. tax collection) and not enough on progressivity. This is partly because countries initially turn to the IMF when they have large budget deficits (as Ghana has done twice) and the main focus of IMF advice is on closing these deficits. How the IMF has aimed to achieve these increases is discussed in the following sections.

The IMF's own assessments indicate that IMF programs have generally been effective in helping countries to raise revenues, especially low-income countries (with the exception of those countries where corruption is high).⁷ All five case studies have achieved substantial increases as a proportion of GDP,⁸ as Figure 1 shows:

- Mozambique achieved one of the sharpest rises in the world (by 13%, to 32%) by ending tax exemptions or holidays on extractives and other investments, and due to a windfall tax on (and high prices for) extractives in 2013–14.
- Senegal achieved a 5.2% rise to reach 24%, due to steady improvements in administration, and recent rises in corporate taxes.
- Ghana also rose by 5%, but to only 18.4%, and sharp rises in 2001 and 2003 have been mitigated by variable performance since then.
- Peru saw only a 3% rise to 22.4%, with sharp falls in 2001–02 and 2009, sharper rises in 2003, 2005–08 and 2010–11, but stagnation since 2012. A major cause of this increase was the commodity boom.
- Nicaragua barely changed at 23%, with sharp falls in 2001 and 2006–09 offsetting gradual rises in 2002–05 and 2010–12.

Figure 1: Case study revenue trends



However, most of these increases have been gradual, due to concerted efforts to improve tax administration. The exceptions to this picture have been explained by one-off major tax policy changes (e.g. introducing a VAT, or sharply increasing corporate and personal income taxes), or institutional changes such as combining multiple tax-collecting agencies into one, or creating

independent revenue authorities with salaries and incentives which are higher than those in normal government employment. Broader evidence from recent analysis indicates that major increases in tax revenue in LICs and LMICs have reflected two other factors: renegotiating contracts with major enterprises (especially mining); and clamping down on tax exemptions.⁹ These policy issues are discussed in more detail below.

Given the unambitious pledges of external finance at the UN Financing for Development conference in Addis Ababa in July 2015, and the UNFCCC COP-21 in Paris in December, Oxfam and Government Spending Watch have calculated that LICs and LMICs will need to increase their revenue/GDP ratio by 10% over the next 15 years to finance the needs of the post-2015 development agenda.¹⁰ So the key question now is whether the methods the IMF has used to help countries raise more revenue can accelerate revenue growth over the next 15 years. Yet the IMF is now forecasting a fall in average revenue for LICs and LMICs in 2014–15, followed by stagnation to 2020.¹¹ It has recently been increasing the number of analyses of ‘tax gaps’, and how best to increase tax revenues in program and Article IV documents, but **needs to assess systematically and annually for every country how there can be a step change in revenue collection to fund the SDGs.**

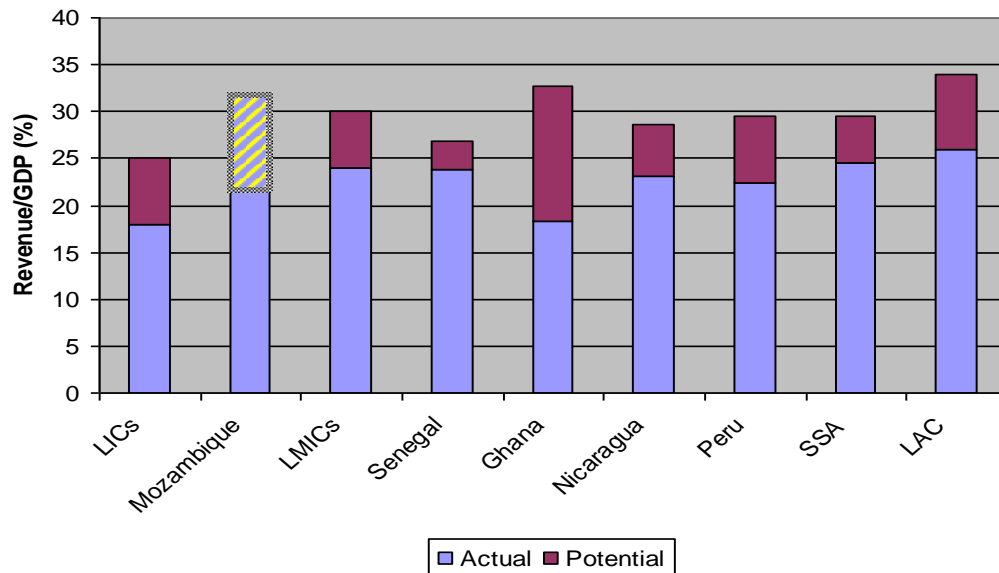
As will become obvious later in this report, significant revenue rises will require major steps such as new taxes (e.g. on land and wealth), sharp cuts in exemptions, and a crackdown on tax avoidance and evasion by large corporations and high net worth individuals. In turn these will require the IMF to aggregate national analysis once a year into **a global report on progress in DRM to fund the SDGs** that tracks progress in revenue mobilization in its member countries (rather than just highlighting negative spillovers from larger economies), and draws conclusions for the major changes needed in global tax rules and behavior by OECD governments, development financing institutions and corporations. The IMF is uniquely placed to compile such a report, given its regular analysis of every country’s fiscal situation.

2.2 Are the countries collecting ‘enough’ revenue?

Many less in-depth studies contrast revenue/GDP ratios with those of OECD countries and concludes that poorer countries are not ‘making enough effort’ to collect taxes. But any such judgement has to take account of country circumstances. A wide literature suggests that country scope for collecting tax depends on income levels, sector composition of the economy, its degree of formalization, and how well public services are delivered (making citizens more willing to pay taxes).¹²

As a result, the IMF has set different benchmarks for expected tax/GDP ratios.¹³ Figure 2 shows how case study countries perform against these, and compared with income and regional groups. Mozambique is well above LIC and African averages, as well as its potential; Senegal matches the LMIC and Sub-Saharan Africa (SSA) averages and is close to potential; Ghana is well below average for SSA and LMICs and the furthest below potential; and Nicaragua and Peru underperform LMICs, Latin America and the Caribbean (LAC) and potential.

Figure 2: Current and potential revenue levels



The IMF has also suggested that countries with low tax rates or high exemptions (as a result of policy choices) are likely to exhibit low levels of tax effort. Among the case study countries, Ghana, Nicaragua, Peru and Senegal provide evidence for this, but Mozambique seems to contradict it. This is because of another key factor: the very high share of extractive industries in Mozambique's GDP – which makes tax collection from a few large companies easier – and its recent efforts to increase extractives revenue by ending exemptions. On the other hand, Peru shows that half-hearted efforts to increase revenue from extractives can yield only relatively marginal results.

Nevertheless, these benchmarks are still well below the levels of revenue needed to fund the SDGs. The IMF should agree with each country long-term revenue targets above these benchmarks, adjusting them to match expected GDP rises, formalization of the economy, improved public services, the importance of extractives, and potential price variations. It should help each country design a multi-year plan to meet these targets, and suggest key measures which would achieve rapid increases.

3 HOW PROGRESSIVE ARE TAX SYSTEMS?

As explained in the introduction, there has recently been an increased focus on the progressivity of tax systems – both within the IMF and among country authorities – as a means to combat inequality and make growth more inclusive, but also as a means to demonstrate equity in tax collection and therefore encourage taxpaying, and as a key policy measure to accelerate and sustain growth.

Partly as a result of this global debate (but also due to the arrival of new governments in Ghana and Senegal), Ghana, Mozambique and Senegal have all increasingly emphasized equity and progressivity in designing their tax policies, as opposed to just the ‘efficiency’ of tax collection. On the other hand, commitment to this issue by governments in Nicaragua and Peru has been much more variable.

In turn, this change of focus by governments has encouraged the IMF to move slowly in the direction of looking more closely at issues of progressivity. Its tax policy diagnostic tool, to be launched publicly in February 2016, will include ‘progressivity/equity’ as one of its three pillars for judging adequacy of tax policies. **It is vital that this pillar of the analysis has a clear impact on IMF recommendations.**

Nevertheless, as emphasized in the New Rules for Global Finance background study for this project, there is precious little evidence yet of an enhanced focus on tax progressivity in IMF program documents, or in the (relatively few) published technical assistance documents. Most discussions of inclusive growth or inequality in 2013–15 program documents focused on sectoral analysis or financial inclusion, with less than 5% raising issues of tax progressivity.¹⁴

3.1 Composition of tax revenues¹⁵

What does the composition of tax revenues among the case study countries tell us about their likely progressivity and impact on inequality?

One proxy for judging progressivity is the composition of revenue by type of tax. Figure 3 shows this for the case study countries. In 2000, indirect taxes were the most important source for all countries – mainly reflecting the introduction of VAT in the 1990s – in which the IMF played a key advisory role. Trade taxes also continued to represent between 10% and 30% of revenue. However, by the end of the decade, direct taxes had become much more important, due to growth in corporate and individual incomes, as well as rises in tax rates, a broadening of the tax base, and windfall taxes on extractives. As discussed in the sections below, the IMF’s role in these decisions varied. On the other hand, due to trade liberalization, trade taxes had virtually disappeared.

Figure 3: Revenue by tax type (2000 and 2014)

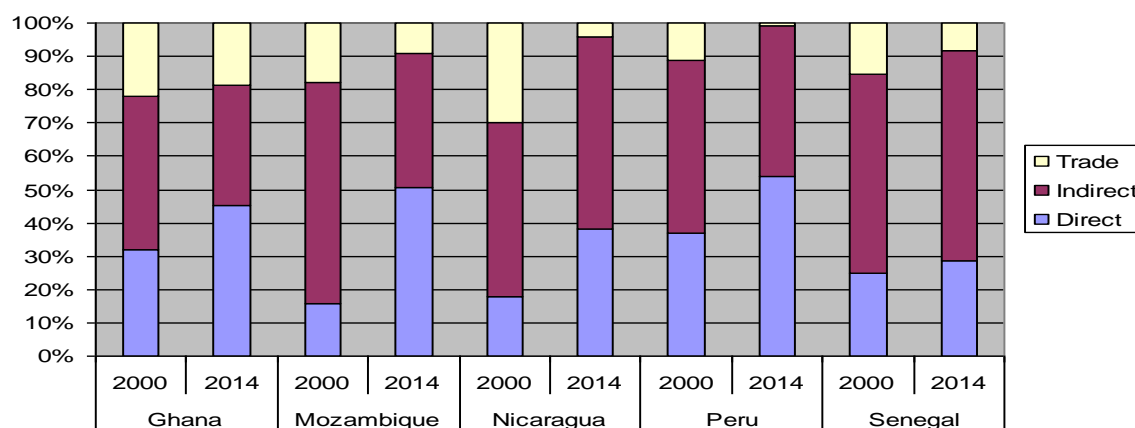
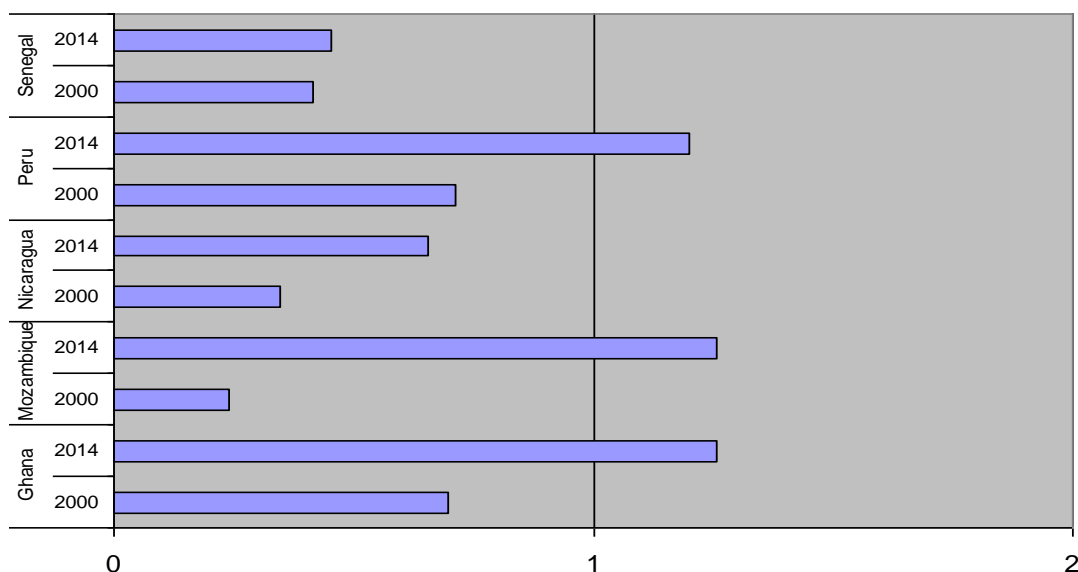


Figure 4 shows the resulting changes in direct/indirect tax ratios. A ratio higher than one means that the system is relatively progressive – and the Ghanaian, Mozambican and Peruvian tax systems surpassed this threshold by 2014. Nicaragua also improved the progressivity of its tax system considerably during the period. On the other hand, Senegal achieved only a marginal increase in progressivity, and continued to collect twice as much indirect as direct tax (before the increase in income taxes in 2015). There is no evidence from case studies or IMF documents that the direct/indirect tax balance was systematically monitored as an indicator of progressivity. Based on interviews with IMF staff, this is because they do not see it as a reliable proxy for progressivity.

Figure 4: Direct/indirect tax ratios



As discussed in Box 1, the ideal way to judge whether a country's tax system is progressive would be an incidence analysis for each country, to assess which groups are paying the highest proportion of their income or consumption for each tax. There has been relatively little such analysis for the case study countries.

In 2001, the IMF and World Bank began to conduct PSIA of key policy conditions in their macroeconomic programs, to assess their potential impact on poverty. Nicaragua was chosen as a case study for this analysis, and a PSIA was done of the potential impact of VAT reform on poverty. It concluded, in line with broader literature, that the reform would be mildly regressive in income terms, and neutral in consumption terms, and thereby helped to influence the government to undertake the reform. Work on PSIA was scaled back in the IMF from around 2005 (though some of the PSIA team members joined the fiscal affairs department) and there has been very little incidence analysis of any tax reforms in IMF programs since then.

Later in the decade, Nicaragua and Peru had such analysis conducted by the Economic Commission for Latin America and the Caribbean (CEPAL) and Inter-American Development Bank (IADB). CEPAL found that Nicaragua has one of the least redistributive fiscal systems in Latin America, and the anti-inequality impact of Peru's fiscal system is less than half that of Argentina, Brazil and Uruguay. This is largely due to very low collection rates on both personal and corporate income taxes, reflecting high exemptions and deductions, and widespread evasion and avoidance; and to low ranges between bottom and top rates.¹⁶ IADB concluded that VAT in both countries had a significantly regressive impact, worsening inequality; while the personal and corporate income taxes had only a marginally progressive impact, due to very low collection rates.¹⁷

Most recently, the Tulane University **Commitment to Equity (CEQ)** initiative has been working in partnership with the Gates Foundation and the World Bank to conduct incidence analysis for 30 countries, of which 19 (mainly in Latin America) have been completed. Its analysis of Peru in 2013 found that direct taxes were helpful in reducing inequality, but not as much as expected (presumably given high levels of avoidance and evasion); whereas indirect taxes actually impacted more on the middle class and wealthy (because the poor bought consumer goods largely via informal channels that do not pay VAT). CEQ has recently completed a preliminary analysis for Ghana, finding that direct taxes decrease inequality a bit, but have only a small effect on poverty, and indirect taxes do not change inequality but do increase poverty significantly.¹⁸ The small effect of direct taxes reflects their relative lack of progressivity and problems with collection (see below – for example PAYE, which is much better collected and much more progressive), and that of indirect taxes (VAT and import duties) reflects the existence of widespread exemptions, for both pro-poor and non-pro-poor reasons. Duties on cocoa exports are also found to be highly regressive. CEQ is completing an analysis for Nicaragua, and intending to expand this program to more African countries during 2016–18 with World Bank and Gates financing. **The IMF should report on and take full account of these analyses in its tax policy recommendations in Article IV and program documents.**

In addition, in the context of a massive expansion of tax-related technical assistance to developing countries projected during 2016–18,¹⁹ it is vital that a major proportion of this assistance be devoted to assessing equity and progressivity, and the potential impact of tax reforms on reducing inequality. Every country should be given the support to build its own capacity to undertake analysis of these issues every time there is a new household survey. Yet there is precious little evidence that there is any such intention – even among more like-minded donors.

In addition, other studies that have been conducted at a global level can give us some indication of the likely progressivity of the overall tax system implied by the composition of tax revenues. Among the most wide-ranging is Martinez-Vazquez et al. (2011), which looked at panel data to test the impact of different taxes on inequality for more than 150 countries during 1989–2010. It found that on average PIT was mildly progressive (reducing the Gini coefficient by 0.09 for each 1% of GDP it collected), CIT highly progressive (reducing Gini by 0.7); customs and excise duties mildly regressive (increasing Gini by 0.23 and 0.26 respectively); and VAT moderately regressive (Gini +0.49).

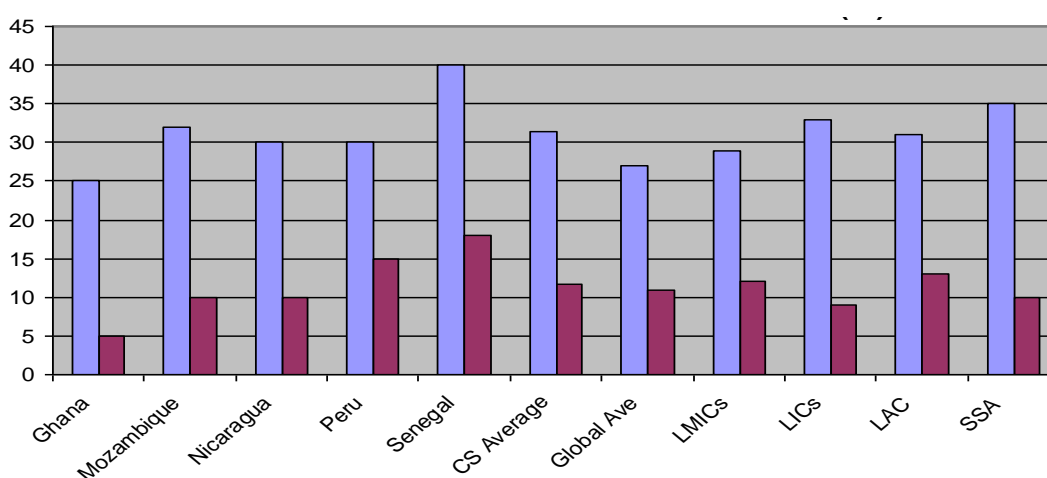
By applying these average coefficients to the different tax composition of the case study countries, it is possible to suggest that Mozambique has the most progressive tax system (reducing Gini by 0.81); Ghana is also progressive (-0.16); while Nicaragua, Peru and Senegal are increasingly regressive (+1.64; +2.38; and +4.13). Of course, these data are only indicative, and real incidence will depend on a) the precise structure of each tax; and b) the degree of exemptions, avoidance and evasion. But they give a fairly clear idea that if these characteristics were similar, Senegal's tax system would be much more regressive than the others, largely because of the predominance of VAT, whereas Mozambique would be most progressive, due to high corporate tax (largely from minerals companies).

3.2 The structure of individual taxes²⁰

Personal Income Tax²¹

Figure 5 shows maximum and minimum personal income tax rates for the case study countries, and compares them with group averages. Senegal has the highest top rate, at 40%, making it the most progressive on paper; while Ghana's is only 25%. Senegal and Mozambique's rates are broadly comparable with African and LIC averages, while Ghana's is well below the LMIC average. Nicaragua and Peru are slightly below the Latin American average, but comparable with LMICs. Nevertheless, all countries except Ghana are above the global average, indicating that this group of countries has to some degree resisted the race to the bottom that has occurred in high-income countries (HICs) since the 1980s.²² In terms of differentials between top and bottom rates, Mozambique and Senegal were the most progressive, with differentials of 22%. Peru was the least progressive, with only 15% (until it introduced a new lower rate of 8% in 2015, increasing its differential to 22%) compared to a global average of around 20%.

Figure 5: Case study maximum and minimum personal income tax rates (%)



What has been the IMF's advice to countries on PIT? It is important to realize that according to the New Rules study, this is the type of tax least often covered by explicit program recommendations (in only 27% of programs), partly because it often collects much less revenue than VAT or CIT. In terms of tax rates:

- For **Ghana**, there is no publicly available evidence that the IMF has ever suggested increasing the rate of income tax from its very low level of 25%, in spite of the relatively low levels of revenue/GDP ratio and the repeated budget crises in Ghana.
- The IMF helped to advise **Mozambique's** government on the introduction of income tax as part of tax reforms in the 1990s, and to set the rate at 32%, which was broadly comparable with rates in other Southern African countries.
- **Nicaragua** has announced that it will reduce rates by 1% each year, starting in 2016, and intends to continue until it reaches only 25%. There is no public evidence that the IMF disagreed with or opposed this decision.
- **Peru** changed rates twice between 2000 and 2015. In 2000 it reduced its maximum rate from 30% to 20%: the IMF advised a smaller reduction only to 25%, but the government wanted to go further in cutting taxes to attract investment and because it believed that lowering tax rates might increase revenue. However, the reverse was true, and revenue fell sharply in 2001–02. As a result, the IMF pushed strongly for an increase back up to 30%, which the government introduced in 2003.
- **Senegal** reduced its top income tax rate from 50% to 40% in 2014. The IMF was involved in supporting the design of the broader tax reform package, and accepted the cut in income tax.

Equally important to judging progressivity are the thresholds above which different rates apply; the differentials between them; and (to reduce the tax burden on the poor), the minimum threshold below which no tax is paid. Analysis of thresholds across the case studies and a broader range of countries finds a huge degree of inconsistency. Globally, on average the top tax threshold is 15.5 times the minimum threshold. In Ghana and Senegal this ratio is 20 and 21, and in Mozambique 36, implying that their systems are less progressive than average. In Nicaragua it is only 5 and in Peru only 2, making their systems much more progressive.

The IMF has recently suggested (2014b) that introducing or increasing minimum thresholds may be one of the most effective ways to increase PIT progressivity, indicating that the OECD level is around 25% of the median wage and developing countries might keep thresholds relatively close to GDP per capita to avoid excluding a high percentage of the population from PIT. Mozambique's minimum threshold is almost twice GDP per capita, indicating that there might be scope for reduction; whereas Ghana, Nicaragua, Peru and Senegal have thresholds well below GDP per capita.

However, the country case studies do not provide any evidence that the IMF suggested changes in threshold differentials, or major increases in minimum thresholds, to make systems more or less progressive. Instead, it seems to have advised countries to increase all thresholds in line with inflation or wage levels, to stop citizens from 'inadvertently' paying higher tax rates; or, when countries had severe budget deficits, it suggested increasing thresholds by lower amounts in order to increase revenue collection.

Overall, the evidence seems to show that the IMF has had no clear and consistent view of desirable rates or thresholds for PIT. Instead, it has tended to compare a country's rates with neighboring countries in order to avoid extremely high rates; and to recommend against very wide ranges or large numbers of rates (in order to keep the system simple and increase collection). In the 1990s and early 2000s, when the global trend was to reduce rates, the IMF seems to have helped countries to do this – going along with, rather than promoting, a race to the bottom (except if countries needed urgently to raise revenue and had low rates). More recently, especially in the light of the IMF's *Spillovers* report, if countries have themselves been trying to avoid a race to the bottom and keep rates at current levels, it seems to have provided them with supporting evidence by showing that rates are higher in neighboring countries.

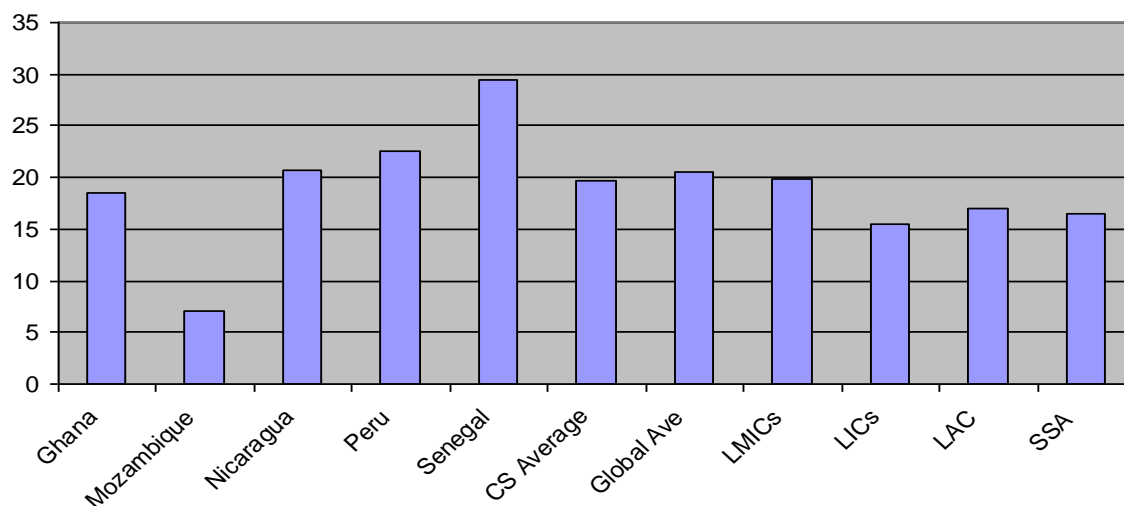
However, there is no evidence that the IMF has been proactively trying at national level to prevent a race to the bottom on the grounds that this will reduce global and national tax revenues. This may reflect a skepticism within the IMF (expressed in IMF 2014b) about whether greater progressivity can achieve much in LICs and LMICs when avoidance and evasion is routine among high net worth individuals (HNWI), and when it sees the main challenge as to 'develop a better-functioning PIT system that helps increase tax ratios', because less than 15% of income is covered by PIT. Nevertheless, its latest analysis (2014b) suggests that low rates should have scope to be increased in developing countries.

Social security taxes and pension contributions

Most countries also require citizens who are in full time formal employment to pay contributions for pensions, and for social security to cover unemployment and sickness. These have been found on average to have the most regressive incidence of all tax types. In most countries, they apply at a fixed rate regardless of income, making them less progressive. In addition, there is often a maximum threshold for contributions, above which contributors do not pay on extra earnings – again tending to make these taxes more regressive.

The design of these taxes varies dramatically in the case study countries, as shown in Figure 6. Ghana, Nicaragua and Peru are reasonably near their regional and income group averages; however, Mozambique is well below them, and Senegal well above.

Figure 6: Social security/pension contributions (%)



In theory, systems which require (wealthier) enterprises to pay higher ‘employer’ contributions are more progressive than those which require (poorer) employees to pay. This is the case in Senegal (where employers pay a higher rate than employees). However, there is some evidence that employers adjust wages downwards to cover the cost of employer contributions, therefore reducing the progressivity. It is also important to remember that, especially in low-income countries, social security and pension contributions are generally limited to employees of government agencies and large corporations, so that many of the poorer citizens do not pay them. So, as the Senegalese report highlights, the largest burden of contributions is usually borne by middle-class formal sector employees.

There is no clear evidence from the case studies about the IMF’s view on the desirable levels of social security/health/pension contributions, in terms of their effects on either inequality or employment levels. In Senegal, where they are highest, the IMF has never expressed strong views on these issues in tax policy discussions.

3.3 Capital gains, property and wealth taxes

Taxes on capital gains, property and wealth are crucial for making tax systems more progressive, and encouraging redistribution and growth, because property and wealth and therefore capital gains are much more unequal than income. All of the case studies conclude that they could do a great deal more to tax wealth, property and capital gains.

There has been some debate historically over whether it is fair to tax income from investments and capital gains for individuals and enterprises, given that the funds used for such investments have sometimes been already taxed, when they were earned as income. However, this is increasingly untrue given that both enterprises and individuals are using investment transactions to avoid income tax, so there has been a growing trend toward taxing capital gains and investment income at the same rate as income from work. This has made the system more equitable and progressive, in that wealthier people have higher non-work income, and has helped governments to combat tax avoidance. Mozambique has always applied the same tax rates, and Nicaragua (since 2009), Peru and Senegal have done so more recently. Ghana is the only country in the group to maintain a lower Capital Gains Tax (CGT) rate of 15% (compared with income taxes of 25%). IMF advice was supportive of Peru’s increases in 2003, and Nicaragua’s standardization of rates in 2009. It is unclear what advice, if any, the IMF has given Ghana on CGT.

To combat misdeclaration and avoidance, Mozambique, Peru and Senegal have also used withholding taxes (taxes deducted up front on the transaction), though Peru’s levels are set much lower than those of the other countries. IMF advice was also prominent in these decisions.

Recently (2014b), the IMF has suggested that it is also important to harmonize PIT and CIT/CGT rates in order to minimize opportunities for arbitrage across rates by corporations and HNWIs. However, Senegal's PIT rate remains 10% higher than its CIT; and Ghana has much lower CGT rates. This was one of the reasons given by the IMF for supporting the reduction of Senegal's PIT in 2013.

Property taxes could be particularly vital in developing countries, as a high proportion of inequality is due to unequal holdings of property and real estate (IMF 2014b; Monkam and Moore 2015; Norregaard 2013), and because taxes on **flows** of income from property are among the most easily evaded. All four case studies have taxes on stock of wealth (i.e. property and land). Nicaragua and Peru levy taxes on land value, and Mozambique levies 0.1–1% (progressive) on house value, to fund decentralized government. Nicaragua has a flat 0.8% tax on property value, and Peru has a progressive 0.2–1%. Ghana taxes rental income at 15%, and property value at between 0.5% and 3% (varying by region). Senegal's tax for undeveloped land and residential property is the highest at 5%, and 7.5% for industrial and commercial property. These taxes have accounted for only very small shares (under 2%) of revenue in each country, partly because it has been very difficult to identify land ownership, value property and collect the taxes due to low capacity in government (especially where local governments are responsible).

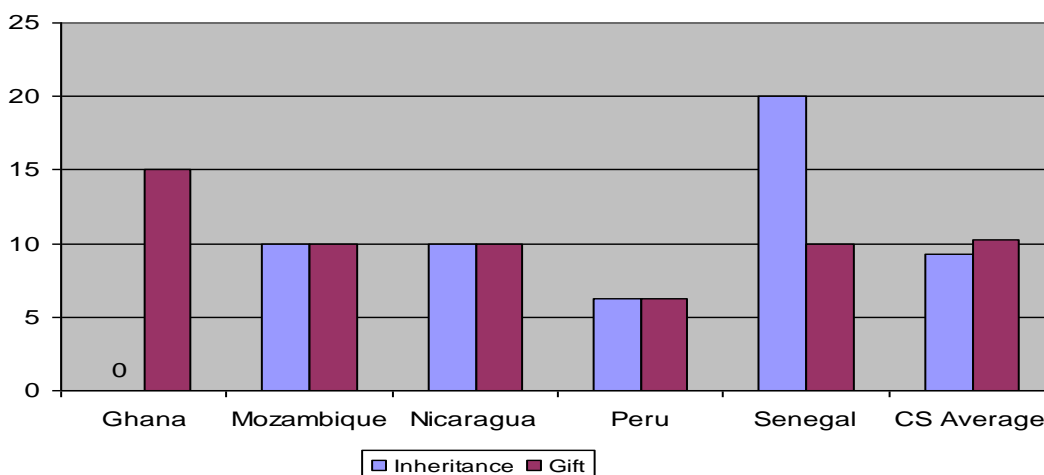
All five countries also have taxes on wealth flows, which are easier to design as they do not require tracking financial assets, valuing land or property. There are three types:

Financial transaction taxes. Mozambique has a range of stamp duty rates on different financial transactions, ranging from 0.02% for credit cards to 5% for gambling. Peru introduced a financial transaction tax of 0.15%, but has reduced it gradually to 0.005%.

Taxes on property sales or rental income. Mozambique has stamp duties at 2–10% for property transfer, and 14–32% for rental (depending on whether the buyer is a resident or a non-resident). Ghana has a rent tax varying from 8% (residential) to 15% (non-residential). Nicaragua has a 3% municipal tax on property and real estate transfers. Senegal has a 20% tax on rental income and a registration fee of 10% tax on property sales, as well as subjecting them to capital gains tax at 30%. Peru applies capital gains tax at 30% on sales, and 24–30% on rental income (depending on the residency status of the landlord).

Taxes on inheritance and donations. The maximum rates of taxes on inheritance and donations are shown in Figure 7 below. Mozambique's inheritance and gift taxes are progressive, from 2% to 10%; and Ghana's gift taxes are from 5 to 15%. Senegal exempts all legacies below 150 million CFAF (\$250,000), but above that, varies the rate based only on the closeness of family relationship. Nicaragua and Peru apply flat taxes regardless of the value.

Figure 7: Inheritance and gift tax rates (%)



There is only limited information available from the case studies on IMF advice in relation to taxes on property and wealth (partly because few such taxes exist).

Across PRGT countries, the New Rules study finds that the IMF mentioned property taxes in only 15% of PRGT documents, encouraging countries to introduce or increase them.

In Nicaragua and Peru, the IMF assisted with the introduction of **taxes based on a percentage of wealth**, but neither of these were genuine wealth taxes. They were instead ‘withholding taxes’ (i.e. a down payment) on corporate income tax, based on wealth, in order to ensure some relationship with the assets of the company. These were then deducted from the ultimate payment of CIT. The IMF (2014b) has encouraged these withholding taxes on the grounds that they increase protection against avoidance and low administrative capacity.

The IMF generally seems to have opposed **financial transaction taxes**. On some occasions, as in Mozambique, this is because it has been opposing ‘double taxation’ of property transactions, through tax on the capital gain as well as on the actual transaction. However, it has also been suggesting the complete removal of stamp duty in Mozambique, and successfully recommended a sharp reduction in the rate of financial transactions tax in Peru, from 0.15% to 0.005% (on the grounds that a 0.15% rate was so high as to be distortionary). This has effectively reduced its contribution to tax revenues to virtually nothing. These reactions may reflect a broader IMF hostility to financial transaction taxes at national level, because some have suggested they may be distortionary (see IMF 2014b); as well as a belief that taxes on financial wealth more broadly fail to work if they are easily avoided.²³

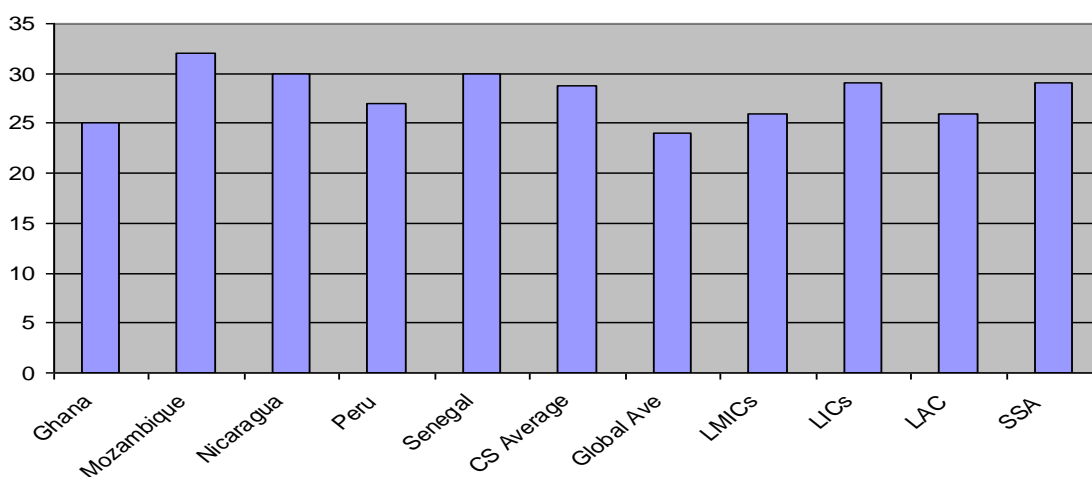
Nothing is known from the case studies about IMF attitudes to **inheritance and gift taxes** at country level. The IMF has suggested in its global publications (e.g. 2014b) that it favors using these to reduce inter-generational inequality, and that exemptions for charitable donations might not be as desirable as commonly believed.

The IMF should publish analysis and a clear policy statement on these types of taxes, and all IMF program documents should analyze these taxes and make recommendations to increase their progressivity.

Corporate Income Tax

Figure 8 shows corporate income tax rates in the case study countries compared with other groups. All countries apply the same basic tax rates to all companies. Once again, Ghana has the lowest rates at 25%, but Peru is only marginally higher at 27%, Nicaragua and Senegal at 30% and Mozambique at 32%. Mozambique and Nicaragua are slightly above the regional and income group averages, Senegal and Peru are close to averages, and Ghana is below them.

Figure 8: Corporate income tax rates (%)



There is much stronger evidence of a race to the bottom for corporation tax in the case study countries. Ghana has cut CIT from 32.5% to 25%, Senegal from 35% to 25% before an increase to 30% in 2015, and Peru from 30% to 20% before restoring 30% in 2003 (though it is now promising to cut by 1% a year until 2019). Only Mozambique and Nicaragua have resisted the trend, and Nicaragua is now promising cuts in 2016–20.

CIT is the area of taxation that is most subject to exemptions and reduced rates. All of the case studies have very complex lists of special regimes, for sectors, regions, smaller enterprises, start-ups and export-oriented investments, as well as deductions for reinvestment, training, etc. For example, Peru provides lower rates for investment in poorer Amazonian regions, agriculture and smaller traders. In all five case study countries, corporations are making extensive use of tax-free investment or export zones. Mozambique and Senegal have recently tried hard to clamp down on preferential treatment of sectors – especially for mining – and Senegal on free zone exemptions. Ghana is beginning to make the same efforts.

The New Rules study finds that the IMF provided advice on CIT in around 40% of programs. As with other taxes, the IMF has generally advised against exemptions unless there is strong proof that they are encouraging additional foreign or domestic investment, moving it to under-invested sectors or regions, or changing corporate behavior to enhance reinvestment, training, etc. It has particularly urged the abolition of exemptions when there is no evidence that they are producing positive effects – for example when they were introduced to increase or influence the nature of investments, but are now subsidizing profitable sectors. It therefore advised Mozambique to end exemptions for mining and gas in 2011, Nicaragua to end exemptions for the financial sector in 2002-03, and Ghana and Senegal to end tourism exemptions in 2014–15.

All of the countries have a flat rate of CIT – so that there is no progressivity according to the size of turnover or profits. However, there are two exceptions to this:

- Countries have occasionally introduced **windfall taxes** on the most profitable companies, notably those benefiting from high windfall profits due to exorbitant commodity prices. The IMF has played some role in advising countries on how to structure such tax regimes.
- The IMF has been clear for many years in advising countries that, given the fact that most of their private sector profits are dominated by a few large companies, the greatest scope for increasing tax collection lies with taxing these companies more effectively. As a result, it has provided TA to all the case study countries except Peru, in setting up special **LTUs** and in training and assisting staff in these units to identify risks of avoidance and to conduct audits of large taxpayers. This has increased the tax collected from these corporations, and has thereby had inadvertent progressive consequences in ensuring the wealthiest paid a fair share.²⁴

As with personal income tax, IMF advice on CIT has not seemed to have any consistent idea about desirable levels of rates. For example, it advised Peru to reduce CIT from 30% to 25% in 2002 (the government went further, to 20%); whereas it advised Senegal to increase it to 30% in 2015. It seems once again that the IMF may have been following global ideology, regional trends, and national government inclinations; with no clear evidence that it was trying to resist a race to the bottom. In this context, does the recent position in Senegal mark a change of attitude, in line with the IMF's publications and speeches opposing harmful global corporate tax competition?

Value Added Tax

There is some debate about whether VAT is progressive or regressive.²⁵ As a share of income, it is usually regressive (largely because the poor consume a much higher share of income); but as a share of consumption, it is sometimes found to be neutral or mildly progressive (i.e. redistributive from rich to poor). Nevertheless, in either case, it is less progressive than income-related taxes, and is generally much more effectively collected, making effective VAT rates higher, and the overall system less progressive. The IMF has also recently emphasized (2014b) that in LICs where direct tax collection and administration of direct welfare transfers may be less effective, it becomes even more important to look at how to make indirect taxes progressive.

Three of the five case studies find that VAT is regressive when assessed as a share of income, which fits with Martinez-Vazquez (2011) findings (though Peru suggests that if calculations are adjusted for the informal sector income of the poor, VAT may be neutral).

As a result, three measures are often considered in order to make VAT less regressive:

- setting it at a relatively low rate compared to income tax levels;
- exempting or applying lower tax rates to goods consumed by poorer citizens; and
- setting minimum thresholds of turnover for companies to register for VAT, so as to exempt small traders (and their smaller/poorer consumers) from the tax.

The IMF played a major role in the design and introduction of VAT in all the case study countries in the 1990s. This was not due to an attraction to regressive taxation, but because increasing revenue was the top priority, and VAT was much easier to collect than income taxes and the sales taxes which preceded it. The New Rules study indicates that the IMF discussed VAT in 60% of programs (69% in Sub-Saharan Africa), mainly with a focus on increasing collection and broadening the base.

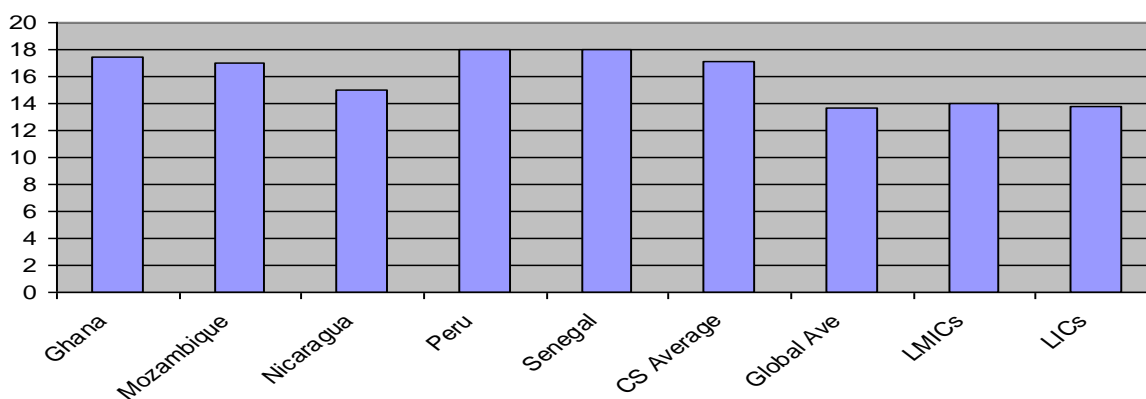
Figure 9 shows VAT rates in the case study countries. The case studies indicate that the IMF did oppose use of multiple lower rates as a distributive measure, arguing that they would be ineffective because the rich generally consumed more exempted goods than the poor (so although proportionally the poor would benefit most, in absolute terms the rich would get the most); that traders would reclassify goods to benefit from the lower rates; and that many of the poorest citizens escape VAT because they buy from informal traders who do not pay it. The IMF was somewhat more prepared to accept limited exemptions for goods that were a higher share of poorer citizens' consumption, such as basic foodstuffs, education and health.

In two countries, VAT rates have also been gradually rising. Ghana has increased its VAT from 12.5% to 17.5% since 2003 (though labelling the first 2.5% increase as a levy to cover extension of the national health insurance scheme). This followed IMF advice, and Ghana had little choice because it had gaping budget deficits and needed to use all options to fill them. On the other hand, when the IMF advised Peru to increase its VAT rate in 2003, Peru did so by much less than the IMF suggested (by only 1%, to 19%), and has since reduced the rate again to 18%.

The case studies find no evidence that the IMF was recommending exemptions or lower rates for goods consumed by the poor: indeed, where this issue was discussed, the IMF was generally pushing for one flat VAT rate, to maximize VAT revenue and minimize scope for misdeclaration. This may also reflect a broader IMF belief (see IMF 2014b) that exemptions or lower rates are a highly inefficient way of making VAT more progressive.

They also find no consistent evidence that the IMF was pushing for high VAT registration thresholds, or had a systematic methodology for assessing what thresholds should be.²⁶ Indeed, three of the case study countries (Nicaragua, Peru and Senegal) had no minimum thresholds and required all businesses to register, and the issue of introducing such thresholds was not raised by the IMF. The New Rules study finds that only 5% of programs discussed thresholds, often with no attention to progressivity.

Figure 9: Case study VAT rates (%)



On the other hand, a big problem with the implementation of VAT has been the existence of widespread exemptions, with the same rationale as income tax exemptions (i.e. trying to promote investment in particular sectors or areas, rather than trying to make VAT less regressive). The New Rules study found that VAT exemptions were discussed with the IMF in 21% of programs. It describes the experience of Uganda, where there was a systematic gradual reduction of VAT exemptions without any published analysis of their effects on equity, and suggests that in only one country (Sierra Leone) was there a published analysis of the impact on equity of removing VAT exemptions. Within the case studies, there are many exemptions which have nothing to do with equity. For example, in Peru, there are lower rates for agriculture enterprises, businesses based in the Amazon regions, and small traders, ranging from 0% to 10%. The IMF has consistently argued against these, on the grounds that they are ineffective and substantially reduce collection. The most common recommendation of IMF missions and TA in the case study countries, and across the broader document sample, was to reduce or eliminate VAT exemptions to broaden the tax base. For example, in Nicaragua it recommended (and the government introduced in 2003) an extension of VAT to the financial sector and NGOs, and an increase in the resources devoted by the LTU to collecting VAT from large taxpayers. In Senegal, the IMF assisted the government to eliminate exemptions for companies registered in free zones, over the objection of some other development partners. In Ghana, it helped the government to increase VAT coverage dramatically in 2014 to include the financial sector, domestic airlines and haulage companies.

However, the IMF has also assisted countries to reduce the number or scope of VAT exemptions that are targeted at making VAT less regressive – with the aim of targeting these more closely on products which are consumed primarily by the poor, or on amounts likely to be consumed by the poor. A good example is Senegal, where the government proposed and the IMF agreed to remove VAT exemption on ‘luxury specialty rice’ while keeping it for normal rice; and where the IMF suggested and Senegal agreed to limit exemptions on electricity and water to those households which consumed small amounts, rather than providing an exemption for all (even wealthy) households on the lowest tranche of consumption. Overall, the IMF’s position on exemptions appears to be to push for maximum removal and to consider equity issues only when governments raise them. The IMF should conduct a much more detailed multi-country analysis and adopt a more explicit policy position to guide all missions to examine this issue, and on which types of exemptions are generally pro-poor (and therefore desirable), and which are not.

Excise duties

All countries have seen a waning importance of excise duties in their tax collection, but have retained them mainly to tax ‘bads’ (e.g., alcohol, tobacco, fossil fuels) or to gain extra income on products such as petroleum. As the poor pay a higher share of their income on these products (including transport costs, which are influenced by petroleum prices), they generally have an even more regressive effect than VAT and general sales taxes.²⁷

The IMF has generally seen excise duties as a relatively effective means of collecting revenues because they are produced by only a few companies, and demand for them is inelastic to tax rises. It has therefore recommended introducing them, and increasing them. Most of its advice and TA in this area has focused on how to switch from fixed amounts to 'ad valorem' amounts which vary with product prices. So in 2000, the IMF advised Peru on how to increase excise duties, to enhance revenue collection.

However, after the 2008 rises in global petrol prices, the IMF showed considerably more sensitivity. The rapid rise in oil prices in 2008 meant sharp rises in transport costs and broader inflation, and especially where these caused major popular protests, the IMF advised Peru (among many other countries) to reduce taxes on fuel, in order to offset these price rises. It has also provided advice on how to rationalize them in cases such as Peru, where they had become excessively complex, with multiple rates.

Mozambique also has excise duties on luxury goods and vehicles, rising to 75%. It is not clear whether the IMF advised against these, but they have survived several rounds of IMF-advised tax reforms, even though at global level the IMF (2014b) has expressed strong skepticism about luxury duties (except on vehicles) on the grounds that they raise little revenue, increase administrative costs and contribute little to redistribution.

Trade taxes

The contribution of **import taxes** to revenues fell sharply in all the case study countries, due to trade liberalization. Tax rates on all imports fell, for example in Peru from an average of 13.5% to 3.2%. In general the structures of tariffs remained mildly progressive, with higher rates for luxury goods, and lower for key basic food and consumer goods. However, differentials between tariff rates narrowed significantly, and the numbers of bands were reduced dramatically, thereby making systems less progressive. The impact of these changes on progressivity also depended on the consumption patterns of different income groups. For example, in Senegal, even poorer citizens ate imported rice, so the tariff level on this (generally minimal or zero throughout the period) was a key influence on living standards in the country.

The IMF has indicated at global level (2014b) that the progressivity of trade taxes is unclear. This is borne out by the literature – some, such as Martinez-Vazquez, find that they are regressive, whereas results of CEQ and IDB studies vary between progressivity and regressivity. The case studies provide no evidence of any significant role by the IMF in the design or implementation of trade liberalization and tariff reduction. The IMF expressed preferences for lower tariffs, regarding high multiple levels as distortionary, and potentially subject to manipulation by traders misdeclaring goods in lower-tariff bands. If asked for input, it preferred mildly progressive structures with as few rates as possible, but tariff levels were generally fixed by multilateral or bilateral trade accords.

The New Rules study finds that the IMF continued to encourage trade liberalization in 27% of PRGT documents, but without considering distributional issues.

The IMF had already played a key role in reducing or abolishing **export taxes** in the 1980s and 1990s, for example on cocoa in Ghana, cashews in Mozambique, coffee in Nicaragua and groundnuts in Senegal, to the point where there were no significant export taxes in any of the case study countries by the time the period of this study began. It advocated their reduction or abolition especially where export taxes were felt to be undermining export earnings and competitiveness. Historical analysis of these taxes indicates that they were, on the whole, mildly progressive; given that most producers were not among the poorer income earners. However, more recently, the CEQ analysis has found that Ghana's cocoa tax is highly regressive.

4 HOW STRONG IS THE FIGHT AGAINST AVOIDANCE AND EVASION?

Tax collection in developing countries is severely undermined by tax exemptions and holidays that governments give to enterprises and individuals, and by taxpayer efforts to engage in 'tax dodging' through legal 'avoidance' or illegal evasion. The latest estimates are that losses from these practices could total 10% of GDP (Martin 2016). These huge losses – largely from the more progressive income and capital gains taxes – mean that far more tax revenue has to be sought from regressive indirect taxes, smaller companies or poorer citizens. So insofar as the IMF helps countries to reduce these practices, this should make the overall tax collection more progressive.

During this period, all the case study countries have tried to improve their efforts to reduce exemptions and fight tax dodging. They have used five main methods:

- analyzing and making transparent the gaps in tax collection;
- eliminating or reducing tax exemptions and 'tax expenditures';
- auditing in more detail the accounts of largest corporations and the highest net worth individuals, by reinforcing capacity of specialized LTUs;
- establishing specialized units to combat transfer pricing and other base erosion and profit-shifting efforts by corporations;
- renegotiating tax treaties to enhance payment of taxes in their countries.

4.1 Analyzing tax gaps and 'tax expenditures'^{28 29}

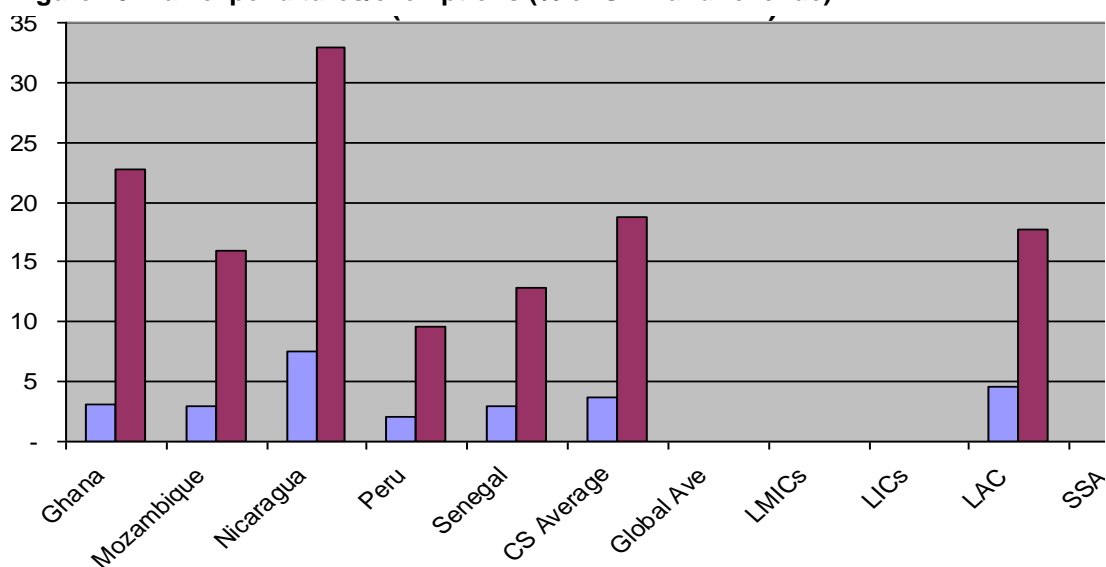
A common first step in combating avoidance and evasion is for a country to know the scale and nature of the problem, by conducting an analysis of its tax gaps (i.e. its uncollected tax revenues). These consist of three components: 1) tax untargeted – due to problems with tax policies which mean that key stakeholders are not taxed; 2) tax voluntarily foregone – due to tax treaties, tax exemptions and tax credits; and 3) tax uncollected – due to tax avoidance, tax evasion and ineffective tax administration. Different definitions of how to assess tax gaps (some of which cover only one component) can lead to dramatically different estimates and patterns. For example, estimates of the UK tax gap range from £34bn or 6.8% of revenue (HMRC 2014, definition 3) to £120bn or 25% of revenue (Murphy 2014, definitions 2 and 3).

All five of the case study countries have published analysis of their tax gaps or their 'tax expenditures' (generally defined as the exemptions and credit parts of definition 2 above). Peru began analyzing tax exemptions in 2000, and conducted a more comprehensive analysis of tax gaps in 2010 with IMF assistance, which the IMF now cites as a best-practice example of its assistance to offset revenue falls provoked by the global economic crisis. The analysis found that they were largest in relation to VAT, and then focused on helping government to improve VAT coverage and enforcement.

Senegal began publishing estimates of tax exemptions with the budget in 2003, and after a pause has done so again for 2010–13. Nicaragua began publishing analysis of tax exemptions in 2006, but has recently published only more limited summaries. Ghana began publishing tax expenditures in 2007,³⁰ and Mozambique in 2011.

As shown in Figure 10, the reports show very considerable losses from tax expenditures. In Ghana's case, these exceed \$1.3bn a year; two-thirds of the education budget and 80% of the health budget.³¹

Figure 10: Tax expenditures/exemptions (% of GDP and revenue)



The IMF has played an increasingly active role in encouraging all the case study countries to publish annual reports on tax expenditures with their budgets. Since 2000, it has assisted the publication of reports by Latin American countries with sufficient analytical capacity (CIAT 2014), recommended publications in its Fiscal Transparency Manual, and reached agreement with UEMOA countries that they will produce such reports over the next few years.

Such publication is a useful first step to provoke debate on scale of exemptions, but:

- It is not clear that it uses a broad enough definition of tax gaps or expenditures – for example showing the impact of all exemptions rather than those which are just ad hoc or additional to sectoral tax codes.
- Many such analyses do not show clearly enough the reasons for gaps, such as tax and investment codes, treaties, and exemptions on donor and CSO-funded goods.
- Some reports such as those published recently by Nicaragua are of very little use in that they do not even identify which taxes lose most from tax expenditures.
- Many reports do not identify clearly the sectors or enterprises benefiting from the exemptions, and the amounts they are not paying as a result.
- Data are not strictly comparable across countries, because there are major variations in methodologies used to estimate tax expenditures. For example, some include only some taxes (excise and trade taxes are often omitted), and others leave out pro-poor reduced rates on VAT, or other exemptions they see as justified.³²
- Virtually no reports assess whether these expenditures are achieving their goals (e.g. to promote certain sectors or regions) by comparing levels of expenditures with economic development indicators, or their incidence on inequality.³³

Most recently, the IMF has developed, with the World Bank, a methodology to help countries assess the costs and benefits of tax incentives. However, as already discussed (see Box 1), the impact of exemptions on the relative productivity of different taxes, and their shares of total revenue, can also influence progressivity. The new IMF methodology, unlike that recommended by the Inter-American Center of Tax Administrations (CIAT) does not include this aspect. **It should be an urgent priority for the IMF to include the impact on progressivity in its assessments of exemption regimes.**

In all five countries, the IMF has argued repeatedly against exemptions, and for their reduction or elimination. Indeed this has often been the strongest focus in discussions with governments. However, it has very often been ignored – for example, the IMF repeatedly recommended eliminating special tax regimes and exemptions in Peru during 2000–06, and suggested that the government might be able to reduce broader tax rates if these were eliminated. However, the government initially maintained the exemptions and also reduced rates, though eventually eliminating some exemptions in 2002–03. The Nicaraguan government also ignored off-program IMF advice in 2012–15, and the Ghanaian government did the same until 2013. The IMF was more successful in getting governments to cut exemptions when this was already a strong government policy, in Mozambique after 2010, Senegal from 2013 and Ghana from 2014.

The success of such initiatives has varied dramatically. There have been repeated efforts by those benefiting from exemptions (and many OECD governments, multilateral development banks [MDBs] and private-sector development financing institutions which support them) to reintroduce the same exemptions through different initiatives. These include duty-free or export processing or industrial promotion zones, sectoral investment codes, accelerated depreciation schemes, bilateral investment and tax treaties, and even conditionalities in aid agreements. One reason highlighted by governments for limited success has been that the IMF is only rarely prepared to speak out in public on these issues, via its resident representatives or visiting mission chiefs and senior officials, and often does not even raise these issues in meetings with other development partners. **Given the current emphasis on financing development via domestic resource mobilization, speaking out at national, regional and global level on these issues should be a top priority for every IMF press conference and every donor or private sector meeting.**

Finally, it is important to credit the IMF for some things it has not done. For example, unlike most of the MDBs and bilateral development financing institutions, it has consistently *not* advocated tax incentives for large corporations. In addition, it no longer uses or refers to the World Bank's 'Doing Business' tax criterion (which gives higher scores to countries for lower tax rates) in its documents, thereby avoiding the discouraging of tax mobilization efforts by countries. Yet such attitudes have remained implicit or been expressed in private – when the IMF could be uniquely placed to lead a more public global discussion about these issues. **The IMF should lead a public global debate on how to eliminate requests for tax exemptions by MDBs and development financing institutions (and by governments for companies headquartered in their countries), and how to reform the 'Doing Business' criterion to make it encourage increases in domestic resource mobilization.**

Box 2: The IMF and harmful tax competition

Another key issue for tax policy has been the existence or absence of harmful tax competition (competitive reductions of tax rates, or proliferations of tax exemptions, trying to attract investment away from other countries) among country authorities. The IMF has repeatedly highlighted the pernicious effects of such competition, most notably showing in its *Spillovers* report (IMF 2014a) that the global average reduction of 5% in corporate tax rates over the last decade could have reduced tax revenues in developing countries by around one quarter.

Among the countries in this study, harmful tax competition has been kept under close scrutiny in the UEMOA region (which includes Senegal), largely because of the UEMOA secretariat's formal role in advising member states on harmonizing tax policy and tax codes. In this context, the IMF played an important role in resisting harmful tax competition in the region, conducting a comprehensive study analyzing the issue to advise UEMOA in 2013 (Mansour and Rota-Graziosi 2013) – but the results have not been perfect, as demonstrated by Cote d'Ivoire slashing its tax rates in 2014.

On the other hand, this has also been a key issue in Latin America, where some Andean and Central American countries have been competing to reduce personal and corporate income tax rates in recent years (CEPAL 2015). Nevertheless, while (as discussed above) the IMF has argued at country level against income tax cuts in Nicaragua and Peru, it is not clear that it has played any significant role at regional level in resisting harmful competition actively.

For Ghana and Mozambique, harmful tax competition has been less of an issue. In Ghana's case, its own tax rates have been so relatively low that it has not faced any regional pressure to modify them downwards – indeed the government has been criticized for encouraging harmful tax competition in West Africa, especially Cote d'Ivoire (Action Aid 2014). In Mozambique, tax rates in neighboring countries have generally been at similar levels and there has also been no regionally generated pressure to reduce tax rates. However, as discussed in section 5.3, there has been extensive competition through the use of tax exemptions.

One other aspect of IMF policy advice and TA is also important in considering the issue of harmful tax competition. The IMF tends in many cases to justify its advice on comparing country tax rates and structures with those of other regional neighbors and similar countries, rather than on having any *ex ante* idea of appropriate or optimal rates. Given this basis, it is not clear how it avoids the risk of automatically incorporating any long-term harmful competition trends into its advice (i.e. advising in favor of tax rate reductions for countries in regions with lower tax levels).

In this context, the IMF needs to play a much more systematic role in analyzing trends within each regional or sub-regional area. It should work with all regional organizations to resist and reverse harmful tax competition (including through much more public advocacy against low tax rates and tax exemptions), basing its comparisons in country reports on other countries if regional averages are excessively low, and setting benchmarks that are more objective.

4.2 Tax evasion and avoidance

The IMF has been relatively strong in providing TA to help recommend institutional measures to strengthen the focus on enterprises and individuals which might be most likely to avoid or evade tax. For example, in four of the five countries (and more broadly in 42% of countries, according to the New Rules study) its TA and/or policy missions have recommended the establishment of large taxpayer units/offices (LTUs/LTOs) to focus tax inspection and audit more on the largest multinational enterprises (and to a lesser extent on HNWIs), and have helped these units to

establish procedures to identify higher-risk sectors and enterprises. It has also encouraged other institutions to conduct training courses on these issues, and consultants to participate in these, in order to reinforce the capacity of LTUs.

On the other hand, the IMF's role in providing direct TA support to help countries to combat tax evasion and avoidance, through such measures as forensic audits of the accounts of individual large corporations or wealthy people, has been very limited. It has instead tended to focus on the 'auditing' of overall economy-wide compliance with particular taxes (e.g. looking at which sectors or types of companies are paying VAT in Ghana and Peru). None of the case studies indicate that the IMF has suggested firm-by-firm audits of particular sectors, let alone enterprises – even where there is a massive disparity between their importance to GDP or exports and their contribution to budget revenues. However, there is some anecdotal evidence from countries such as Burkina Faso that the IMF has made such suggestions informally. If asked by governments, it has tended to refer them to other sources of TA (such as the governments of France, the Netherlands and Norway) for such support. Some other TA providers have suggested that the IMF might be reluctant to find itself caught between developing country governments and the OECD headquarters country governments of the enterprises. **In the context of the current focus on DRM and expansion of its TA resources, the IMF should be helping countries to conduct systematic risk assessments to identify which enterprises and individuals are most likely to be avoiding/evading tax, and then encouraging them to audit high-risk taxpayers, with TA including from the IMF.**

In terms of direct efforts to combat tax avoidance by enterprises, the IMF has encouraged all five countries to establish specialized units or reinforce staff numbers working on transfer pricing issues – and has provided support to countries at national level on ways to assess prices used by countries, using data from other sources for comparable transactions. However, it has increasingly emphasized that this needs to be seen as part of a broader effort to combat corporate tax avoidance, especially because transfer pricing is a highly complex issue to calculate and negotiate, which can result in relatively little benefit to the government's tax collection. It has therefore not invested substantial resources in training on these issues, leaving them to other organizations such as ATAF (African Tax Administration Forum), CIAT, the OECD and the UN Tax Committee. There is also no evidence from any of the case studies that the IMF has encouraged governments to take more pre-emptive measures such as setting fixed prices for different transactions and goods, rather than accepting those suggested by the enterprises (as several countries, including Brazil, currently do).

More recently, the IMF has been involved in the global initiatives to combat BEPS efforts by corporations, working with the OECD, World Bank and UN on designing new regulations and recommendations to the G20, as well as beginning to design various components of a toolkit to help countries combat BEPS. However, it sees the recent BEPS initiative as an initiative designed largely to overcome tax collection problems for OECD countries.³⁴ This reflects to some degree the views expressed by country authorities in the case studies and other public declarations, that many other measures need to be taken 'in addition to BEPS', though some aspects such as treatment of interest deductions and updated methods on transfer pricing and permanent enterprises could be helpful.³⁵ In addition, many other organizations (as well as the IMF) will be mandated to provide BEPS-related assistance to countries (including ATAF, CIAT, OECD, and the UN) using donor funding. The IMF has therefore not been allocating substantial resources to the issue at country-TA level, though its involvement looks likely to grow, given the availability of donor funds. **The IMF should at same time be emphasizing to donors that BEPS-related funds should not be at the expense of other funding to provide TA to increase DRM through other means.**

The IMF has not engaged at country level at all with discussions on **unitary global taxation of corporations** and apportionment of revenues among countries based on formulas, as recommended by the ICRICT (ICRICT 2015). The IMF's official, globally published view (IMF 2014b) has been that there is a risk that formulary apportionment might (if decided largely by developed countries) agree formulas that would reduce tax collection for developing countries by

channeling revenues to the countries where companies make sales profits. Clearly pending a global agreement on these issues, this is not an area in which the IMF could expand its support. It could, however, **encourage like-minded countries to examine these issues with one another for regionally-headquartered companies that have affiliates in neighboring countries.**

In relation to **illicit financial flows and tax avoidance and evasion by HNWIs**, apart from its advice on LTUs discussed above, IMF advice has been largely restricted to implementation of global agreements on exchange of information, and on money laundering and terrorist financing. It has not had the mandate or the resources to provide in-depth support to countries by examining tax records of individuals – and has mainly focused on corporate tax and macro-level recommendations (i.e. changes to tax codes, rates, etc.). It has, however, made recommendations to plug obvious system-wide loopholes and deductions such as different rates between income and capital gains taxes (as discussed above). Going forward, there is clearly a need for much more emphasis on this area by all international organizations, including more assistance on enforcing automatic exchange of information, combating bank secrecy, interpreting information received, etc. But it is not clear what role the IMF wants to or should play within a broader picture, where there are already OECD and World Bank initiatives under way.

Overall, illicit flows and tax avoidance do not seem to have been a high priority in past IMF missions and discussions – the New Rules study finds mentions of illicit flows in only 7% of documents, and transfer pricing in less than 2%. However, this does seem to be changing somewhat, with the global focus on BEPS and other avoidance issues.

4.3 Tax and investment treaties

Tax and investment treaties have been proliferating across the world in the last two decades, with the declared aims of facilitating investment flows and preventing companies from being ‘double taxed’ in source and home countries. Major pressure has been brought on developing countries to sign such treaties, at an average cost to their tax revenues of 3% of GDP or more.³⁶ This is because tax treaties signed with OECD countries allow enterprises to pay taxes in their ‘headquarters country’, and protect enterprises against the application of excessive withholding taxes that might pre-empt tax payments in headquarters countries, and against application of capital gains taxes. They also apply reduced tax rates on dividends, interest, royalties and management and technical/service fees (which are in themselves major channels through which enterprises engage in BEPS). Investment treaties also contain clauses which guarantee ‘tax stability’ to investors and therefore prevent governments from making major sudden changes in tax rates or thresholds.

The case study countries have all signed significant numbers of such treaties:

- **Ghana** has signed tax treaties with 12 countries (Belgium, Denmark, France, Gambia, Germany, Italy, Netherlands, Nigeria, South Africa, Sweden, United Kingdom). However, these have not had much effect on tax revenue, largely because Ghana has set very low withholding tax rates (8–20%) that are generally similar to the ceilings in the treaties (i.e. Ghana has deprived itself of withholding taxes);
- **Mozambique** has signed nine treaties (Botswana, India, Italy, Macao, Mauritius, Portugal, South Africa, United Arab Emirates and Vietnam), whose withholding tax limits mostly fall below 10%, whereas Mozambique’s normal rates are 20%. Macao and Mauritius are also both tax havens, and there is evidence of companies directing investment via affiliates in those countries, in order to avoid paying taxes in Mozambique, or in the countries where they really take their investment decisions.
- **Nicaragua** has refused to sign tax and investment treaties with other countries. However, agreements with several key partner countries have had similar effects: for example, Venezuelan companies importing petrol products are tax exempt.

- **Peru** has signed with Brazil, Canada, China, Mexico, Portugal, South Korea and Switzerland. All these treaties specify maximum withholding tax levels of 10–15% (compared to Peru’s own rates of up to 30%), and give preference to paying taxes in headquarters countries. However, treaties signed with other Andean countries have given preference to tax payments in Peru and allowed it to apply the normal national withholding taxes.
- **Senegal** has signed the largest number of treaties (19: Belgium, Canada, Congo, France, Gabon, Italy, Mauritania, Mauritius, Morocco, Norway, Qatar, Tunisia, and the seven other members of UEMOA). Many of these have withholding tax ceilings on dividends and interest which are comparable to prevailing Senegalese rates. Notable exceptions are Mauritius and Qatar, which allow no withholding tax; but rates on royalties are generally 10–15%, compared to Senegalese rates of 20%.

The case studies provide no evidence that the IMF has played any role in helping countries to negotiate double taxation or investment treaties. Interview evidence indicates that on a few occasions where the IMF has become aware that countries are about to sign tax treaties with tax havens such as Mauritius, which could allow major enterprises to register headquarters in the haven and avoid paying tax, they have warned them about the potential negative effect this could have on tax revenues, and discouraged the signature of the treaty.

However, they have not encouraged any countries to use alternative treaty models such as those designed by the UN Tax Committee, CIAT or ATAF, which would allow higher withholding taxes or encourage payment of taxes in ‘source countries’ where commodities are grown or extracted. Nor is there any evidence that they have helped countries to work out how to modify treaties to avoid clauses which limit withholding taxes or insist on ‘tax stabilization’ periods. Such interventions might well have been seen as taking sides in discussions among member states, which the IMF is not encouraged to do. **Nevertheless, given the IMF’s commitment to increasing domestic resource mobilization in developing countries, it should be making such suggestions, as well as provoking and leading a global debate on how to reform tax treaties.**

5 CONCLUSIONS AND RECOMMENDATIONS

Based on the preceding findings, the following recommendations are appropriate.

5.1 Overall tax collection and composition

The desk study and case studies confirm that IMF advice and TA in almost all countries has focused on increasing tax collection and efficiency, rather than on progressivity. The case studies show an average rise of 5% in revenue/GDP (between 0% and 13%). Most increases have reflected gradual improvements in tax administration, with some rapid rises due to major policy changes. In the 1990s these were introducing VAT, increasing corporate and personal income taxes, and reforming tax collection institutions. More recently, they have focused on reducing tax exemptions, and on windfall taxes or renegotiating contracts with extractive enterprises.

Given the unambitious pledges of external finance at the recent UN Financing for Development conference, countries will need to increase revenues dramatically to finance the more ambitious post-2015 development agenda. Yet recently the IMF Fund has been forecasting stagnation of revenue/GDP in LICs/LMICs. **The IMF needs to analyze systematically for each country, in program and Article IV documents, how revenue can be increased much more rapidly post-2015, and to aggregate this analysis into an annual report on global progress in DRM to fund the SDGs.**

The IMF has identified 'potential' tax revenue mobilization benchmarks for tax/GDP ratios. Mozambique is above these, but the other countries (especially Ghana) are below. The benchmarks provide little guidance on how countries can increase tax revenue progressively to meet them, and are well below the levels needed to fund the SDGs. **The IMF should agree with each country on long-term revenue targets to reach these benchmarks, adjusting them to match key factors identified in the benchmark studies. It should help each country design a multi-year plan to meet targets, and suggest key progressive tax measures which would achieve them.**

Since 2012, there has been increased focus by the IMF and governments on combating inequality, leading to more emphasis on tax progressivity by three case study governments. Yet the IMF has contributed little to these discussions. For example, it has conducted no systematic monitoring of tax progressivity through proxies such as indirect/direct tax ratios, systematic incidence analysis of tax effects on income distribution, or PSIA of proposed tax policies (with one 2002 exception in Nicaragua). **The forthcoming tax policy diagnostic tool from the IMF/World Bank intends to analyze tax progressivity and equity as one of its pillars: it is vital that it has a clear impact on IMF policy recommendations.**

Tax policy advice and TA from the IMF has rarely focused explicitly on progressivity, and this focus has not increased significantly in recent years. Other studies using incidence and other econometric analysis have assessed that three of the case studies have clearly regressive tax systems, and that it is likely the other two are also regressive (due partly to the design of individual taxes, and partly to failure to collect more progressive direct taxes). **The IMF should take full account of this analysis in its policy and TA recommendations, and devote a major proportion of its future tax TA to building country capacity to analyze progressivity.**

5.2 Designing individual taxes

Personal Income Tax. All case studies except Ghana have top rates above global averages, having resisted a race to the bottom since 1980. They also have relatively average differentials (>20%) between top and bottom rates. Yet there is no evidence that the IMF has had a consistent policy on desirable PIT levels (beyond opposing extremely high or low rates, and comparing with neighbors). It advised against reduction to 20% in Peru, but allowed Ghana to keep a rate of only 25%. It did not publicly oppose Nicaragua cutting to 25%, encouraged Mozambique to use 32%, and helped Senegal to reduce to 40%. Similarly, the thresholds at which different PIT rates apply (and minimum thresholds below which poorer citizens pay no PIT) vary dramatically across case study and other countries, with Mozambique less progressive, and Nicaragua and Peru more progressive. There is no evidence of consistent IMF recommendations. **The IMF should develop policy guidelines for recommending more consistent and progressive PIT rates and thresholds, to combat any harmful competition among countries, and justify policy advice in its program and TA documents based on their impact on inequality.**

Social security and pension contributions are among the most regressive taxes, though they generally apply to only middle and high incomes. They can be made less regressive by shifting the burden to employers, or by requiring higher-income earners to pay on all their income. There is no evidence from the case studies that the IMF has a consistent policy on these taxes. **The IMF should adopt a consistent policy to maximize the progressivity of social security and pension contributions.**

Taxes on capital gains, property and wealth are crucial to make tax progressive, because these are much more unequal than income. Four of five countries (except Ghana) tax capital gains at the same rate as income, and three collect some up front using withholding taxes. Four countries have property taxes, which are set very low and generate little income. All five have taxes on wealth flows (two on financial transactions, and five on property sales/rental income, inheritances and gifts). The IMF has helped two countries to introduce taxes based on wealth (but only as withholding taxes on CIT). It seems to have opposed financial transaction taxes, or suggested their reduction to tiny amounts, and its attitude to inheritance and donation taxes is unclear. **The IMF should put much more emphasis on capital gains, property and wealth taxes as key means to raise progressive revenue, consistently recommend taxing capital gains at the same rates as income, and support significant property, financial transaction and inheritance and gift taxes.**

The range of **Corporate Income Tax** rates is much narrower across the countries (25–32%), with only Ghana lower than comparable country groups. There is strong evidence of a race to the bottom in the 1990s, and Nicaragua and Peru are currently planning rate cuts, though Senegal has recently raised its rate. The IMF does not seem to have a consistent policy on rates, having advised Peru to cut to 25% in 2002, but Senegal to increase to 30% in 2015. However, it has recently strongly suggested that PIT and CIT rates should be similar, to cut scope for avoidance. **The IMF should adopt more clearly consistent policies on CIT rates, to minimize harmful tax competition among countries and prevent a race to the bottom, and advise countries to standardize PIT and CIT rates, to reduce scope for avoidance.**

The IMF's other main positive TA on CIT – in four countries – has been in advising them to **standardize rates** across sectors and types or sizes of enterprises, thereby reducing exemptions for some; and in helping them to establish **LTUs** to collect more from largest taxpayers. This has increased tax revenues considerably.

Value Added Tax has been found to be regressive in the literature and three case studies. The IMF played a major role in designing VAT in all countries, as a key way to increase revenue, but did not analyze its progressivity or regressivity (except in Nicaragua). As for measures to make VAT progressive, it opposed multiple rates for distributional reasons as ineffective; accepted a limited number of exemptions for basic goods; and does not appear to have pushed for high

registration thresholds to exempt small traders (or indeed any thresholds in three of the countries). Equally, there is no evidence that the IMF has a consistent policy on desirable VAT rates (case study rates vary from 15–18% and global averages are 14%), though it has advised Ghana and Peru to increase rates to close budget deficits. However, it is important to realize that some of its advice to reduce VAT exemptions has been progressive, because they exist for reasons (investors in some sectors, exporters etc.) that have nothing to do with fighting inequality, or are not well enough targeted (e.g. all citizens in Senegal getting VAT exemption on a basic tranche of water and electricity, regardless of income). **The IMF should recommend consistent policies supporting exemptions or zero ratings for basic goods, and setting thresholds that exclude small traders.**

Excise taxes are even more regressive than VAT, unless they rise sharply for luxury goods. In general, the IMF has favored them and provided advice on how to adjust them automatically with product prices, and to rationalize excessively complex multiple rates (though it did not publicly advise reduction of Mozambique's luxury rates). However, after the global 2008 rises in petroleum prices, it did advise many countries (including Peru) on how to reduce fuel taxes. **The IMF should adopt clearer guidelines for recommendations on less regressive excise duties.**

Trade taxes have a mixed impact on progressivity, depending on who consumes imports and produces exports. Since the 1990s their share of revenue has fallen sharply due to global and regional trade liberalization. The IMF has played only a marginal role on import taxes, but advised countries in the 1980s and 1990s to abolish or reduce export taxes, on the grounds that they discouraged exports. **The IMF should recommend progressivity on these taxes based on incidence analysis.**

5.3 Fighting exemptions, avoidance and evasion

Tax exemptions – also known as 'tax expenditures' – are large in all five countries, at 2.5–7.5% of GDP, and 10–33% of revenues. The IMF has strongly encouraged countries nationally, regionally and globally to publish reports on tax expenditures. However, many countries still do not do this, or publish reports which do not cover all exemptions, or do not provide enough detail of beneficiary sectors or enterprises. **The IMF should scale up assistance in this area in cooperation with regional organizations such as ASEAN, ATAF, CIAT, EAC and UEMOA, to ensure that all countries publish comprehensive tax expenditure reports.**

At country level, the IMF has had mixed success in getting its consistent advice to reduce exemptions implemented. It has recently developed methodology to help countries assess the costs and benefits of tax incentives, which should help in this effort, and **it is important that this methodology includes an analysis of impact on equity and progressivity in tax collection.** The IMF has not always expressed enough support for government policy on these issues in public: **this should be a priority for every press conference and donor meeting.** Other institutions including IFC, MDBs and bilateral development financing institutions continue to advocate incentives, and the World Bank's Doing Business rankings to advocate low tax rates. In this context, **the IMF should lead a global public debate on how to end exemptions and reform the Doing Business tax indicator.**

The IMF has repeatedly highlighted the pernicious effects of **harmful global tax competition** – the race to the bottom in tax rates as well as the proliferation of exemptions. It provided key analysis resisting this in the UEMOA region, but there is much less evidence of it playing an active role in other regions – indeed, to the degree that it basis recommendations on comparison with other countries, it may inadvertently be encouraging the competition. **The IMF should take a much more active role in analyzing this issue in all its global, regional and national reports, and recommending benchmarks for tax rates that reduce its effects.**

On **tax evasion and avoidance**, the IMF has provided TA to establish and support LTUs, to 'audit' economy-wide compliance with taxes (especially VAT), and sometimes to help countries

assess risks of likely avoidance/evasion. However, to combat evasion and avoidance, by specific enterprises and individuals, through audits and other measures, it has suggested other sources of TA rather than providing direct support itself. **Given the current expansion of its TA resources, the IMF should be helping countries to conduct systematic risk assessments, and encouraging them to audit high-risk taxpayers, with TA including from the IMF.**

The IMF has encouraged all countries to establish or reinforce teams specializing in **transfer pricing**, provided documentation to support price assessments, and referred countries to other institutions' training courses. However, there is no evidence that it has encouraged more proactive measures by governments such as setting fixed prices for different goods/services to pre-empt transfer prices. It has been involved in the **BEPS** process but has not allocated large amounts of TA resources to this, given the involvement of many other organizations. It appears to have seen the other issues on which it has traditionally provided TA as being more vital to mobilizing revenue in developing countries. **In this light, it should be emphasizing the need to ramp up TA on its traditional tax issues discussed in this report, including analysis of tax progressivity.**

The IMF has not engaged extensively with discussions on **unitary global taxation of countries and formulary apportionment of resulting revenues**, including the 2015 suggestions of the ICRICT. **It should publish more analysis of the potential impact of such measures, and encourage like-minded countries to examine these issues at regional level for enterprises doing most of their business in regions.**

Neither has the IMF engaged extensively with **tax evasion by individuals and illicit financial flows**, except in encouraging tax information sharing and efforts against money laundering and terrorist financing. **The IMF should be making stronger recommendations for tax havens to end bank secrecy laws, and make all information on beneficial ownership of corporations and trusts public; and be providing extensive assistance to developing countries in analyzing information supplied and enforcing resulting tax collection demands.**

All case study countries have signed **tax treaties** or other agreements (from three in Nicaragua to 20 in Senegal) which could be losing them revenues of 3% of GDP. The IMF has played no systematic role in advising countries on costs and benefits of treaties, or encouraging them to use more advantageous treaty models. It has provided some ad hoc advice against signing treaties with tax havens, but **should be systematically reviewing treaties, providing advice on how to change them, and leading a global debate on how to change treaties to enhance DRM in developing countries.**

Finally, the IMF could contribute much to global transparency in two main ways.

First, as examined in the New Rules background study, there is only very limited publication of IMF TA reports, including on tax, because the country has to specifically request publication. As a result, it has been very complicated for this study to establish the nature of advice the IMF gives to countries. **The IMF should apply to TA reports the same Transparency Policy it has for other country documents – of publication unless the government requests otherwise, in order to make more transparent what it is recommending to governments.**

Second, there is no single global database which includes figures on tax/GDP ratios, tax composition, rates and thresholds across different types of taxes, exemptions and estimates of avoidance or evasion. The IMF publishes tax data for various countries, but this is dispersed across multiple databases and documents with different formats. Such a database is essential to help governments and other analysts judge relative performance, and assess progressivity, harmful competition and other trends. **The IMF should create such a database, to support country policy choices.**

The above suggestions for changes in IMF practice would do much to ensure that the institution is living up to its own policy announcements and research findings. Of course, in order to ensure

more progressive national tax systems, countries need to demand that IMF assistance analyzes these issues. And to achieve fundamental change in global tax rules, changes in IMF practice will need to be accompanied by efforts by OECD countries to go way beyond BEPS by ending tax exemptions, redesigning treaties and fighting tax evasion and illicit flows. However, as the leading global source of tax advice to developing countries, the IMF can play a clear lead role, helping countries to mobilize the funding essential to finance the SDGs.

Finally, in assessing the role of IMF policy advice and TA assistance in promoting progressive tax systems and fighting tax evasion and avoidance, it is important to remember – but qualify – three caveats often expressed by the institution itself.

First, IMF recognition of a need for progressive tax systems – not only to fight inequality but also to accelerate growth – is very recent (2013–14). Typically, new insights in IMF senior management and research take time to influence country teams giving policy advice and those organizing and planning TA. Without clear instructions via mission and TA guidelines, and relatively simple tools to allow missions to analyze issues rapidly and regularly, they are not always incorporated systematically into IMF work.

Second, the IMF's role and mandate has always been at the macro, system-wide level rather than looking at the detailed tax evasion and avoidance behavior of companies or individuals. Yet this should not be (and, in best practices explored in this study, has not been) used as an excuse to avoid commenting informally on bad behavior and recommending formal measures where it is widespread.

Third, IMF technical assistance is demanded by its members and most of the demand it has received from countries has not (until recently) mentioned progressivity. Nevertheless, terms of reference are typically discussed extensively between the IMF and the country authorities, so there is ample scope for IMF suggestions that progressivity should be a focus, to reduce inequality and accelerate growth.

A step-change increase in tax collection sufficient to fund the SDGs (or of the order of 10% of GDP in most countries) will therefore require a much more fundamental change of global rules and behavior. In this context, it is necessary to question the IMF's level of ambition. It should be recommending to countries how to achieve a step change, i.e. analyzing in full the tax gaps at national, regional and global level; recommending how to fill them progressively by abolishing exemptions, auditing major companies, taxing undertaxed sectors, wealth and property, renegotiating contracts and treaties; and publicly advocating these measures. Only then will it be able to live up to its public statements supporting progressive taxation and opposing tax avoidance, and help its developing member states to mobilize enough tax revenue to fund the SDGs.

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NOTES

- 1 On progressivity see IMF 2014b; on avoidance and evasion, IMF 2011 and IMF et al 2011.
- 2 Notably in the Richard Dimpleby Lecture given in London on 3 February 2014, retrieved October 2017 from <https://www.imf.org/external/np/speeches/2014/020314.htm>
- 3 These included Article IV consultation reports, loan-related documents, policy support instrument documents, other program-related documents, and the small number of published TA reports.
- 4 An earlier study by DFI for Oxfam International (2009) indicated that there is virtually no difference between the content and impact of IMF policy advice in PSIs and those in loan-funded programs. This study seems to reconfirm that impression.
- 5 For a useful assessment of the pros and cons of incidence analysis, which also emphasizes the need to consider pass-through effects (e.g. of higher corporate taxation reducing worker wages), see IMF 2014b.
- 6 All revenue data are from IMF WEO database (IMF 2015c), and the country studies for this project.
- 7 See IMF 2015e and Crivelli and Gupta 2014.
- 8 However, it is important to note that recent upward revisions of GDP figures due to inclusion of informal sectors can distort trends in revenue/GDP. For example, if measured without adjusting for the change in GDP series in 2006, Ghana's revenue/GDP appears wrongly to have fallen from 18% to 16%.
- 9 See Martin 2016.
- 10 See Government Spending Watch 2015.
- 11 Data from IMF WEO October 2015 database.
- 12 A large literature shows this in developing countries, including Brautigam 2008; and Moore 2015.
- 13 They have found that GNI per capita and education spending increase tax collection; whereas large agricultural sectors, high inequality, corruption and inflation reduce it (Fennochietto and Pessino 2013).
- 14 Consultations with IMF staff have indicated that fiscal progressivity should also analyze the impact of spending. While this is true, and a key concern of Oxfam and DFI, it is not the subject of this report.
- 15 Data on composition of tax revenues are taken from the country case studies prepared for this project, as well as IMF Article 4 and program documents for 192 countries, examined for this study.
- 16 For these conclusions see Barcena 2015 and Jimenez 2011.
- 17 For these conclusions see Bes, Roca and Barreix 2011; and Barreix, Bes and Roca 2009.
- 18 For a presentation on these results, see http://www.commitmenttoequity.org/publications_files/Ghana/Fiscal%20Policy%20Inequality%20and%20Poverty%20-%20A%20CEQ%20Assessment%20for%20Ghana%20Oct%2029%202015.pdf
- 19 See for example the Addis Tax Initiative at www.addistaxinitiative.net, which aims to double tax-related technical assistance to countries but does not mention these issues.
- 20 Data on the structures of individual taxes have been taken from the country case studies prepared for this project; global tax databases and publications by Deloitte, Ernst and Young, KPMG, PwC, and the Global Property Guide; and online tax codes available at national Ministry of Finance websites.
- 21 For a more complex way to calculate PIT progressivity, which might be useful and feasible to compile for future Oxfam assessments, see Duncan and Sabirianova 2008.
- 22 Global PIT top marginal rates have fallen throughout the last 35 years, from an average of 56% to only 33% (Duncan and Sabirianova 2008, updated using global PIT databases). However, earlier and more complex analysis of progressivity by Duncan and Sabirianova 2008 suggests that the fall in the progressivity of the whole PIT system stopped during 1995–2005.
- 23 For strong government views in favor of wealth taxes, see Fenet 2011 and Valenduc 2011.
- 24 See also Ebeke et al 2015 for evidence on the efficacy of LTUs in increasing collection.
- 25 For good analyses of the spread of VAT, its collection efficiency and regressive impact, see Martinez-Vazquez and Bird 2010, Keen 2009 and Shome 2012.
- 26 In spite of the fact that Michael Keen, Deputy Director of the IMF Fiscal Affairs Department, has written extensively on methodologies to set thresholds and suggested that a threshold of \$100,000 might be appropriate in low-income countries. See Keen 2009.
- 27 For analysis of this see IMF 2014b, paragraph 25.
- 28 For a broad discussion of IMF work on tax compliance and a presentation of its assistance and key successes including in Peru, see IMF 2015e; and for an excellent IMF study of Madagascar looking at tax gaps and potential for closing them, but not dealing at all with the issue of equity, see IMF 2015d.
- 29 Information on the scale of tax exemptions and expenditures is from a variety of sources, including CIAT 2014, and the country case studies prepared for this project.
- 30 For a comprehensive analysis of tax exemptions in Ghana, see Action Aid 2014.
- 31 For the tax lost, see Action Aid 2014. For spending data, see www.governmentspendingwatch.org

- 32 For a comprehensive discussion of definition and measurement issues related to tax expenditures and reliefs, see UK NAO 2014.
- 33 CIAT has proposed a model tax expenditures report for the Latin America region, recommending especially that the report focus on sectors and enterprises exempted, and on the impact on tax productivity and progressivity, but this has not yet been implemented.
- 34 The IMF's own estimates indicate that even if fully enforced it might improve tax collection in developing countries by only around 1.3% of GDP. See IMF 2014a. This compares with the potential impact of other global measures, which could increase revenues by over 10% of GDP (Martin 2015/2016).
- 35 For a summary of these views, see OIF Ministerial Meeting declarations, and Martin 2016.
- 36 For more information on the impact of treaties on revenue levels, see SOMO 2013 and Weyzig 2013.

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The draft of this paper was completed in October 2015 and revised in April 2016. As such, some of the information in the study (especially data on case studies) may now be out of date.

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